State Auditor's Office

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An Audit Report on

Agencies' and Higher Education Institutions' Compliance with Benefits Proportional by Fund Requirements

February 2007

Report No. 07-013

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Overall Conclusion

In fiscal years 2005 and 2006, state agencies and higher education institutions generally complied with requirements to pay employee benefits **proportionately to funding sources**. They did this by submitting the required reports and making the required refunds to General Revenue that were identified on those reports.

The requirements to pay benefits proportionately to funding sources are set forth in Article IX, Section 6.11, of the General Appropriations Act (79th Legislature) and Comptroller of Public Accounts' Accounting Policy Statement (APS) 011 (see text box for additional details).

Although agencies and higher education institutions generally complied with proportionality requirements, the timeliness of report submission and processing of **refunds to General Revenue** could be improved. In fiscal years 2005 and 2006, state agencies and higher education institutions were required to refund a net total of **$8,640,113** to General Revenue to comply with proportionality requirements. Of that amount, $425,116 (5 percent) has not yet been refunded.

General Appropriations Act (79th Legislature) Article IX, Section 6.11, Benefits Paid Proportional by Fund

Proportionality requirements apply to agencies' and higher education institutions' appropriated funds and federal receipts. These entities are required to:

- Maximize balances in the General Revenue Fund by paying benefits in proportion to the source of funds, unless otherwise provided.
- Refrain from using General Revenue to pay for benefits associated with salaries and wages paid from any source other than General Revenue.
- Submit Benefits Proportional by Fund reports demonstrating compliance and make necessary adjustments to the General Revenue Fund not later than November 19 for the preceding fiscal year.

The 79th Legislature clarified the focus of this requirement by changing the title from "Salaries to be Proportional by Fund" to "Benefits Paid Proportional by Fund."

Beginning in fiscal year 2005, community colleges were required to submit Benefits Proportional by Fund reports for **informational purposes** only. Community colleges are not required to make refunds to General Revenue to achieve proportionality until fiscal year 2008. Although community colleges significantly increased the timeliness of their report submissions in fiscal year 2006, 20 of them (40 percent) still did not submit reports by the established due date for that fiscal year.

This audit was conducted in accordance with the General Appropriations Act (79th Legislature), Article IX, Section 6.11.

For more information regarding this report, please contact Kelly Linder, Federal Funds Audit Manager, or John Keel, State Auditor, at (512) 936-9500.

The State Auditor's Office also audited the accuracy of three agencies' fiscal year 2005 Benefits Proportional by Fund reports. The Department of State Health Services and the Department of Aging and Disability Services should improve controls to ensure compliance with proportionality requirements. The third agency audited—the Commission on Environmental Quality—has adequate procedures to ensure its Benefits Proportional by Fund report is complete and accurate.

The Office of the Comptroller of Public Accounts has assisted agencies and higher education institutions in complying with proportionality requirements by clarifying Accounting Policy Statement 011. For example, it has clarified the criteria that qualify an agency to claim Single Funding status, and it has established clear due dates for making refunds to General Revenue.

The State Auditor's Office has previously reported that, in some cases, agencies and higher education institutions must comply with other proportionality requirements that differ from the requirements to pay employee benefits proportionately to funding sources. This caused a lack of clarity about how to handle these circumstances. During this audit, we determined that agencies and higher education institutions still face inconsistencies between laws, rules, and federal grant restrictions that may prevent them from achieving proportionality requirements.

Summary of Objective, Scope, and Methodology

The objective of this audit was to determine state agencies and higher education institutions compliance with benefits paid proportional by fund requirements in the General Appropriations Act (78th and 79th Legislatures).

The scope of the audit included testing fiscal year 2005 and 2006 Benefits Proportional by Fund reports that state agencies and higher education institutions submitted to the Office of the Comptroller of Public Accounts.

The audit methodology consisted of determining whether the three audited agencies' Benefits Proportional by Fund reports were complete and accurate. For all other entities, we determined whether they submitted the report and made necessary adjustments to General Revenue to achieve proportionality in a timely manner. Auditors also reviewed internal controls within the Uniform Statewide Accounting System and did not identify any significant control weaknesses in that system.

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Detailed Results

Chapter 1

Agencies and Higher Education Institutions Generally Complied with Proportionality Requirements, But the Timeliness of Report Submission and Processing of Refunds to General Revenue Could Be Improved

The majority of agencies and higher education institutions submitted Benefits Proportional by Fund reports and processed required refunds to General Revenue as required by the General Appropriations Act and Comptroller of Public Accounts' Accounting Policy Statement (APS) 011 (see Table 1).

