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An Audit Report on Financial Management at the Department of Health

March 2001

Overall Conclusion

Over the last ten years, the State Auditor's Office, the Department of Health's (Department) internal auditor, and others have reported findings concerning the Department's business and financial practices. Many of the previous findings are similar to those identified in the current audit. The issues identified in these findings affect the Department's accountability and hinder its ability to provide reliable financial information. The consistency with which these issues continue to appear raises questions about the Department's ability to implement the comprehensive and long-term policy, operational, and technical solutions necessary to fix and prevent recurrent problems. The Department has not fully met all state and federal requirements and lacks an effective compliance monitoring process. Other concerns include the recurrent use of adjustments to correct accounting errors, incorrect expenditure coding, and inadequate information systems.

Key Facts and Findings

- The Board of Health (Board) delegates its oversight responsibility by authorizing the Department to adjust appropriation transfers at the Department's discretion to meet the financial obligations of the Department. As a result, the Department has made million-dollar adjustments to approved appropriation transfers without additional review.
- According to the Department's *1999 Fee Resource Manual*, in 22 of 47 programs that require fees to cover program costs, total expenditures exceeded revenues by more than $5 million. The Department indicates that the Board has authority to change fees for 11 of the 22 programs, and other fees are subject to control of external parties.
- The Department may have incurred an interest liability under the federal Cash Management Improvement Act as a result of its handling of federal funds.
- Errors in the Department's Indirect Cost Recovery Plan for fiscal year 2001 may result in overcharges to the federal government.
- The Department makes recurrent adjustments to its accounting systems to correct bookkeeping errors. The need to make recurrent corrections raises concerns about the accuracy of other accounting transactions.
- Inadequate maintenance of user access for both the Department's and the State's accounting systems could result in intentional or unintentional damage to financial information.

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This audit was conducted in accordance with Government Code, Sections 321.0131, 321.0132, and 321.0133.

Executive Summary

Over the last ten years, the State Auditor's Office, the Department of Health's (Department) internal auditor, and other outside entities have reported findings concerning the Department's business and financial practices (see Appendix 2). Many of the previous findings are similar to those identified in this audit. The issues identified in these findings affect the Department's accountability and hinder its ability to provide reliable financial information. The consistency with which these and similar issues continue to appear raises questions about the Department's ability to implement the comprehensive and long-term policy, operational, and technical changes necessary to fix and prevent recurrent problems.

The Department has not fully met all state and federal requirements, including General Appropriations Act mandates. Additionally, the Department may have incurred an interest liability as a result of the way it handles federal funds. The Department also lacks an effective compliance monitoring process. Other concerns include the Department's incorrect use of expenditure codes in its accounting systems and in the Uniform Statewide Accounting System (USAS); its recurrent use of accounting adjustments; and its aging information systems, which cannot provide timely and reliable information and lack adequate protection from unauthorized use.

These individual findings do not by themselves substantially increase risk to the Department. Combined, however, they raise concern and could affect the reliance that can be placed upon the Department's financial information.

The Department Has Not Fully Met State and Federal Requirements

The Board of Health (Board) delegates its oversight responsibility to the Department by authorizing it to adjust appropriation transfers at the Department's discretion to meet the financial obligations of the Department. This practice appears contrary to state requirements and at odds with the Board's fiscal stewardship responsibilities. As a result, the Department has made million-dollar adjustments to approved appropriation transfers without additional review.

The Department does not always provide the Legislative Budget Board (LBB) and the Governor's Office of Budget and Planning (GOBP) with all information relating to appropriation transfers, as required by General Appropriations Act Rider 3, 75th and 76th Legislatures. As a result, oversight agencies may not have the full information necessary to assess the appropriateness of transfer transactions, and transactions are not fully documented for public review.

The Department may have incurred an interest liability under the Federal Cash Management Improvement Act (CMIA) as a result of its handling of federal funds.

According to the Department's *1999 Fee Resource Manual*, program revenues and fees do not cover program costs as required by the General Appropriations Act. Total expenditures exceeded revenues by more than $5 million for 22 of 47 programs reviewed. The Department indicates that the Board has authority to change fees for 11 of the 22 programs, and other fees are subject to the control of external parties.

The Department used inaccurate data to prepare its Indirect Cost Recovery Plan, which could result in overcharges to the federal government. The Department's policies and procedures for plan preparation are outdated.

At the time of this audit, the Department had not fully implemented a comprehensive, effective process to monitor and ensure compliance with State and Federal requirements.

The Department's Accounting Practices Reduce the Reliability of Financial Information Used for Decision-Making

The Department's assignment of expenditure codes for similar transactions is inconsistent and sometimes inaccurate, which reduces the comparability and reliability of information provided to decision-makers.

The Department's recurrent use of accounting adjustments decreases the reliability and consistency of its financial information and raises concern about the accuracy of accounting transactions. During fiscal years 1999 and 2000, the Department processed 530 USAS expenditure transfers totaling more than $250 million dollars.

The Department's Aging Financial Information Systems Are Inflexible and Cumbersome and Are Not Adequately Protected from Misuse

The Department's aging financial systems do not adequately support the functions required to track financial events significant to the financial management of the Department. The systems are cumbersome and do not provide the flexibility necessary to provide timely and reliable information for decision-makers.

