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An Audit Report on

# **Financial Operations at the Texas Education Agency**

**May 2006**

**Report No. 06-036**



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### Overall Conclusion

Weaknesses in the Texas Education Agency's (Agency) operations left the Agency unable to correctly forecast a \$170 million funding deficit that occurred in the Foundation School Program in fiscal year 2005. The Foundation School Program is the program through which the Agency distributes state funds to school districts. Although the Agency incorrectly forecasted the amount of the deficit, it should be noted that the \$170 million deficit represented less than 1 percent of the \$19.9 billion in original appropriations to the Foundation School Program for the 2004-2005 biennium (see text box for additional details).

The Agency has made improvements in its Budget Office and State Funding Division that should help to detect future deficits, but it should implement additional controls. Most significantly:

- The Commissioner of Education should regularly certify the status of Foundation School Program funding (including any forecasted deficits or surpluses) to the Governor and the Legislative Budget Board.
- The Agency's Budget Office and State Funding Division should regularly monitor Foundation School Program funding trends to identify potential deficits or surpluses and, through the Commissioner of Education, formally report that information periodically to the Governor and the Legislative Budget Board on a timely basis.

The Agency's controls over automated processes that support the Foundation School Program reasonably ensure that data is protected and that distributions to school districts are accurate. However, there are opportunities to improve controls in areas such as server security, password requirements, and security settings.

#### Events that Led to a \$170 Million Foundation School Program Deficit

- The General Appropriations Act (78th Legislature) originally appropriated over \$19.9 billion to the Texas Education Agency (Agency) for the 2004-2005 biennium for the Foundation School Program. The Agency was aware that the original appropriation would not be enough to cover the entire biennium.
- In June 2005, the Agency requested and received a supplemental appropriation of \$560 million through House Bill 10 (79th Legislature, Regular Session) to cover the \$560 million deficit it forecast for the Foundation School Program in fiscal year 2005. The \$560 million supplemental appropriation came from the Economic Stabilization Fund.
- Shortly after the Agency received the \$560 million supplemental appropriation, it recognized that its \$560 million deficit forecast was inaccurate. As a result, the Agency requested an additional \$170 million to fully cover the deficit for fiscal year 2005. By authority granted through House Bill 1 (79th Legislature, First Called Session), the 79th Legislature reallocated \$170 million appropriated for fiscal year 2006 to fiscal year 2005.

The Agency's insufficient oversight of the development of new Foundation School Program automated system applications continues to expose it to risks related to the accuracy of payments to school districts.

## **Key Points**

**Weaknesses in its operations impaired the Agency's ability to correctly forecast the funding requirements of the Foundation School Program.**

Weaknesses in the Agency's operations led it to incorrectly forecast the full amount of the fiscal year 2005 Foundation School Program deficit. Specifically:

- The Agency's Budget Office and State Funding Division operated autonomously, did not communicate adequately or frequently, and did not manage the Foundation School Program to an established and discrete budget for each fiscal year.
- The Agency lacked formal policies and procedures or training to ensure transfer of Foundation School Program knowledge among employees; it also lacked sufficient planning to fill vacancies in key Foundation School Program positions.

It is important to note that the funding deficit was not caused by noncompliance with statute or unusual changes in funding drivers such as average daily attendance or property values. Distributions the Agency made to school districts were consistent with Texas Education Code requirements, and growth in funding drivers in the 2004-2005 biennium was consistent with growth in previous biennia.

**Weaknesses in its operations impaired the Agency's ability to respond properly to funding constraints and changes in the management of appropriated funds.**

Weaknesses in its operations impaired the Agency's ability to respond to the following:

- At the beginning of the 2004-2005 biennium, the Agency was already aware that original appropriations would not be sufficient to fund school district distributions for the entire biennium. The amount of the original appropriation for the biennium was constrained by the potential budget deficit the State was facing at that time. The Agency responded to this challenge by using part of fiscal year 2005 appropriations to cover the fiscal year 2004 distributions it made to school districts (which was permitted by the General Appropriations Act), but the weaknesses in its operations prevented it from correctly forecasting the deficit in fiscal year 2005.
- Between fiscal year 2001 and fiscal year 2005, there was a material shift in the outcome of the Foundation School Program "settle-up" process. The Agency makes distributions to school districts based on estimates of average daily attendance and property values. When actual average daily attendance

and property values become known, the Agency “settles up” with the school districts to adjust funding. In fiscal year 2001, the net result of the settle-up process was that school districts owed the State \$694 million; however, in fiscal year 2005, the net result was that the State owed school districts \$267 million.

- In fiscal year 2005, the Office of the Comptroller of Public Accounts implemented controls that limited the Agency’s ability to spend the local revenue portion of funds that are “recaptured” from school districts through the wealth equalization requirements of the Texas Education Code, Chapter 41. This limited the Agency’s ability to use other available funds to cover the Foundation School Program deficit.

**Improvements the Agency has made should help it to forecast future deficits, but additional controls are necessary.**

To improve communication, the Agency reorganized to include its Budget Office and State Funding Division under the same organizational branch. The Agency also now reconciles Foundation School Program expenditures to appropriations on a monthly basis.

However, the Agency continues to rely on old Foundation School Program applications to calculate the amount of the distributions it makes to school districts, which complicates budget management and forecasting. The Agency’s Budget Office and State Funding Division continue to have vacancies in key positions related to the analysis of the Foundation School Program. Forty percent of the positions in the Budget Office are vacant, including the budget analyst position responsible for the Foundation School Program. Twenty-seven percent of the positions in the State Funding Division are vacant, including a manager position and system analyst positions.

## ***Summary of Information Technology Review***

**Automated processes for the Foundation School Program reasonably ensure that school district distributions and related data are accurate, but security improvements should be made.**

Server-level security is insufficient on the servers for Foundation School Program applications. Password requirements are insufficient, and there are weaknesses in encryption settings and user account settings.

The TEA Secure Environment (TEASE), which is the portal through which school district users can access Foundation School Program applications, allows unlimited login attempts, does not track login attempts, and has weaknesses in access security.

**The Agency's controls over development of new Foundation School Program applications may not ensure that State resources are used efficiently and effectively.**

Foundation School Program operations are dependent on a complex 1970s-era automated process whose operability is dependent upon a few long-tenured employees who possess unique knowledge. The Agency is replacing certain old Foundation School Program applications with new applications, but its controls over the development and implementation of the new applications may not ensure that state resources are used effectively and efficiently.