Table 1

Summary of State Entity Compliance with Proportionality Requirements		
Category	**Fiscal Year 2005**	**Fiscal Year 2006**
Number of entities that were required to submit a Benefits Proportional by Fund report or a single source letter	178	168[a]
Number of entities that **submitted a Benefits Proportional by Fund report or a single source letter by the due date**	125	132
Number of entities **that submitted a Benefits Proportional by Fund report or a single source letter after the due date**	50	29
Number entities that **did not submit a Benefits Proportional by Fund report or a single source letter**	3	7[b]

[a] The difference in total number of entities between fiscal years is primarily due to the consolidation of health and human services agencies.

[b] Reports or letters were not submitted as of December 1, 2006.

A total of 10 agencies and higher education institutions did not submit a Benefits Proportional by Fund report or a single source letter in fiscal years 2005 and 2006. Not submitting this documentation prevents the State from potentially identifying and recouping General Revenue that could be used for other programs or services.

Summary of Refunds to General Revenue

In fiscal years 2005 and 2006, state agencies and higher education institutions refunded $8,214,997 to General Revenue (see Table 2 on the next page). These entities were required to refund a net total of $8,640,113 to comply with proportionality requirements. Of that amount, $425,116 (5 percent) has not yet been refunded.

Table 2

Summary of State Entity Compliance with Requirements to Make Refunds to General Revenue						
	Fiscal Year 2005		Fiscal Year 2006		Total for Both Fiscal Years	
	Number of Entities	Amount	Number of Entities	Amount	Number of Entities	Amount
Number of entities that **made refunds by the due date**	43	$ 2,089,037	43	$ 6,919,692	86	$ 9,008,728
Number of entities that **made refunds after the due date**	26	($1,544,499)	18	$ 750,767	43	$ (793,732)
Total	**69**	**$ 544,538**	**61**	**$7,670,459**	**129**	**$8,214,997**
Number of entities that **reported no refunds were required**	32	n/a	55	n/a	88	n/a

Community College Compliance

Beginning in fiscal year 2005, community colleges were required to submit Benefits Proportional by Fund reports for information purposes only. Community colleges are not required to make adjustments to achieve proportionality until 2008. Although community colleges significantly increased the timeliness of their report submission in fiscal year 2006, 20 of them (40 percent) still did not meet the established due date for that fiscal year (see Table 3).

Table 3

Summary of Community College Compliance with Requirement to Submit Benefits Proportional By Fund Reports		
Category	Fiscal Year 2005	Fiscal Year 2006
Total number of community colleges required to submit a Benefits Proportional by Fund report	50	50
Number of community colleges that **submitted Benefits Proportional by Fund reports by the due date**	10	30
Number of community colleges that **submitted Benefits Proportional by Fund reports after the due date**	40	7
Number of community colleges that **did not submit Benefits Proportional by Fund reports**	0	13 [a]
[a] Reports not submitted as of December 1, 2006.		

Chapter 2

Two of Three Agencies Audited Should Improve Controls to Ensure Compliance with Proportionality Requirements

Audit testing of fiscal year 2005 Benefits Proportional by Fund reports at three agencies indicated that two of those agencies should improve controls to ensure compliance with proportionality requirements. The completeness and accuracy of this report is critical in preventing state agencies from inappropriately using General Revenue to pay for employee benefits.

Department of State Health Services

The Department of State Health Services (Department) should improve internal controls to ensure employee benefit payments are paid in compliance with APS 011. The Department's initial fiscal year 2005 Benefits Proportional by Fund report contained several errors, and because of this, the Department had to resubmit its report. While the initial report was mathematically accurate, it was not complete and it did not adhere to certain APS 011 requirements. Specifically:

- The Department's initial report included fiscal year 2005 revenues instead of appropriation year 2005 revenues, as required by APS 011. The Department also excluded the amount of benefits paid with federal funds from its method of finance. It also did not include $27,045,982.87 in federal end-of-year revenue accruals on its report. All of these errors skewed the Department's overall method of finance and, therefore, the amount of benefits required to be paid by each fund. After correction of these errors, recalculation of the Department's fiscal year 2005 report shows that the Department should refund an additional $393,895 to General Revenue.