The Department has not implemented adequate user access management practices to minimize the potential for unauthorized access to its financial information systems and to USAS.

Summary of Management's Response Provided by the Department of Health

The Texas Department of Health (TDH) believes that the State Auditor's Office (SAO) has conducted a thorough Financial Management Review. We would like to emphasize that these findings do not by themselves substantially increase the risk to TDH. This review focuses on some appropriately noted areas where there are opportunities for improvement. As always, TDH is committed to addressing each of the individual SAO findings and implementing appropriate corrective action.

As noted in Appendix 2 as well as in multiple State Auditor reports, the Department has taken appropriate corrective action to address the findings in the various audit reports. TDH is very complex in terms of number and type of programs, as well as in the number of funding sources, and is therefore thoroughly audited. TDH is committed to ensuring accountability, efficiency, and integrity as evidenced by the progress the Department has made toward the replacement of our administrative systems to address many of the issues brought up over time. The Department is further demonstrating this commitment by doing risk analysis and benchmarking our existing processes against those of other health and human services agencies and the new administrative systems software. Our intent is to change our business processes to conform to best practices.

Summary of State Auditor's Follow-Up Comments

The Department is entrusted with substantial public resources. Therefore, it is responsible for establishing and maintaining controls to ensure that appropriate goals and objectives are met; resources are safeguarded; laws and regulations are followed; and reliable information is obtained, maintained, and fairly disclosed. The Department is solely responsible for its operations and must be proactive in determining how to comply with laws and regulations.

It is critical that the Department establish financial and business practices to ensure that its operations are efficient, effective, and in compliance with requirements. Addressing individual findings in isolation does little to ensure that comprehensive and long-term policy, operational, and technical changes are made to address recurrent problems.

Summary of Audit Objective, Scope, and Methodology

The primary objective of this project was to perform a comprehensive review and audit of accounts and depository practices at the Department in response to a legislative request. The scope of the project included fiscal operations, compliance with various requirements, and security over Department information resources. We performed various types of analyses on Department budgeting and accounting transactions. We also reviewed various policies, plans, and work products.

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Section 1:

The Department Has Not Fully Met State and Federal Requirements

The Department did not fully meet requirements of the General Appropriations Act relating to appropriation transfers and program revenues that are required to cover program costs. In addition, it did not fully meet the requirements of the Federal Cash Management Improvement Act.

At the time of the audit, the Department lacked a comprehensive, effective process to monitor and ensure compliance with all state and federal requirements. The Department also used inaccurate data to prepare its indirect cost recovery plan for fiscal year 2001.

Laws, regulations, and rules (requirements) as they apply to an agency's operations are designed to make certain that the agency operates within the boundaries provided by the rule-making bodies. It is necessary to determine, on an ongoing basis, whether the operations of an entity fall within these boundaries. Otherwise, the entity may fail to meet rule-makers' intentions.

Section 1-A:

The Board of Health Has Delegated its Oversight Responsibility by Authorizing the Department to Make Million-Dollar Adjustments to Approved Appropriations Transfers Without Additional Review

The Board of Health (Board) delegates its oversight responsibility to the Department by authorizing it to adjust, at the Department's discretion, previously approved appropriation transfers. This practice appears contrary to state requirements and at odds with the Board's fiscal stewardship responsibilities. In our opinion, a Department-specific rider (Rider 3, General Appropriations Act, 75th and 76th Legislatures), which is more restrictive than general riders affecting other agencies, requires the Board to approve all appropriation transfers.

The Department adjusted one appropriation transfer twice during an eight-month period, resulting in an increase of 126 percent ($16 million to $36.2 million) over the original amount approved by the Board. In another example, according to the Department, it obtained initial approval to transfer appropriations of more than $1.5 million during the September 1998 board meeting. However the transfer was not made until September 1999 and amounted to $2 million. The Department later adjusted this transfer to $3.7 million in May 2000, twenty months after the initial authorization. By approving all transfers, the Board would meet the

The Department Adjusted One Appropriation Transfer Twice During An Eight-Month Period

Activity	Date	Total Transfer of General Revenue Appropriations	Federal Funds Related To Transfer
		(rounded in millions)	
Initial Transfer	June 1999	$16.0	$26.6
Adjustment	September 1999	$33.0	$54.8
Adjustment	May 2000	$36.2	$60.2

requirements of the General Appropriations Act and strengthen the Department's accountability.

Recommendation:

The Board should consider limitations on the amounts and/or percentage adjustments to transfers the Department is allowed to make before further approval by the Board is necessary. While it may not be practical for every transfer to be approved by the Board, in the instances noted, the Department transferred a substantially larger amount than initially approved. Limitations should be restrictive enough to reduce the possibility of significant transfers being made without the opportunity for Board review.