In its internal reports, the Agency has inaccurately categorized the project to replace certain old Foundation School Program applications as a "baseline operations" project. However, the project has cost at least \$4.9 million and, therefore, meets the statutory definition of a "major information resource project." Categorizing the project as a major information resources project would subject the project to review by the State's Quality Assurance Team. Major information resources projects must also follow the statutory Texas Project Delivery Framework, which requires development of a business case and statewide impact analysis, project plan, procurement plan, and a post-implementation review.

The Agency's partial employment of a system development life cycle to replace certain Foundation School Program applications has resulted in the following:

- New Foundation School Program applications that have been placed into production are not adequately documented and require continuous monitoring and enhancement.
- The Agency continues to rely on old Foundation School Program applications for core functionality. This continues to expose the Foundation School Program to the risks associated with the old applications that have been identified during previous audits.
- The Agency is running new and old Foundation School Programs in parallel with additional points of manual intervention, which increases risks for errors.

The Agency's current strategic plan and allocation of resources do not support full replacement of all old Foundation School Program applications. This may limit the Agency's ability to respond to future funding challenges.

### ***Summary of Management's Response***

The Agency agrees with the findings in this report. The Agency's responses to specific recommendations are included in the Detailed Results section of this report; the Agency also provided a summary of its responses, which is included in Appendix 2.

## Summary of Objectives, Scope, and Methodology

The audit objectives were to:

- Determine the causes of the unanticipated funding shortfall in the Foundation School Program identified in June 2005 and whether the Agency's State Funding Division and Budget Office have controls in place to detect future funding shortfalls and ensure that accurate financial information is produced.
- Determine whether the development and implementation of new automated processes that support the Foundation School Program have controls that are adequate to (1) protect data from unauthorized alteration, loss, or improper use; (2) ensure that distributions to school districts are accurate and made in accordance with law; and (3) ensure the effective and efficient use of state resources.

The audit scope included (1) Foundation School Program school funding, budgeting, and management procedures and the controls over these processes and (2) the procedures and controls related to the implementation and management of the new Foundation School Program applications focusing on, but not limited to, the 2004-2005 biennium.

The audit methodology included interviewing staff, examining the impact of Foundation School Program processes on Agency budget, performing data analysis of key school funding drivers, identifying causes of the unanticipated Foundation School Program deficit, testing Foundation School Program processes for compliance with state law, reviewing Foundation School Program application development resources and expenditures, and testing of high-risk applications.

Recent SAO Work		
Number	Product Name	Release Date
03-033	An Audit Report on The Texas Education Agency's Administration of the Foundation School Program	April 2003

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# Detailed Results

Chapter 1

## ***Weaknesses in Its Operations Impaired the Agency's Ability to Correctly Forecast the Funding Requirements of the Foundation School Program***

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Several weaknesses in the Texas Education Agency's (Agency) operations left the Agency unable to correctly forecast a \$170 million funding deficit in the Foundation School Program in fiscal year 2005.

The Agency's Budget Office and State Funding Division operated autonomously, did not communicate adequately or frequently, and did not manage the Foundation School Program to an established and discrete budget for each fiscal year. The separation of the Budget Office and the State Funding Division hindered accurate forecasting of the fiscal year 2005 Foundation School Program deficit. Each unit reported to separate branches of the Agency and asserted to auditors that the other was responsible for monitoring the Foundation School Program budget.

The Agency decentralized management of the \$19.9 billion Foundation School Program budget away from the Budget Office, and the Budget Office's budget analyst assigned to the Foundation School Program did not participate in the management of Foundation School Program funds. The Budget Office informed auditors that the State Funding Division managed the Foundation School Program's budget because of the complexity of the program. However, the State Funding Division informed auditors that it was responsible only for calculating the school district distributions and that the Budget Office was responsible for monitoring the budget. As a result, there was no documented comparison of the Foundation School Program expenditures with the budgeted funds.

### **Foundation School Program Budget**

The budget for the Foundation School Program is the amount appropriated under Texas Education Agency Strategy A.1.1 "Equalized Operations" in the General Appropriations Act.

The original budget for the Foundation School Program for the 2004-2005 biennium was \$19.9 billion. The \$170 million deficit was 0.85 percent of the original budget.

During this audit, the Agency reorganized the Budget Office and the State Funding Division and placed both under the same branch of the organization, which reports to the Associate Commissioner of Finance and Information Technology. The Budget Office and the State Funding Division also began meeting on a monthly basis to track current and projected Foundation School Program expenditures and compare expenditures to available funds. They have also instituted cross-cutting training regarding the Foundation School Program, which should foster communication and understanding between these two units.



The Agency lacks formal policies and procedures and training to ensure transfer of Foundation School Program knowledge among employees and documentation of program processes for future reference. The Agency was unable to provide formal written policies or procedures regarding Foundation School Program operations.

The amounts of individual distributions to school districts are calculated by a complex 1970s-era automated process whose operability is dependent upon a few long-tenured employees who possess unique knowledge. These employees rely on their knowledge, experience, and informal notes as reference to set up, maintain, and query Foundation School Program applications. There is no backup coverage or formal reference documentation. In addition, the Agency has no formal training program to ensure that personnel in the State Funding Division or Budget Office are knowledgeable about the Foundation School Program.

The risk associated with a lack of formal policies and procedures and training is demonstrated by what occurred when the Agency's former Deputy Associate Commissioner for School Finance and Fiscal Analysis left the Agency. The Agency was dependent upon this individual to coordinate Foundation School Program funding, conduct "what if" modeling, and facilitate changes between to Foundation School Program applications based on legislative requirements. After this individual's departure, the Agency was unable to explain the basis for the \$560 million in supplemental appropriations it initially requested or provide a "what if" analysis for changes in the Texas Education Code. The Agency has to consult with personnel outside of the State Funding Division to make changes to Foundation School Program applications that could be necessary as a result of changes to statute.