- The Department did not file its fiscal year 2005 report by the required due date, nor did it make required adjustments by the due date. The Department also did not make any of the adjustments required to achieve proportionality for group insurance benefits. In fiscal year 2006, the Department submitted its report on time, but it processed required adjustments after the due date.

- Data in the Uniform Statewide Accounting System (USAS) indicates that, in appropriation year 2005, the Department paid for 20 percent of total salaries and wages with federal funds (approximately $53.5 million); however, it paid for only 13.2 percent of total benefits with federal funds (approximately $13 million). Several factors could cause these percentages to be different; however, the difference in percentages indicates that the Department may not be paying the appropriate amount of benefits associated with the salaries and wages it paid with federal funds.

The Department has adequate controls to ensure that, if employees' benefits are charged to federal accounts, the correct amounts are drawn down from the federal agency.

Department of Aging and Disability Services

While the Department of Aging and Disability Services' (Department) fiscal year 2005 Benefits Proportional by Fund report was mathematically accurate, it was not complete and did not adhere to certain APS 011 requirements. Specifically:

- The Department had to resubmit its fiscal year 2005 report because it estimated employee benefits instead of reporting actual benefits as recorded in the USAS. The Department made $150,213, or 0.13 percent of total benefit expenditures, in adjustments to its fiscal year 2005 employee benefits as late as 14 months after the end of the fiscal year. Total employee benefits charged to an appropriation year or fiscal year should not change unless an agency determines it was not calculating benefits accurately or employees were not paid accurately; neither the Department nor the Health and Human Services Commission payroll unit that processes payroll on the Department's behalf indicated that either of these events occurred. The Department's revised report underreported total benefits by $52,639.
- The Department's original fiscal year 2005 report did not specify the legal citations that authorized it to exclude certain funds from the proportionality calculation, including its exclusion of 100 percent of its federal funds. In its revised report, the Department made reference to APS 001 – Fund Reimbursement for Employee Benefit Costs and its Public Assistance Cost Allocation Plan (Allocation Plan) to justify its exclusion of federal funds from the proportionality calculation. According to Office of Management and Budget Circular A-87, agencies can only charge federal funds for benefits that are associated with salaries paid from federal funds. However, these policies do not authorize the Department to exclude 100 percent of its federal funds from the proportionality calculation.
- The Department did not file its fiscal year 2005 and 2006 reports by the required due date.

Although the issues identified above did not affect the General Revenue fund and no adjustments were required, the Department should identify the programs and amount of federal funds that qualify to be excluded from the calculation to ensure compliance with APS 011.

While audit tests determined that federal funds paid an adequate amount of employee benefits based on the Department's method of finance, the amount of benefits paid with federal funds is determined by the Department's allocation plan. This plan, which follows the Health and Human Services Commission's (Commission) methodology, has been reviewed and approved by the Commission, which has financial oversight over the Department for certain federal programs. However, the Commission's allocation plan has not been approved by the federal cognizant agency. Any changes to the Commission's allocation plan by the federal cognizant agency may also require changes to the Department's allocation plan, and this could have a positive or negative effect on General Revenue.

The Department has adequate controls to ensure that, if employees' benefits are charged to federal accounts, the correct amounts are drawn down from the federal agency.

Commission on Environmental Quality

The third agency audited—the Commission on Environmental Quality (Commission)—has adequate procedures to ensure its Benefits Proportional by Fund report is complete and accurate. The Commission also complied with other requirements by submitting its fiscal year 2005 and 2006 Benefits Proportional by Fund reports and making the required adjustments by the required due dates. Furthermore, the Commission has adequate controls to ensure that, if employees' benefits are charged to federal accounts, the correct amounts are drawn down from the federal agency.

Chapter 3

Proportionality Requirements Have Been Clarified, But Stronger Internal Controls and Further Clarification of Requirements Could Improve Compliance

The Office of the Comptroller of Public Accounts has revised APS 011, which has helped agencies and higher education institutions achieve compliance with proportionality requirements. However, agencies and higher education institutions have opportunities to strengthen their internal controls to ensure compliance. In addition, as we have previously reported, agencies and higher education institutions still face inconsistencies between laws, rules, and federal grant restrictions that may prevent them from achieving proportionality.