Management's Response:

In accordance with the General Appropriations Act, the Board of Health approves all appropriation transfers and has also authorized adjustments in the amount of certain transfers when the adjustment is necessary to meet the agency's financial obligations. Generally this authority has been granted for transfers between Medicaid strategies because actuarial estimates can fluctuate significantly from month to month. Since another Department-specific rider (Rider 2, General Appropriations Act, 75th and 76th Legislatures) restricts transfers from Medicaid strategies, such flexibility seems warranted. While we do not believe that the Board has failed to comply with the General Appropriations Act by granting this authority, we can support a recommendation to strengthen accountability. The Board of Health has proposed that staff include a page in the Quarterly Strategic Financial Issues Report that would report any adjustments in transfers that it has previously approved.

State Auditor's Follow-Up Comment:

Adjustments to Board-approved transfers were not limited to the Medicaid strategies. For example, through adjustments, the Department increased transfers out of its Family Planning strategy and its Medically Dependent Children Waivers strategy, neither of which is a Medicaid-related strategy.

Section 1-B:

The Department Does Not Provide Oversight Agencies With All Required Information Relating to Appropriation Transfers

The Department does not always provide the Legislative Budget Board (LBB) and the Governor's Office of Budget and Planning (GOBP) with all information relating to appropriation transfers, as required by the General Appropriations Act, Rider 3, 75th and 76th Legislatures.

In the appropriation transfers we reviewed, the Department did not disclose the amounts of funds to be spent on direct client services as opposed to both general and operating support costs, as required by a strict interpretation of the rider. Additionally, ambiguous language such as "This budget transfer is necessary to align budgets with currently [sic] project expenditure patterns" does not seem adequate to explain why transfers are necessary.

The following transfer information is required in notification to the Legislative Budget Board and the Governor's Office of Budget and Planning, according to General Appropriations Act Rider 3.

- The source of the funds to be transferred.
- Changes in federal funds related to the proposed transfer.
- Strategy from which the transfer is to be made and the strategy to which the transfer is to be made.
- Need intended to be served through the original appropriation and the basis for the decrease in need.
- Need to be served in the strategy receiving the funds and the basis for such selection.
- Amounts of funds to be spent on direct client services as opposed to both general and operating support costs.
- When program expansion is under consideration, the population to be served, criteria for eligibility, source of funding, and impact on existing programs.

By providing all required information to the LBB and the GOBP, the Department would ensure that these oversight agencies have the information necessary to assess the appropriateness of transfer transactions. It also would guarantee strict compliance with the rider.

<u>Recommendation</u>:

The Department should make appropriate disclosure of transfer specifics as required by the General Appropriations Act.

<u>Management's Response</u>:

The Department has utilized its current format for transfer notification to the Governor's Budget Office and Legislative Budget Board since the requirement for notification was first established in the General Appropriations Act by the 74th Legislature. TDH has never been notified by these oversight agencies that it was not meeting the requirements of the Act. However, TDH will revise the format to incorporate these recommendations.

Section 1-C:

The Department May Have Incurred an Interest Liability Under the Federal Cash Management Improvement Act (CMIA) as a Result of its Handling of Federal Funds

The manner in which the Department manages certain federal funds could result in the payment of unnecessary interest expenses. As a result of making expenditure transfers that change a transaction's method of financing from federal to state funds, the Department creates unobligated federal funds. As a result of these types of transactions, the Department may have incurred an interest liability. The interest due to the federal government on these carry-forward funds could exceed several million dollars.

The intent of the CMIA, which was enacted in the 1990s, is to improve the timing of the flow of federal dollars so that states receive funds when they need them, but not before. The Act requires that one party pay interest to the other if funds are received late or if funds are drawn too early.

The Department uses expenditure transfers to maximize its overall funding by using General Revenue funds and carrying forward federal funds for later use. The Department acknowledges that this has been its policy for many years. While the exact amount of federal cash balances on hand as a result of this practice is unknown, the balance of federal funds on hand has averaged millions of dollars for at least the last four fiscal years. According to federal representatives, the CMIA does not address the specifics of this type of transaction. However, guidance from federal representatives suggests that expenditure transfers should be treated in the same manner as a refund that the Department might receive from a vendor. Interest would be calculated for the period between the date the federal funds are created by the expenditure transfer and the date the balances are paid out for program purposes or credited to the federal government.

One of the primary purposes of the CMIA is to make sure that recipients of federal funds request and disburse funds in a timely manner. In one example, the Department determined that it took nearly one and a half months to spend down the federal cash balances created by one such expenditure transfer. As a result of this transfer, the Department would owe interest to the federal government from the time the transfer was made until the time that the funds were spent.

Although numerous factors and transactions spanning many years would need to be reviewed to determine the true interest liability, there is a high probability that the Department has incurred a liability under the CMIA.

Recommendation:

The Department should discuss with appropriate parties the means for assessing whether it has incurred an interest liability and the methods for determining the extent of such liability.

Management's Response:

We disagree with the SAO finding that "the Department may have incurred an interest liability" as a result of certain accounting adjustments. The CMIA clearly addresses the treatment of refunds and this type of transaction does not meet the definition of a refund.