The deficit in the Foundation School Program was not caused by noncompliance with statute or unusual changes in funding drivers. It is important to note that the Foundation School Program deficit was not caused by noncompliance with statute or unusual changes in funding drivers such as average daily attendance or property values. Specifically:

- The Agency distributed Foundation School Program funds to school districts in accordance with the requirements of the Texas Education Code. The State Auditor's Office previously determined that the Agency's Foundation School Program applications accurately calculate the amount of distributions to school districts in accordance with statute (see *An Audit Report on the Texas Education Agency's Administration of the Foundation School Program*, SAO Report No. 03-033, April 2003). During the current audit, auditors verified that the new transportation application of the Foundation School Program calculates transportation distribution amounts correctly.
- Changes in funding drivers did not cause the deficit. Student average daily attendance and property values are the primary drivers of the amount of Foundation School Program funding school districts receive. Neither of

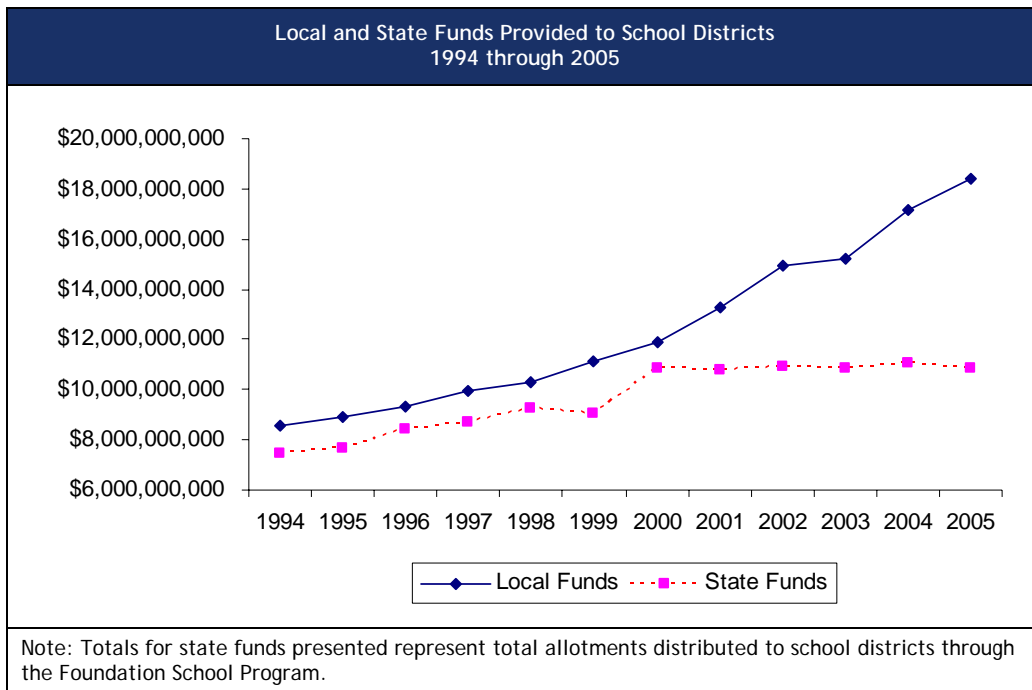
these drivers changed significantly in the 2004-2005 biennium. As Table 1 shows, average daily attendance has grown an average of 1.52 percent each biennium since 2000. Property values grew less than 11 percent each fiscal year since 2000. Changes in these two drivers left Foundation School Program funding virtually static during the past two biennia, with increases of 0.44 percent in the 2002-2003 biennium and 0.64 percent in the 2004-2005 biennium. See Figure 1 for a history of state and local funding provided to school districts from 1994 through 2005.

Table 1

Changes in Average Daily Attendance						
	Fiscal Years					
	2000	2001	2002	2003	2004	2005
Refined Average Daily Attendance (RADA)	3,707,519	3,769,651	3,859,644	3,941,887	4,016,837	4,085,215
Growth from Previous Fiscal Year	64,905	62,133	89,992	82,243	74,950	68,379
Percent Increase from Previous Fiscal Year	1.78%	1.68%	2.39%	2.13%	1.9%	1.7%
Average Increase for the Biennium	3.49%		4.57%		3.64%	
Average Increase Over All Three Biennia	1.52%					

Source: Texas Education Agency

Figure 1



Source: Texas Education Agency

## Recommendations

The Agency should:

- Ensure that the Commissioner of Education regularly certifies the status of Foundation School Program funding (including any projected deficits or surpluses) to the Governor and the Legislative Budget Board.
- The Agency's Budget Office and State Funding Division should regularly monitor Foundation School Program funding trends to identify potential deficits or surpluses and, through the Commissioner of Education, formally report that information periodically to the Governor and the Legislative Budget Board on a timely basis.
- Develop and implement formal written policies and procedures for all Foundation School Program operations.
- Develop formal training for the Foundation School Program to ensure successful and efficient continuity of Foundation School Program operations in the event of the departure of employees in key positions.

## Management's Responses

*The agency agrees with the findings. The agency is pleased that the report notes both the organizational changes in the financial management area and that the nature of the deficit was not caused by either non-compliance with statute or unusual changes in funding drivers. The agency will continue improvements in the management of the FSP and implement the following SAO recommendations:*

- *The Commissioner of Education will certify the status of FSP funding.*
  - ♦ *Person Responsible: Commissioner of Education*
  - ♦ *Timeline: The agency anticipates an annual certification. Management would appreciate consultation from the SAO and state leadership on when an appropriate annual certification should occur.*
- *The agency Budget Division and State Funding Division will regularly monitor FSP funding trends and formally report that information.*
  - ♦ *Person Responsible: Associate Commissioner, Finance and Information Technology*
  - ♦ *Timeline: The agency has already implemented a monthly reconciliation and forecast of the FSP. This analysis is copied to both the LBB and Governor's Office and is provided upon request to legislative offices.*
- *The agency will develop and implement formal policies and procedures for FSP operations and formal training for FSP staff.*
  - ♦ *Person Responsible: Associate Commissioner, Finance and Information Technology*
  - ♦ *Timeline: An FSP policy and procedures document should be completed by September 1, 2006. Some FSP staff training has been implemented, but a full training program for all areas will not be complete until December 1, 2006.*

## ***Weaknesses in Its Operations Impaired the Agency's Ability to Respond Properly to Funding Constraints and Changes in the Management of Appropriated Funds***

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The weaknesses in the Agency's operations impaired the Agency's ability to respond properly to the challenges of funding constraints and changes in the method by which appropriated funds were managed.