Chapter 3-A

Revisions to APS 011 Have Assisted Agencies and Higher Education Institutions to Achieve Compliance with Proportionality Requirements

The State Auditor's Office previously reported that agencies could refrain from submitting the Benefits Proportional by Fund reports by combining multiple sources of funding into a single operating fund as authorized by the General Appropriations Act. These agencies were able to submit a letter claiming single source funding status and could circumvent the requirement of paying benefits based on their method of finance.

Single Source Letter

If state entities are funded from a single fund (and this fund does not include federal funds), they are permitted to submit a letter specifying this fact rather than a Benefits Proportional by Fund report.

In fiscal year 2004, the Office of the Comptroller of Public Accounts clarified the criteria for agencies to determine whether they qualify for the single source funded status and whether they could submit a single source letter in lieu of a Benefits Proportional by Fund report. This resulted in fewer state agencies submitting single source letters when they did not meet the criteria. In fiscal year 2005, four agencies submitted single source letters when they did not meet the criteria for doing so; in fiscal year 2006, only two agencies submitted single source letters when they did not meet the criteria for doing so.

The State Auditor's Office also previously reported that agencies and higher education institutions delayed making refunds to General Revenue because neither the General Appropriations Act nor APS 011 established a due date by which they should make these refunds. As of fiscal year 2004, the Office of the Comptroller of Public Accounts updated APS 011 to establish due dates for these refunds. As a result, for fiscal years 2005 and 2006, 67 percent of agencies and higher education institutions made refunds in a timely manner. However, in fiscal year 2005, some of the agencies did not process adjustments in a timely manner and were still making adjustments as late as July 2006.

Chapter 3-B

Agencies and Higher Education Institutions Have Opportunities to Strengthen Controls to Ensure Compliance with Proportionality Requirements

In reviewing state agencies' and higher education institutions' Benefits Proportional by Fund reports and auditing three agencies' reports, auditors identified opportunities for entities to strengthen controls to ensure they comply with proportionality requirements. Specifically, state entities should ensure that they:

- Use actual benefit expenditure information in USAS to prepare their Benefits Proportional by Fund reports (see discussion in Chapter 2 for additional details).
- Consistently provide legal citations that justify the exclusion of certain funds from the proportionality calculation (see discussion in Chapter 2 for additional details).
- Make adjustments by the required due date (see discussion in Chapters 1 and 2 for additional details).
- Submit Benefits Proportional by Fund reports by the required due dates (see discussion in Chapters 1 and 2 for additional details).

Chapter 3-C

Complying With Certain Aspects of Proportionality Requirements May Cause Agencies and Higher Education Institutions to Violate Other Requirements

The State Auditor's Office has previously reported that, in some cases, agencies and higher education institutions must comply with other proportionality requirements that differ from the Benefits Proportional by Fund requirements in the General Appropriations Act and APS 011. This caused a lack of clarity about how to handle these circumstances.

During this audit, we determined that agencies and higher education institutions still face inconsistencies between laws, rules, and federal grant restrictions that may prevent them from achieving proportionality. Specifically:

- Complying with proportionality requirements may require agencies and higher education institutions to use dedicated General Revenue to pay for employee benefits. However, dedicated General Revenue is originally earmarked for a specific purpose and to provide a predetermined level of service. In some cases, agencies and higher education institutions must choose between providing the expected level of service for which funds were originally earmarked or complying with APS 011.

- Many agencies that receive federal funds exclude the entire amount from proportionality requirements or do not make adjustments to achieve proportionality. Agencies contend that according to federal regulations (OMB A-87), grant restrictions, or cost allocation plans, they can only pay for benefits associated with salaries paid with federal funds. Therefore, regardless of the proportionality report results, entities will not charge the federal government more than they are authorized because they risk losing the federal funds.

- Furthermore, based on its Benefits Proportional by Fund report, an agency or higher education institution may be required to draw additional General Revenue funds to achieve proportionality by method of finance. Because salaries are not subject to proportionality requirements, the agency or higher education institution may choose to pay salaries in proportions other than the proportions in its method of finance. However, according to the General Appropriation Act, Article IX, Section 6.11 (b), an agency or higher education institution cannot pay for benefits if the associated salary was not paid with General Revenue. Therefore, agencies may choose not to draw additional General Revenue because receiving those additional funds could be considered a violation of proportionality requirements.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether entities required to pay benefits proportionally by fund (1) complied with Accounting Policy Statement (APS) 011 reporting requirements and (2) processed needed adjustments to accomplish proportionality.