The State Comptroller's Office has responsibility for coordinating the State's CMIA report to the federal government. Each agency provides information to the Comptroller for their portion of the report. As the Comptroller is the single point of *contact related to CMIA issues, we have not dealt directly with the federal representatives. We have had discussions with the Comptroller regarding this SAO finding and we will need to work together to research this issue.*

<u>State Auditor's Follow-Up Comment</u>:

The CMIA does not specifically address the treatment of expenditure transfer transactions. However, federal regulations define a refund as a recovery of funds previously paid out for program purposes. When the Department processes an expenditure transfer transaction, it recovers federal funds by using state funds. The interpretation used by the State Auditor's Office is consistent with the interpretations of various federal government representatives with whom we had numerous discussions. These representatives included individuals from the U.S. Department of Health and Human Services' Division of Payment Management and Office of Inspector General, and from the U.S. Department of Treasury, Financial Management Service. The Comptroller of Public Accounts (Comptroller) relies on state agencies to provide accurate information for the CMIA report.

Section 1-D:

Program Revenues and Fees Do Not Cover Program Costs as Required by the General Appropriations Act

According to the Department's *1999 Fee Resource Manual*, 22 programs generated less income than necessary to fund program operations. Out of 47 programs required to generate fees sufficient to cover operations, 22 programs generated less than 90 percent of operating costs. For these 22 programs, expenditures exceeded program-generated revenues by more than $5 million. (See Appendix 4 for additional detail by program.) The Department indicates that the Board has the authority to change fees for 11 of the 22 programs, and other fees are subject to the control of external parties.

The General Appropriations Act, Rider 6, 75th Legislature, states:

> It is the intent of the Legislature that fees, fines, and other miscellaneous revenues as authorized and generated by the agency cover, at a minimum, the cost of the appropriations made for the programs . . . as well as the 'other direct and indirect costs' associated with these programs, appropriated elsewhere in this Act. 'Other direct and indirect costs' for these programs are estimated to be $5,713,928 for fiscal year 1998 and $5,712,719 for fiscal year 1999. In the event that actual and/or projected revenue collections are insufficient to offset the cost identified by this provision, the Legislative Budget Board may direct that the Comptroller of Public Accounts reduce the appropriation authority provided above to be within the amount of revenue expected to be deposited under the following revenue codes or account numbers: [A list of revenue costs and account numbers follows in the rider.]

The Department asserts that revenues for the listed programs should be compared to related program costs in the aggregate. However, the rider does not specifically address aggregation of revenues and costs, which leads us to conclude that the intent is to compare individual program revenues and costs.

Recommendation:

The Department should obtain written clarification from appropriate sources regarding the intent of the rider.

Management's Response:

The General Appropriations Act requires the Board of Health to review all fee schedules annually (Rider 40, 75th Legislature). The Department is also required to submit a report summarizing this review to the Legislative Budget Board and the Governor's Office of Budget and Planning. TDH has complied with this rider requirement since its inception, and to date the Legislative Budget Board has not exercised its authority to reduce the Department's appropriation authority (Rider 6, General Appropriations Act, 75th Legislature). We assume that the Legislative Budget Board has sought appropriate guidance regarding the intent of Rider 6.

The SAO cites twenty-two programs from the Department's FY 1999 Fee Study that did not generate fees sufficient to cover 90 percent of operating costs. For eleven of these programs, the Board was precluded from increasing fees either because the fee was capped by statute or because the fee was set by an independent board. For four of the twenty-two programs, the Board increased the fee in FY 1999. After weighing various policy considerations, the Board chose not to increase the fees for the remaining seven programs. However, revenues for four of those seven did equal costs in FY 2000. Moreover, in aggregate, total revenues related to all TDH fee programs exceeded total expenditures for FY 1999.

State Auditor's Follow-Up Comment:

The rider addresses neither the aggregation of fee revenues from programs listed in the rider nor the aggregation of revenues from all of the Department's programs.

Section 1-E:

The Department Used Inaccurate Data to Prepare Its Indirect Cost Recovery Plan for Fiscal Year 2001

The Department prepared its fiscal year 2001 Indirect Cost Recovery Plan (IDCRP) with inaccurate data. The IDCRP is a means through which the Department receives federal fund reimbursements to cover a portion of overhead costs.

Preparation of the Department's IDCRP is an extensively manual process that requires the compilation of many different reports from many different sources of information. Although the Department reviewed the procedures to ensure the correct process was followed, it did not perform a review to ensure that it used correct data.

Our review revealed several balances that were allocated for indirect costs that did not include encumbrances and estimated obligations. These omissions resulted in incorrectly calculated indirect cost rates. When the indirect cost rates are applied to the Department's millions in expenditures, what appears to be a small percentage error becomes magnified. The potential overcharges to the federal government using the Department's incorrectly calculated indirect cost rates would be adjusted the following year, resulting in fewer funds for the Department to use in its budgeting process.

Although the proposed indirect cost rates are best estimates, it is crucial to estimate these rates as accurately as possible in order to prevent either over- or under-claiming federal funds. Although any miscalculation in one year will be adjusted in future years, such miscalculation can result in an imbalance in the amount of federal funding received to cover indirect costs.

Outdated policies and procedures regarding the preparation process further weaken the Department's preparation of its IDCRP. The Department has an "Indirect Cost Proposal Preparation Handbook" that was written in 1990 and has not been revised to address changes in the current process. The Department relies on the institutional knowledge provided by key individuals in the organization to prepare the IDCRP. In the absence of these key individuals, the correct procedure may not be followed.