The Agency used Foundation School Program appropriations for fiscal year 2005 to distribute funds to school districts in fiscal year 2004; weaknesses in its operations impaired the Agency's ability to correctly forecast the deficit for fiscal year 2005.

At the beginning of the 2004-2005 biennium, the Agency was already aware that the original appropriations would not be sufficient to fund school district distributions for the entire biennium. The amount of the original appropriation for the biennium was based upon independent calculation of Foundation School Program funding needs and analysis performed by the Legislative Budget Board and was constrained by the potential budget deficit the State was facing at that time.

The Agency responded to this challenge as follows:

**Excerpt from Riders 35 and 36,  
pages III-12 and III-13,  
General Appropriations Act  
(78th Legislature)**

Rider 35: "To the extent necessary to avoid reductions in state aid as authorized by §42.253(h), Texas Education Code, the Commissioner of Education is authorized to transfer Foundation School Program funds from fiscal year 2005 to fiscal year 2004. Such transfers are subject to prior approval by the Governor and the Legislative Budget Board... Such transfers shall not exceed \$150 million."

Rider 36: If the appropriations provided by this Act for the Foundation School Program are not sufficient to provide for expenditures for enrollment growth, district tax rate or taxable value of property, after accounting for any other appropriations made to the TEA and available for transfer for this purpose, the Legislative Budget Board and the Governor may provide for, and are hereby authorized to direct, the transfer of sufficient amounts of funds to the TEA from appropriations made elsewhere in this Act."

- At the end of fiscal year 2004, Foundation School Program expenditures exceeded the \$10.4 billion appropriated for that fiscal year by \$360 million. In accordance with the provisions of Riders 35 and 36, pages III-12 and III-13, General Appropriations Act (78th Legislature), the Agency used part of the funds appropriated to the Foundation School Program for fiscal year 2005 to make school district distributions in fiscal year 2004 (see text box for additional details).
- In June 2005 the Agency requested and received a \$560 million supplemental appropriation through House Bill 10 (79th Legislature, Regular Session) to cover the \$360 million deficit from fiscal year 2004 and a \$200 million deficit the Agency forecasted for fiscal year 2005. The \$560 million supplemental appropriation came from the Economic Stabilization Fund. Shortly after receiving the \$560 million supplemental appropriation, the Agency determined that its forecasted deficit for fiscal year 2005

was inaccurate and that an additional \$170 million would be needed. By authority granted through House Bill 1 (79th Legislature, First Called Session), the 79th Legislature reallocated \$170 million that had been appropriated for fiscal year 2006 to fiscal year 2005.

The net result of the “settle-up” process for fiscal year 2005 was that the Agency owed school districts funds.

Between fiscal year 2001 and fiscal year 2005, there was a material shift in the outcome of the Foundation School Program “settle-up” process that occurs after the end of each fiscal year. The Agency makes distributions to school districts based on estimates of average daily attendance and property values. When actual average daily attendance and property values become known, the Agency “settles up” with the school districts to adjust funding.

At the end of fiscal year 2001, the net result of the settle up process was that school districts owed the State \$694 million. However, at the end of fiscal year 2005, the net result of the settle up process was that the State owed \$267 million to school districts. This shift from school districts owing funds to the State to the State owing funds to school districts may be attributed to a change in how property values were estimated. As required by Texas Education Code, Section 42.253(b), property values were estimated as the higher of either (1) 2003 final property values or (2) 104.98 percent of 2002 final property values.

**Sources of  
Foundation School Program Funding**

The Foundation School Program is funded from the following:

- General Revenue.
- The Available School Fund (earnings from the State’s Permanent School Fund and 25 percent of the motor fuel taxes).
- Lottery proceeds.
- Appropriated receipts, which are local funds that school districts provide directly or indirectly to the Foundation School Program in accordance with wealth equalization requirements of Texas Education Code, Chapter 41.

**Options for School Districts to  
Achieve Wealth Equalization**

Texas Education Code, Section 41.003 specifies that:

“A district with a wealth per student that exceeds the equalized wealth level may take any combination of the following actions to achieve the equalized wealth level:

- (1) Consolidation with another district as provided by Subchapter B;
- (2) detachment of territory as provided by Subchapter C;
- (3) purchase of average daily attendance credit as provided by Subchapter D;
- (4) education of nonresident students as provided by Subchapter E; or
- (5) tax base consolidation with another district as provided by Subchapter F.”

A limitation was imposed on the Agency’s expenditure of local revenue recaptured as part of statutory wealth equalization requirements.

In fiscal year 2005, the Office of the Comptroller of Public Accounts (Comptroller’s Office) implemented a control to limit the Agency’s expenditure of \$776 million in non-cash appropriations.

The Foundation School Program receives funds from several sources. One of those sources is the non-cash revenue benefit that results when school districts directly exchange local revenue under the provisions of the wealth equalization requirements of Texas Education Code, Chapter 41 (see text box for additional details).

Prior to fiscal year 2005, the Agency spent the local revenue that school districts exchanged. In fiscal year 2005, however, the Comptroller’s Office established a separate fund for the \$776 million that school districts exchanged and removed this amount from the main Foundation School Program Fund. This control helped to prevent the Agency from spending more than it was appropriated.

Before that control was implemented, the Agency was able to spend \$564 million more than it was appropriated in fiscal years 2002 and 2003 (see Table 2 for additional details).

Table 2

Amounts Appropriated to and Spent from the Foundation School Fund Fiscal Years 2002 and 2003				
	Fiscal Year 2002		Fiscal Year 2003	
	Amount Appropriated	Actual Amount Spent	Amount Appropriated	Actual Amount Spent
Available School Fund	\$ 833,100,000	\$ 833,100,000	\$ 1,464,900,000	\$ 1,464,900,000
Foundation School Program	7,235,400,000	7,235,400,000	7,391,239,000	7,391,239,000
Lottery	807,000,000	1,081,379,892	799,000,000	929,801,867
Recapture of funds from School Districts from Wealth Equalization	621,500,000	710,598,776	692,600,000	868,702,215
Cash and appropriations transferred out	0	(91,356,107)	0	(14,381,056)
<b>Totals</b>	<b>\$9,497,000,000</b>	<b>\$9,769,122,561</b>	<b>\$10,347,739,000</b>	<b>\$10,640,262,026</b>
<b>Amount by which Expenditures Exceeded Appropriations</b>		<b>\$272,122,561</b>		<b>\$292,523,026</b>

Source: Texas Education Agency

### Recommendations

The Agency should ensure that it continues to operate within the controls implemented to prevent it from spending non-cash appropriations.