While the General Appropriations Act (78th Legislature) requires state entities to pay salaries, wages, and benefits proportionately to the source of fund, the Office of the Comptroller of Public Accounts historically has focused its proportionality instructions and required reports on only the payment of benefits. This is because salaries are appropriated directly to entities, while benefits are estimated and not appropriated directly; thus, benefit payments need to be monitored. Therefore, this audit also focused on the payment of benefits. This requirement was clarified by the 79th Legislature by changing the requirement title from "Salaries to be Proportional by Fund" to "Benefits Paid Proportional by Fund."

Scope

The scope of this audit covered state agency and higher education institution compliance with proportionality requirements for fiscal years 2005 and 2006. Community college compliance was limited to verifying that these entities filed the Benefits Proportional by Fund reports by November 20, as required by the General Appropriations Act (78th Legislature, Article III, Rider 15 and 79th Legislature, Rider 14). Auditors also reviewed internal controls within the Uniform Statewide Accounting System (USAS) and did not identify any significant control weaknesses in that system.

Methodology

The audit methodology consisted of analyzing three agencies' fiscal year 2005 Benefits Proportional by Fund reports to determine whether the reports were complete and accurate. Auditors compared information on these reports with information in USAS. Auditors also reviewed these agencies' procedures to make refunds to the General Revenue Fund when this fund pays for benefits associated with salaries paid from sources other than General Revenue.

For all other agencies, auditors reviewed information in USAS to verify whether entities made necessary adjustments to the General Revenue Fund for fiscal years 2005 and 2006.

Information collected and reviewed included the following:

- Benefits Proportional by Fund reports and single source funding letters entities submitted in fiscal years 2005 and 2006.
- Documentation supporting the Benefits Proportional by Fund reports for the three agencies audited.
- Fiscal year 2005 benefits expenditure information in USAS.
- Proportionality requirements established by the 78th and 79th Legislatures.

Procedures and tests conducted included the following:

For the agencies audited:

- Verified report completeness by verifying that agencies reported only appropriation year 2005 revenues and benefits as recorded in USAS.
- Reviewed agencies' procedures to complete the Benefits Proportional by Fund report.
- Reviewed agencies' legal citations authorizing the exclusion of certain funds from the proportionality calculation.
- Reviewed agencies Benefits Proportional by Fund report for mathematical accuracy.
- Conducted interviews with selected agency staff and Appropriation Control Officers at the Office of the Comptroller of Public Accounts.

For all other entities:

- Identified report submission date and adjustments processed date to determine entities' compliance with due dates.
- Verified that adjustments were posted in USAS to achieve proportionality.

Criteria used included the following:

- Comptroller of Public Accounts' Accounting Policy Statement 001 and 011 and related instructions for fiscal years 2005 and 2006.
- Article IX, Section 6.11, the General Appropriations Act (78th and 79th Legislatures).
- Selected agencies' appropriations for the 2004-2005 bienniuim and corresponding riders.

- Selected agencies' statutes as referenced by the agencies.

Project Information

Audit fieldwork was conducted from November 2006 through January 2007. This audit was conducted in accordance with generally accepted government auditing standards.

The following members of the State Auditor's staff performed the audit:

- Ileana Barboza, MBA, CGAP (Project Manager)
- Nick Ballard (Assistant Project Manager)
- Robert H. Bollinger, CPA, CFE
- Stephen Randall, MBA
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Kelly Linder, MSCRP, CGAP (Audit Manager)

Appendix 2

Recent State Auditor's Office Work

Recent SAO Work		
Number	**Product Name**	**Release Date**
04-039	An Audit Report on State Entity Compliance with Benefits Proportional by Fund Requirements in Fiscal Years 2002 and 2003	June 2004
03-025	An Audit Report on Compliance with Benefits Proportional by Fund Requirements at 20 State Entities	March 2003
02-069	An Audit Report on State Entity Compliance with Benefits Proportional by Fund Requirements	August 2002

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 Warren Chisum, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Commission on Environmental Quality

Members of the Commission on Environmental Quality
  Ms. Kathleen Hartnett White, Chair
  Mr. Larry R. Soward
Mr. Glenn Shankle, Executive Director

Comptroller of Public Accounts

The Honorable Susan Combs, Comptroller of Public Accounts

Department of Aging and Disability Services

Ms. Adelaide Horn, Commissioner

Department of State Health Services

Dr. David L. Lakey, Commissioner

Health and Human Services Commission

Mr. Albert Hawkins, Executive Commissioner