<u>Recommendation</u>:

The Department should:

- Establish appropriate review processes over the preparation of the IDCRP. These processes should include necessary review of source data accuracy and completeness.
- Submit a corrected IDCRP to the federal government.
- Ensure that policies and procedures regarding the preparation of the IDCRP are revised and kept up-to-date.

<u>Management's Response</u>:

The rates referred to by the SAO have not yet been approved for use by our federal cognizant agency; therefore, we have taken the opportunity to submit the revised rates for approval.

We will evaluate and strengthen our review procedures and ensure that documentation of the process is current. We have included up-to-date documentation within the working papers, rather than incorporate it into a procedures manual; however, we are agreeable to consolidating the information into a manual.

Section 1-F:

The Department Did Not Fully Implement a Comprehensive, Effective Process to Monitor and Ensure Compliance with State and Federal Requirements

At the time of the audit, the Department had not fully implemented a comprehensive, effective process to monitor its compliance with state and federal requirements. As a result, there was an increased risk that the Department would not meet all applicable requirements.

The Department presumed that established policies and procedures would ensure its compliance with appropriate requirements. The Department modified its policies and procedures to address new compliance requirements. However, modifying policies and procedures to address changing requirements does not by itself ensure continued compliance with all requirements. An ongoing assessment is necessary to determine that all requirements are being met.

At the time of audit, the Department was in the process of implementing a compliance-tracking tool. However, the tool was only partially implemented and did not contain the full information necessary to determine whether the Department complied with various requirements. In addition, the tool had not been adopted as a Department-wide compliance monitoring system.

Recommendation:

The Department should establish, implement, and maintain the processes and tools that are necessary to ensure its compliance with applicable laws, rules, and regulations.

Management's Response:

The Department has fully implemented the TDH Legislative Tracking and Planning Tool, monitored by the Office of Policy and Planning, to insure [sic] *compliance with state and federal requirements.*

Section 2:

The Department's Accounting Practices Reduce the Reliability of Financial Information Used for Decision-Making

The Department's assignment of expenditure codes in its accounting systems and in the Uniform Statewide Accounting System (USAS) for similar transactions is inconsistent. In several instances, the assignment of expenditure codes was inaccurate. Additionally, recurrent accounting adjustments decrease the reliability and consistency of financial information provided to decision-makers.

Section 2-A:

The Department's Assignment of Expenditure Codes for Similar Transactions Is Inconsistent and Sometimes Inaccurate

Examples of Inconsistencies and Errors in Expenditure Code Assignment

Temporary nursing services – The Department used three different codes to record this service. While any of these codes may be appropriate, coding should be consistent from one month to the next.
7253 - Other Professional Services
7274 - Temporary Employment Agencies
7666 - Medical Services and Specialties

Consultant activities regarding planning - The Department used four different codes to record this service from the same vendor. The most appropriate code would be "Other Professional Services."
7213 - Training Expenses-Other
7253 - Other Professional Services
7299 - Purchased Contracted Services
7666 - Medical Services and Specialties

Physician insurance premiums – The Department used two different codes to record physician insurance premiums in consecutive months. The most appropriate would be "Insurance Premiums."
7204 - Insurance Premiums
7248 - Medical Services

Administrative Support (including information system support services) – The Department was inconsistent in the coding of million-dollar expenditures for services provided under the same contracts. Neither expenditure code was appropriate.
7243 - Training
7643 - Other Financial Services

Expenditure codes are not always consistently and correctly used to classify expenditures for similar transactions in both the Department's accounting systems and in USAS. A review of purchases from the same vendor providing the same product over an extended period of time indicated that the Department assigned expenditure codes inconsistently.

The Department's failure to correctly classify expenditures impairs the comparability of its expenditures and weakens the reliability of the information it presents to decision-makers and other users. Incorrect decisions could be made using the data the Department provides. Additionally, inconsistencies and incorrect assignment of expenditure codes may negatively affect the evaluation of individual program objectives and, when expenditure caps are in place, could impair the evaluation of all Department expenditures.

Department staff indicated that the individuals responsible for assigning expenditure codes choose codes based on a combination of personal judgment and the definitions provided in the Comptroller's *Manual of Accounts*.

The Comptroller defines expenditure codes and descriptions for use in USAS. The Department uses these expenditure codes with slight modification for internal use. These definitions provide general guidance on how expenditures should be classified. The Department is responsible for determining which expenditure code best suits each purchase and for assuring that codes are used consistently.

Recommendation:

The Department should determine why errors and inconsistencies in expenditure coding exist and take appropriate action to improve expenditure coding accuracy.

Management's Response:

We agree that consistency of expenditure coding decisions is an important, but difficult, goal. We have already started implementation of a new Accounts Payable system as part of the new financial administrative systems project. We are confident it will help us to achieve both accuracy and consistency of coding. The system will retrieve coding assigned at the requisition level each time a payment is made. Currently, staff has to recode each payment without the benefit of seeing the coding applied to the previous payments. In addition, we will review issues such as staff performance and supervisory review of the coding process.