### Management's Responses

*The agency agrees with the findings and will continue to operate within the controls implemented to prevent expenditure of non-cash appropriations.*

- *Person Responsible: Chief Financial Officer*
- *Timeline: ongoing*

## *Improvements the Agency Has Made Should Help It to Forecast Future Deficits, But Additional Controls are Necessary*

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As discussed in Chapter 1, the Agency reorganized to include its Budget Office and State Funding Division under the same organizational branch and leadership. No material discrepancies were identified during this audit that would affect the accuracy of financial reports, and a review of the collection and recording of refunds that school districts owed the State indicated these funds are collected and recorded in a timely manner.

However, the Agency should implement additional controls to help ensure that it can forecast future deficits. Specifically:

- The Agency continues to rely on old Foundation School Program applications to calculate the amount of the distributions it makes to school districts. These applications generate vouchers that are passed to the accounting system for payment and provide financial information to the Agency's internal accounting system. The process used to determine the final distribution amounts for individual school districts combines payment data for current year operations and prior year obligations, which makes accurate budget management and forecasting difficult.
- In fiscal year 2005, the Agency established a project grant code to pay and track prior year distributions to school districts. However, the Agency's State Funding Division did not classify and distribute some prior year adjustments to distributions separately from current year distributions. This decreased the level of detail in the Agency's financial records and made it difficult to track the status of funding for a specific fiscal year.
- The Agency's payments to school districts for property value adjustments are not budgeted and are made out of current year Foundation School Program funding. In fiscal year 2004, \$42 million in unbudgeted prior year payments for property value adjustments were made; in fiscal year 2005, \$157 million in unbudgeted prior year payments for property value adjustments were made.
- To achieve the wealth equalization requirements of Texas Education Code, Chapter 41, school districts that do not meet the equalized wealth level can sell weighted average daily attendance (WADA) credits to school districts that exceed the equalized wealth level. In fiscal year 2005, 38 school districts were allowed to sell more WADA credits than they had available to sell; in fiscal year 2004, 29 school districts were allowed to sell more WADA credits than they had available to sell. This decreased the amount of recaptured funds available to the Foundation School Program by \$12,380,730.



- Detailed information for fiscal year 2004 school district distributions and adjustments was not readily available or clearly documented in the Agency's internal accounting system or records of the Agency's State Funding Division.
- The Agency's Budget Office and State Funding Division continue to have vacancies in key positions related to the analysis of the Foundation School Program and its budget. Forty percent of the positions in the Budget Office are vacant, including the budget analyst position responsible for the Foundation School Program. Twenty-seven percent of the positions in the State Funding Division are vacant, including a manager position and system analyst positions.

### Recommendations

The Agency should:

- Implement adequate supervisory review of prior year school district Foundation School Program distributions to ensure correct classification and processing.
- Account for prior year Foundation School Program obligations and receipts separately.
- Implement a reconciliation of State Funding Division records with information in its internal accounting system on a monthly basis.
- Actively pursue options to ensure that a sufficient number of personnel are assigned to manage and analyze the Foundation School Program.

### Management's Responses

*The agency agrees with the findings. The agency also notes that, even with the findings identified, it is the auditors' opinion that "No material discrepancies were identified during this audit that would affect the accuracy of the financial reports, and a review of the collection and recording of refunds that school districts owed the State indicated these funds are collected and recorded in a timely manner." The agency will implement the following SAO recommendations:*

- *Implement adequate supervisory review of prior year school district FSP distributions to ensure correct classification and processing.*
  - ♦ *Person responsible: Director of School Finance*
  - ♦ *Timeline: beginning with fiscal year 2007*

- *Account for prior year FSP obligations and receipts separately.*
  - ♦ *Person responsible: Associate Commissioner, Finance and Information Technology*
  - ♦ *Timeline: The separation of accounting is already performed. The agency intends to strengthen this function by developing an interface between the FSP payment system and the agency general ledger.*
  
- *Implement a reconciliation of State Funding Division records with information in its internal accounting system on a monthly basis.*
  - ♦ *Person responsible: Director of Accounting*
  - ♦ *Timeline: This reconciliation is currently performed on a quarterly basis.*
  
- *Actively pursue options to ensure that a sufficient number of personnel are assigned to manage and analyze the FSP.*
  - ♦ *Person responsible: Associate Commissioner, Finance and Information Technology*
  - ♦ *Timeline: The agency has already created a new division, Forecasting and Analysis, to increase analytical resources in the school finance area. The division is headed by a very senior information technology manager and another senior level programmer has been hired. The agency will continue to pursue qualified staff, including a replacement for the state funding director. This recruitment will commence in earnest at the conclusion of the Third Called Session of the 79th Legislature. Agency senior management expects the school finance area to be fully staffed by September 1, 2006. In addition, all vacancies in the agency budget staff will be filled in accordance with the same timeline.*

## ***Automated Processes for the Foundation School Program Reasonably Ensure that School District Distributions and Related Data Are Accurate, but Security Improvements Should Be Made***

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The Agency's automated processes for the Foundation School Program ensure that distributions to school districts are accurate and made in accordance with law. Results of testing of the new automated transportation module also indicated that transportation payment calculations are accurate.

The Agency has taken measures to secure its internal network, which includes securing servers that are integral to the Financial School Program. The Agency uses a layered approach to secure its internal computer resources that includes firewall filtering of network traffic, switching and filtering by routers, and configuring servers with only essential services and access.

Security of information technology supporting the Foundation School Program should be improved.

Security for the servers that host new Foundation School Program applications should be improved. For example, the Agency does not regularly conduct periodic, documented reviews of necessary services and users. In addition, baseline security settings of the Foundation School Program server should be improved. This server (1) stores user authentication data, (2) holds school distribution payment files before they are loaded into the Agency's internal accounting system, and (3) processes information in the agency's internal accounting system. The Agency performed preliminary remediation of weaknesses in security during this audit, but additional weaknesses should be corrected. Specifically:

- Password requirements for Foundation School Program applications are not adequate because:
  - ♦ Password length is not sufficient and password composition is not sufficiently complex.
  - ♦ Passwords do not expire, and no minimum password age has been established.
  - ♦ Password history is not maintained.
- The number of invalid access attempts is not limited.