Section 2-B:

The Department's Recurrent Use of Accounting Adjustments Decreases the Reliability and Consistency of Financial Information

Recurrent adjustments made to the Department's accounting information decrease the reliability and consistency of information provided to internal and external decision-makers. During fiscal years 1999 and 2000, the Department processed 530 USAS expenditure transfers totaling more than $250 million. In a review of these expenditure transfers, we found that many were used to correct bookkeeping errors. For example, we noted a single expenditure transfer of nearly $120 million that the Department indicated was made "to correct bookkeeping errors" from vouchers processed over a period of several months.

The modification of transactions throughout the year decreases the consistency and comparability of information provided to internal and external users from one period in time to the next. Unless users are notified that key information has been changed, they risk making decisions based on incorrect or inconsistent information.

The number of expenditure transfers needed for "corrections of errors" raises concerns about the validity of other processed transactions. While accounting adjustments may be necessary to maintain meaningful financial information, it is just as important to ensure the correctness of accounting transactions before they are entered into the accounting systems in order to minimize future corrections and adjustments.

Recommendation:

The Department should determine why "bookkeeping error" adjustments are made and establish appropriate processes to ensure that adjustments are minimized.

Management's Response:

We agree with the SAO that processes should be in place to ensure that adjustments are minimized; however, we do not expect to ever be able to eliminate them completely. We will always strive to be as accurate as possible.

We disagree with the finding that 530 accounting adjustments amounting to approximately $250 million made during a two-year period is in and of itself a problem, particularly when compared to over a million transactions and $15 billion expended during that same time.

Furthermore, when you consider that almost one-half of the $250 million was made on one adjustment, the materiality of the rest is extremely diminished. We have examined the $120 million adjustment in the one example provided by the SAO. This adjustment was caused by revised information received from a vendor regarding the nature of the services they had performed for TDH. The new information caused us to have to make a one-time adjustment to funding allotments on various transactions that had already been processed. This action affected internal coding only and had no effect on the total payment amount to the contractor.

State Auditor's Follow-Up Comment:

While the magnitude of the Department's Medicaid transactions and funding significantly exceeds that of its other programs, this does not diminish the materiality of the "bookkeeping errors" in non-Medicaid programs. In addition, expenditure transfers can correct more than one transaction. In the case of the $120 million expenditure transfer, more than 9,000 transaction lines were changed. The Department also made expenditure transfers to correct duplicate payments to vendors, incorrect coding of transactions, and erroneous funding sources.

Section 3:

The Department's Aging Financial Information Systems Are Inflexible and Cumbersome and Are Not Adequately Protected from Misuse

Issues with the Department's financial practices are exacerbated by outdated and fragmented information technologies that form the basis for the Department's automated financial systems. Weaknesses in critical safeguards over the Department's automated information systems increase the risk of intentional and unintentional data corruption.

Weaknesses in critical access controls impair the Department's ability to prevent or detect financial system intrusions and misuse.

Section 3-A:

The Department's Aging Financial Systems Do Not Adequately Support the Functions Required to Track Financial Events Significant to the Financial Management of the Department

The Department's aging financial systems are cumbersome, and they are incapable of performing customized queries at the user level. These impediments prevent users from obtaining timely information. Department personnel indicate these systems are responsible for recording more than four million transactions exceeding $8 billion annually.

In one instance, Department staff was unable to provide total amounts paid for staff overtime related to retroactive overtime payments. During the last several years, the Department estimates that it has made more than $1 million in retroactive overtime payments to its employees. Although the Department put significant effort into reaching the decision to pay retroactive overtime and in developing the related process, it was unable after nearly four months to provide an exact dollar amount for the overtime paid retroactively to its employees.

A Snapshot of the Department's Financial Accounting Systems

- The primary system was designed more than 20 years ago. It captures the Department's day-to-day transaction data and provides the basis for the Department's other accounting systems. The system has limited flexibility and adhoc reporting capabilities.
- MIPS (microcomputer-based fund accounting system) was purchased in the 1980s. It added flexibility in the reporting and tracking of federal programs.
- The Great Plains Accounting system was purchased in the mid-1990s for nearly $290,000. The system was shelved and never implemented because it did not have the functionality the Department needed.
- USAS is used as the Department's general ledger. It does not track detailed transaction data. The Department reports summarized data obtained from its primary system to USAS.
- PeopleSoft is currently being implemented. The target implementation dates for payroll and core accounting are July 2001 and September 2001, respectively. Additional modules and functionality will be implemented in the future.

In another instance, the Department's current financial systems were unable to provide sufficient information regarding the use of federal funds. In the 1980s, the Department purchased a microcomputer-based financial system (MIPS) to track federal funds. However, during our review of the processes the Department uses to maintain this system, we determined that the system is unable to provide reliable information due to the manual manipulation of data that takes place while transferring data from the Department's primary financial system to the MIPS system.

This manual manipulation occurs when data is downloaded from the Department's primary system, manual "corrections" are made to the data, and the data is reintroduced into the MIPS system for further processing. Relying upon manual corrections rather than automated controls reduces the reliability of the information produced.

Another example of inadequate information systems at the Department is the lack of an adequate system to track employee positions and related historical job information. According to Fair Labor Standards Act criteria, the Department may have misclassified some exempt employees as non-exempt because its system did not have sufficient historical information regarding individual job duties. As a result, individuals incorrectly classified as non-exempt were paid overtime.