### **Department of Information Resources Guidelines for Protecting Information Resources Assets**

#### **Passwords:**

- Establish an effective password policy.
- Encrypt reusable passwords in transmission and storage.
- Select security subsystems and applications that provide a password history to prevent the reuse of recent passwords.
- Use commercially available applications to test the validity of users' passwords.
- Disable user accounts after a preset period of inactivity; purge them after a longer period of inactivity.
- Provide mechanisms to reduce the number of unsuccessful logon attempts.
- Display the date and time of the last successful logon each time the user signs on.

#### **Protecting Transmitted Data:**

- The encryption systems used to protect data in transit need to be powerful since simple encryption is subject to penetration by attackers.

Source: *Practices for Protecting Information Resources Assets*, Department of Information Resources, September 2003.

- User access accounts do not expire, and users are allowed to switch to other users' accounts to attempt to access the Foundation School Program applications.
- External users of Foundation School Program applications (for example, users at school districts) are allowed to encrypt their session using the relatively weak version of Secure Socket Layer encryption instead of the stronger 128-bit encryption version.
- The TEA Secure Environment (TEASE) portal through which school district users access Foundation School Program applications allows unlimited login attempts and does not maintain a record of the number of login attempts. In addition, there is no formal process for disabling idle or terminated user accounts at the school district level.

**Excerpts from Information Security Standards in Title 1, Texas Administrative Code, Chapter 202**

- Information resources residing in the various state agencies of state government are strategic and vital assets belonging to the people of Texas... Measures shall be taken to protect these assets against unauthorized access, disclosure, modification or destruction, whether accidental or deliberate, as well as to assure the availability, integrity, utility, authenticity, and confidentiality of information.
- All state agencies are required to have an information resources security program consistent with these standards, and the state agency's head is responsible for the protection of information resources.
- All individuals are accountable for their actions relating to information resources.
- Risks to information resources must be managed.
- The integrity of data, its source, its destination, and processes applied to it must be assured. Changes to data must be made only in an authorized manner.
- Information resources must be available when needed. Continuity of information resources supporting critical governmental services must be ensured in the event of a disaster or business disruption.
- Security requirements shall be identified, documented, and addressed in all phases of development or acquisition of information resources.
- State agencies must ensure adequate controls and separation of duties for tasks that are susceptible to fraudulent or other unauthorized activity.

Auditors also identified several weaknesses in user access to Foundation School Program applications:

- One user at the school district level was incorrectly given access to edit data for all school districts.
- Three Agency users shared two administrator level accounts with review and edit capabilities for all Foundation School Program applications.
- Agency user's maintained access to both the old and new Foundation School Program applications after their job duties no longer required them to have this access.
- Foundation School Program directors can edit data and approve their own edits.
- The process of disabling one user's access was extended beyond a reasonable time.

## Recommendations

For all Foundation School Program applications, the Agency should follow the guidance regarding password policies and access security provided by the Department of Information Resource in *Practices for Protecting Information Resources Assets*.

For all Foundation School Program applications, the Agency should also adhere to user-level access security requirements in Texas Administrative Code, Chapter 202. In particular, the Agency should:

- Ensure there are adequate controls and separation of duties for tasks that are susceptible to fraudulent or other unauthorized activity.
- Manage access to information resources to ensure all use of those resources is authorized.
- Ensure it has established adequate user identification and authentication including:
  - ♦ The appropriate modification or removal of a user's access when the user's job responsibilities change.
  - ♦ The assignment of a unique identifier to each user, except for situations for which risk analysis demonstrates no need for individual accountability. User identification should be authenticated before users access applications.

## Management's Responses

*The agency agrees with the findings. The agency will review the Department of Information Resources' Practices for Protecting Information Resource Assets. The agency will implement all feasible recommendations during the summer of 2006 and report back to the SAO on the progress of that implementation.*

- *Persons responsible: Chief Information Officer in consultation with the Agency Confidentiality Officer*
- *Timeline: The agency will report progress to SAO by September 1, 2006.*

## ***The Agency's Controls Over Development of New Foundation School Program Applications May Not Ensure that State Resources Are Used Efficiently and Effectively***

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As discussed in Chapter 1, Foundation School Program operations are dependent on a complex 1970s-era automated process whose operability is dependent upon a few long-tenured employees who possess unique knowledge. The Agency is replacing certain old Foundation School Program applications with new applications, but controls over the development and implementation of the new applications may not ensure that State resources are used effectively and efficiently.

### **Statutory Definition of a Major Information Resource Project**

Texas Government Code, Section 2054.003, defines a "major Information resource project" as:

- Any information resources technology project identified in a state agency's biennial operating plan whose development costs exceed \$1 million and that:
  - ♦ Requires one year or longer to reach operations status;
  - ♦ Involves more than one state agency; or
  - ♦ Substantially alters work methods of state agency personnel or the delivery of services to clients; and
- Any information resources technology project designated by the Legislature in the General Appropriations Act as a major information resources project.

### **Texas Project Delivery Framework**

Texas Government Code, Sections 2054.310 through 2054.306, require state agencies to prepare the following documents for a major Information resources project:

- A business case and a statewide impact analysis.
- A project plan.
- A procurement plan and a method for monitoring contracts.
- A post-implementation review.

Texas Government Code, Sections 2054.310 through 2054.307, require a state agency's executive director to approve a proposed contract amendment or change order that changes the value of the contract by more than 10 percent or significantly changes the completion date.

Weaknesses in oversight of the development of new Foundation School Program applications continues to expose the Agency to risks related to the accuracy of payments to school districts. Current Agency strategic planning does not include replacement of all old Foundation School Program applications; therefore, the Agency continues to rely on a combination of new and old applications to operate the Foundation School Program.

The Agency does not categorize the development of the new Foundation School Program applications as a "major information resource project" and does not follow the Texas Project Delivery Framework required for major information resources projects.