We are encouraged that the Department is in the process of implementing a new financial system (PeopleSoft). The new technology provided by PeopleSoft software will serve as a tool to address some of the current systems' deficiencies. Correction of the remainder of the deficiencies is dependent upon the Department's successful implementation and integration of the new system into its operations.

Recommendation:

The Department should update its processes and operations to ensure that the implementation of PeopleSoft produces the functionality necessary to provide timely and reliable information to decision-makers.

Management's Response:

We appreciate the SAO's encouragement related to the Department's implementation of the new health and human services administrative system. This project is proceeding according to the implementation plan.

Section 3-B:

The Department Has Not Implemented Adequate User Access Management Practices to Minimize the Potential for Unauthorized Access to Its Financial Information Systems

The Department has not implemented adequate user access management practices to reduce the risk that inactive user access accounts (IDs) could be used to gain unauthorized system access. If user IDs for terminated employees are not removed in a timely manner, they could potentially be used to gain unauthorized access to the Department's accounting systems to read, modify, copy, and delete data. Additionally, some employees who change positions within the agency continue to have access to information they do not need in their new positions.

Access controls limit or detect inappropriate access to computer resources (data, equipment, and facilities), thereby protecting these resources against unauthorized modification, loss, and disclosure. Without adequate access controls, unauthorized individuals (including outside intruders and terminated employees) can covertly read and copy sensitive data and make undetected changes or deletions for malicious purposes or personal gain. In addition, authorized users can unintentionally modify or delete data or execute changes that are outside of their span of authority.

More than 500 terminated employees continued to have valid IDs for the Department's accounting systems. Some of these employees were terminated as long ago as 1992. The Department has indicated that there is a compensating control that relies upon two other programs' access IDs (Winframe and Novell) to control access to the

Department’s systems. However, when we made similar comparisons between terminated employees and valid access IDs for Winframe, we determined that 68 Winframe user IDs matched those of terminated employees.

Other weaknesses noted include duplicate IDs for some employees; incorrect Social Security numbers; and temporary, group, and test IDs that may need to be disabled. Incorrect Social Security numbers are occasionally used in order to circumvent established controls. The Department modifies an individual’s Social Security number when an employee transfers from one position to another and the previous access ID has not been revoked. A second access ID cannot be established for the same Social Security number.

For access controls to be effective, they must be properly implemented, maintained, and enforced. An organization must analyze the responsibilities of individual computer users to determine the type of access (read, modify, delete) they need to fulfill their responsibilities. User access authorizations and related controls must be maintained and adjusted on an ongoing basis to accommodate new and terminated employees and changes in users’ responsibilities and related access needs.

Recommendation:

The Department should review, update, and implement policies and procedures to update (revoke, change, or add users) access to its financial information systems on a timely and consistent basis. User access must be updated and maintained to provide adequate safeguards over data and systems. Additionally, users should have only the access necessary to perform their jobs.

Management’s Response:

The Department is confident that terminated employees no longer have access to the financial system. However, we agree that processes can be improved to insure [sic] *that all levels of access have been removed for terminated employees. TDH is addressing the security concerns mentioned by implementing revised procedures for the verification and deletion of invalid TDH-ISA UserIDs. A verification process has been developed to compare the TDH Employee Database to the TDH-ISA Application Security Database and delete terminated employees. TDH is reviewing its internal notification procedures for terminating UserIDs. Several areas have been identified for revision to improve security. To date, we are aware of no instances of unauthorized access to these systems.*

Section 3-C:

The Department Has Not Implemented Adequate User Access Management Practices for USAS

Thirteen individuals in the Department's fiscal and budgeting areas have "chief accountant" access for USAS. Eleven of these individuals also have access to create, edit, and release transactions for posting to USAS without review by a second individual. The "chief accountant" designation represents the highest level of access afforded to agency personnel and provides access to all transaction codes except those restricted to the Comptroller.

It is the Department's responsibility to determine the access capabilities that individuals need to perform their jobs. Typically, an agency would have three or fewer individuals with "chief accountant" status. The ability of these individuals to create, edit, and post entries also would be limited.

For example, although the Texas Department of Mental Health and Mental Retardation has 266 "chief accountants" assigned in USAS, none of these individuals has the ability to create, edit, and then release a transaction. A person other than the individual creating the transaction must release transactions for posting to USAS. Key duties and responsibilities in creating, editing, releasing, and reviewing agency transactions should be separated among individuals.

We also identified two individuals whose access to USAS should have been revoked. One individual was transferred to another function within the Department in early 2000. However, as of August 2000, the individual continued to have "chief accountant" access to USAS. A second individual terminated employment and five months later access had not been revoked. According to the Department's security manager, these accesses should have been revoked immediately.

A consultant the Department hired to prepare its annual financial report had continuing access to USAS throughout the year. However, this individual needed access during the report preparation process only. The consultant also had the ability to create and release journal vouchers without approval or review by Department management.

Finally, USAS user access, as set up by the Department, provides more than five individuals with the ability to edit profiles established in USAS for the purpose of linking Department data. These profiles link data in USAS and are customized by each agency. If the profiles were changed throughout the year, even unintentionally, the Department's historical data could be rendered useless. Typically, one individual should have the primary responsibility for agency profiles; another individual should have backup responsibilities.