Since fiscal year 2003, the Agency has categorized the project to replace old Foundation School Program applications as a "baseline operations" project. The Agency's project reports do not provide full visibility on the project's financial status and do not present total actual and estimated project costs since inception. The Agency has not performed a business case analysis for the replacement of old Foundation School Program applications, and the Agency's Information Planning Committee (which is responsible for prioritizing agency-wide technology projects) has not addressed the status of the project to replace Foundation School Program applications since its August 2004 meeting.

The Agency has spent at least \$4.9 million on the development of new Foundation School Program applications, and the new applications are still not fully operational. Based on its cost, the project meets the statutory definition of a “major information resources project.” Major information resources projects are required by Texas Government Code, Section 2054.301, to follow the Texas Project Delivery Framework and are subject to regular review by the State’s Quality Assurance Team.

The Agency did not fully employ system development life cycle methods to replace old Foundation School Program applications.

The Agency only partially employed system development life cycle (SDLC) methods for managing the development and implementation of new Foundation School Program applications. The following are examples of challenges that could have been avoided if the agency had fully employed an SDLC:

- The Agency established an initial project budget of \$3 million and an implementation schedule before completing business process and requirements analyses. Establishing a budget prior to conducting these analyses may have resulted in an overly optimistic estimate of resource requirements to complete a project of this scope.
- The Agency’s former contractor for the development of new Foundation School Program applications did not obtain user acceptance prior to putting new applications into production. User acceptance ensures that applications perform according to the user requirements and helps to identify errors prior to placing applications into production. The contractor attempted to obtain user acceptance, but Agency users found that the new applications did not meet their original requirements and refused to provide their formal acceptance.
- New Foundation School Program applications placed into production lack detailed program documentation and require continuous monitoring and development of enhancements. For example, system and user documentation for the payment application does not contain sufficient detail. Developer staff must develop program documentation for new Foundation School Program applications as they resolve the backlog of software change requests necessary to fix new applications that have been placed into production. This increases the time required to address software change requests and restricts the developers’ availability to work on new development tasks.

During this audit, 270 software change requests still had not been resolved; some of those requests date back to August 16, 2001. Most of them have a status of “On-Hold.” Some of the more recent unresolved software change requests are for topics that continue to be discussed at weekly project meetings. For example, one unresolved request is to change the date and status

fields for every Foundation School Program application. Making this change will be a time-consuming effort the Agency's project team currently does not have the resources to address.

Since the former contractor left the project, the Agency has employed the change management processes of its SDLC. However, this is only one part of following a full SDLC.

The Agency inaccurately reported the status of its implementation of new Foundation School Program applications and did not actively monitor the implementation of the new applications.

Prior to fiscal year 2003, the Agency was reporting the status of the Foundation School Project to the State's Quality Assurance Team. In May 2003, the Agency reported that a new Foundation School Program system was in full production and that applications to summarize finances would be completed by summer 2003. This was not an accurate depiction of the project's status. At the time of this audit, key functionality of new Foundation School Program applications were still not developed and implemented. Specifically:

- Key functions of the payment ledger application, summary of finance application, and estimated debt allotment /instructional facilities allotment application are not fully functional.
- The new payment application for school district distributions is not complete and is still operating in parallel with the old application.
- The Agency has not placed full reliance on new applications and continues to benchmark new applications against the old applications to verify that new applications are calculating school district distributions accurately.
- The transportation and charter school applications were placed into production even though they were not accepted by users. A substantial number of software change requests exist for these applications.

The Agency's reliance on old Foundation School Program applications exposes it to previously identified risks.

The Agency still relies on old Foundation School Program applications for core functionality. This continues to expose the Agency to risks the State Auditor's Office has previously identified. For example, in *An Audit Report on The Texas Education Agency's Administration of the Foundation School Program* (State Auditor's Office Report No. 03-033, April 2003), the State Auditor's Office recommended that the Agency improve the detail of the documentation for old applications that will not be replaced. However, there is still no formal documentation for the old applications.



The Agency does not follow its formal software change processes when changes are made to old Foundation School Program applications. As a result, there is no assurance that the correct versions of applications are being modified and that the modifications are authorized. Modifications to old Foundation School Program applications are not independently verified, documented, and retained. In addition, management has not provided for sufficient cross-training or back-up of key personnel.

In 2003, the State Auditor's Office also recommended that the Agency establish adequate separation of duties for collecting, processing, and reporting data used in determining the amount of school district distributions. During the current audit, auditors determined that distribution amounts are still developed and reviewed by the same employee. In addition, programming staff still have access to production source code and data. This risk is partially mitigated by reviews conducted by Agency program analysts and school districts' independent recalculations.

Audit testing during the current audit also identified an error in a report produced by one of the old Foundation School Program applications that is still in use. Specifically, the Total Summary of Finance report presents a total figure that does not equal the sum of the components of that figure.

The Agency's strategic planning and budgeting for the development of new Foundation School Program applications should be improved.

The Agency's methodology to prioritize information technology projects does not include a formal risk assessment process. Individual projects are risk assessed during the planning stage of the development cycle, but they are not periodically reassessed. The Agency's strategic plan identifies the Foundation School Program as a major component of financial accountability and public education excellence, but the project to replace old Foundation School Program applications does not appear in the list of planned technology projects for the 2006-2007 biennium. To secure funding for the 2008-2009 biennium, agencies that have projects that meet the definition of a major information resources project must submit a business case for their projects by August 31, 2006.

For fiscal year 2006, the Agency has established a \$650,000 budget for the project to replace Foundation School Program applications. Those funds are intended only for maintenance, and existing developer resources have been consumed with addressing software change requests for new applications that are in production. The budget allows for the planned addition of one budgeted full-time contractor and one full-time employee to the project, but there is no project plan against which to evaluate whether these additional resources will be sufficient to address the scope of remaining tasks. The Agency's State Funding Division and Information Systems Division are also experiencing difficulties in filling vacant positions, which is delaying the Agency's ability

to complete detailed business requirements for new Foundation School Program applications.

The absence of a business case or project plan to support the completion of all new Foundation School Program applications may limit the Agency's ability to respond to future funding challenges.

### Recommendations

The Agency should administer the project to replace Foundation School Program applications using a full SDLC methodology and in compliance with the statutory Texas Project Delivery Framework. This requires the Agency to:

- Complete user requirements and develop a business case to determine the feasibility of completing the new Foundation School Program applications and determine the level of resources required.
- Improve program documentation for old Foundation School Program applications that will not be replaced.
- Improve program documentation for new Foundation School Program applications.
- Improve project status and budgetary reports to include the full cost of in-house resources, total actual and estimated project costs since inception, and a variance analysis.

### Management's Responses

*The agency agrees with the findings. The agency does not regard current work on the FSP Payment System as the continuation of a major IT project and believes it is properly characterized as maintenance, albeit on a former project with an unsatisfactory result. Nevertheless the agency will fully implement the DIR SDLC methodology on a new FSP Payment System project. There is a risk that the agency will not secure adequate funding for the project. The agency will complete a business case by July 1, 2006.*

- *Person responsible: Associate Commissioner, Finance and Information Technology*
- *Timeline: Business case will be complete by July 2006 and project will be included in the agency 2008-09 Legislative Appropriations Request*

# Appendices

Appendix 1

## **Objectives, Scope, and Methodology**

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### Objectives

The audit objectives were to:

- Determine the causes of the unanticipated funding shortfall in the Foundation School Program identified in June 2005 and whether the Texas Education Agency's (Agency) State Funding Division and Budget Office have controls in place to detect future funding shortfalls and ensure that accurate financial information is produced.
- Determine whether the development and implementation of new automated processes that support the Foundation School Program have controls that are adequate to (1) protect data from unauthorized alteration, loss, or improper use; (2) ensure that distributions to school districts are accurate and made in accordance with law; and (3) ensure the effective and efficient use of state resources.

### Scope

The audit scope included (1) Foundation School Program school funding, budgeting, and management procedures and the controls over these processes and (2) the procedures and controls related to the implementation and management of the new Foundation School Program applications focusing on, but not limited to, the 2004-2005 biennium.

### Methodology

The audit methodology included interviewing staff, examining the impact of Foundation School Program processes on Agency budget, performing data analysis of key school funding drivers, identifying causes of the unanticipated Foundation School Program deficit, testing Foundation School Program processes for compliance with state law, reviewing Foundation School Program application development resources and expenditures, and testing of high-risk applications.

Information collected and reviewed included Agency policies and procedures applicable to current-year and prior-year Foundation School Program data, user access, security, and physical security, and all other applicable communications between the Agency and legislative bodies.

Procedures and tests conducted included the following:

- Conducted interviews with key staff from the Agency, Legislative Budget Board, and the Office of the Comptroller of Public Accounts regarding the management of the Foundation School Program, internal Agency policies and procedures, and the school district funding process.
- Analyzed Foundation School Program school funding processes related to current-year funding, year-end settle-up, wealth equalization, and prior-year payments.
- Analyzed key school funding formula drivers and identified controls to manage the Foundation School Program budget and detect future deficits.
- Reviewed project management procedures for development of new Foundation School Program applications for compliance with standards.
- Reviewed staffing levels and available funding for the development of new Foundation School Program applications.
- Tested data controls to ensure accuracy of information, adequate separation of duties, proper transaction authorizations, and output distribution security.
- Reviewed and followed up on prior State Auditor's Office recommendations.

Criteria used included the following:

- Texas Education Code, Chapters 41 and 42
- Title I, Texas Administrative Code, Chapters 201 and 202
- *Practices for Protecting Information Resources Assets*, Department of Information Resources, September 2003
- Agency policies and procedures
- Control Objectives for Information & Related Technology (COBIT)
- Texas State Classification Office human resources guidelines

### **Project Information**

The audit was conducted from November 2005 through March 2006. The audit was conducted in accordance with generally accepted government auditing standards. The following members of the State Auditor's staff performed this audit:

- Bruce W. Dempsey, MBA, CIA (Project Manager)

- Fabienne Robin, MBA (Assistant Project Manager)
- Ron Cornelius, CPA
- Michelle DeFrance, MA
- Joe K. Fralin, MBA
- Jennifer R. Logston
- Cherisse Robison, MPAff
- Carlos Toste
- Dean Duan, CISA (Information Systems Audit Team)
- Priscilla Garza (Information Systems Audit Team)
- Joseph A. Kozak, CPA, CISA (Information Systems Audit Team)
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Dave Gerber, MBA, CISA (Audit Manager)

## *The Agency's Summary of Its Responses*

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The Texas Education Agency provided the following summary of its responses to this report:

*The agency agrees with the findings and recommendations delineated in the report. The agency appreciates the auditor's recognition of a number of responses already taken to improve agency management of the Foundation School Program (FSP). The audit report correctly notes several factors that contributed to the inaccurate revenue forecast in the spring of 2005. It should also be noted that the agency's inaccurate forecast was rectified by an accurate agency forecast made in June, 2005. Regrettably, this was after the 79th Legislature had passed the fiscal 2005 supplemental appropriations bill and adjourned sine die.*

*The agency would also note the following excerpts from the audit report:*

*No material discrepancies were identified during this audit that would affect the accuracy of the financial reports, and a review of the collection and recording of refunds that school districts owed the State indicated these funds are collected and recorded in a timely manner (page 9).*

*and,*

*The Agency's automated processes for the Foundation School Program ensure that distributions are accurate and made in accordance with law (page 12).*

*The agency will continue to make accurate and timely payments to school districts in accordance with statute. Further, the agency will to the best of its ability implement the recommendations in this report to strengthen the controls over the FSP and enhance its automated processes to support these controls.*

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair  
The Honorable Tom Craddick, Speaker of the House, Joint Chair  
The Honorable Steve Ogden, Senate Finance Committee  
The Honorable Thomas “Tommy” Williams, Member, Texas Senate  
The Honorable Jim Pitts, House Appropriations Committee  
The Honorable Jim Keffer, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

### **Members of the State Board of Education**

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Ms. Mary Helen Berlanga  
Dr. Joe J. Bernal  
Mr. David Bradley  
Ms. Barbara Cargill  
Mr. Bob Craig  
Ms. Pat Hardy  
Ms. Terri Leo  
Ms. Gail Lowe  
Mr. Dan Montgomery  
Mr. Rene Nunez  
Ms. Cynthia A. Thornton

### **Texas Education Agency**

Dr. Shirley J. Neeley, Commissioner of Education



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