Access to USAS must be restricted to protect information and information resources against accidental or unauthorized disclosure, modification, or destruction. Restricted access also is necessary to assure the security, reliability, and availability of information.

Recommendation:

The Department should:

- Review, update, and implement policies and procedures to update (revoke, change, or add users) USAS and all other systems access on a timely and consistent basis. User access must be updated and maintained to provide adequate safeguards over data and systems. Additionally, users should have only the access necessary to perform their jobs.
- Review and update user access to USAS profiles. Access to USAS profiles should be limited to key individuals.

Management's Response:

We made some basic business decisions several years ago, based on our organizational structure and staffing patterns, to configure our security levels for USAS. The Department authorizes individuals to have "chief accountant" status in order to provide one overall level of security. This allows them to do all their tasks without having to switch back and forth between multiple security levels. None of these individuals with "chief accountant" access has the ability to release an expenditure document in USAS. As a result, this finding presents a potentially misleading picture of the risk created by this arrangement.

All USAS access is coordinated through the State Comptroller's Office. They have never indicated we were unusual, or in any way atypical for an agency our size, nor has the State Auditor's Office ever raised this issue. We have a Security Coordinator and a back-up who go through the Comptroller's security certification process twice a year. They have never been alerted to the concerns raised by the SAO in this finding. However, we are not opposed to reviewing these decisions and will agree to do so.

State Auditor's Follow-Up Comment:

The Department minimizes the risk surrounding the release of an expenditure document in USAS. However, our concerns are not limited to this risk alone. Allowing numerous individuals within the Department to create and release budgetary entries and journal vouchers without requiring another individual to review these transactions also is a risk. No single individual should have control over an entire transaction, regardless of whether it is a budgetary or expenditure transaction.

Other health and human service agencies, such as the Commission on Alcohol and Drug Abuse, the Department of Protective and Regulatory Services, and the Department of Mental Health and Mental Retardation, conduct business without allowing individuals to create and release transactions into USAS without review. The Department of Human Services has only two individuals with these capabilities.

Section 3-D:

The Department's Policies and Procedures Over Information System Operations and Disaster Recovery Plans Do Not Adequately Protect Electronic Resources and Information

Inadequate policies and procedures over information system resources and electronic data could lead to the loss of vital information. While the Department has made progress toward addressing previous audit findings, at the time of our review, several opportunities for improvement continued to exist:

- Policy required that data backup tapes be taken off-site only on a monthly basis. This policy would allow data from an entire month to be lost in the event of a disaster.
- Physical access to the server rooms was not limited to authorized individuals.
- The disaster recovery plan lacked team member contact information that would be necessary in an emergency.

Disaster recovery plans that are properly developed, communicated, and implemented help to ensure service continuity for a range of potential disruptions. These disruptions may include relatively minor interruptions, such as temporary power failures or accidental loss or erasing of files, as well as major disasters, such as fires or natural disasters that could require the reestablishment of operations at a remote location.

Losing the capability to process, retrieve, and protect electronic information can significantly impair an agency's ability to accomplish its mission. If controls are inadequate, even relatively minor interruptions can result in lost or incorrectly processed data, which in turn can cause financial losses, expensive recovery efforts, and inaccurate or incomplete financial or management information. Service continuity controls include routinely making backup copies of files to prevent and minimize potential damage and interruption, developing and documenting a comprehensive contingency plan, and periodically testing and adjusting contingency plans.

Recommendation:

The Department should review, update, and implement policies and procedures over information systems and related data to ensure that these resources are adequately protected against loss.

Management's Response:

The SAO report cites three opportunities to improve our policies and procedures. We are reviewing our current file back up policy regarding timeframes governing the frequency of off-site storage to benchmark industry best practices.

Additionally, the disaster recovery contact information policy will be reviewed and updated in accordance with industry standards. TDH has taken action to improve security over the physical access to its various servers throughout the Department. In some cases, servers have been relocated to improve security.

Appendix 1:

Objective, Scope, and Methodology

Objective

The Chairman of the Texas House of Representatives Committee on Appropriations requested a "comprehensive review and audit of accounts and depository practices at the Texas Department of Health." The request included a review of the following:

- Verification of fee amounts and other revenue collected by the agency
- Verification of deposits of fees and revenue in the appropriate accounts
- Appropriateness of the allocation of indirect administration to Department accounts
- Compliance with the Federal Cash Management Improvement Act
- Compliance with the provisions of the General Appropriations Act
- Compliance with the Uniform Statewide Accounting System (USAS)

Scope

The scope of the audit covered various aspects of the Department's operations including regional and program operations; information systems and technology; budgeting; human resources/payroll; grants management; material and acquisition management; and accounting functions including cash receipts, cash disbursements, and recording and reporting.

The Medicaid program was not included in this audit because the State Auditor's Office has performed work and issued reports regarding this program over the past few years.

As audit work was nearing completion, assistance was provided to the Legislative Budget Board in determining the accuracy of information presented in the Department's Legislative Appropriations Request. Our correspondence to the Legislative Budget Board can be reviewed in its entirety in Appendix 3.

Methodology

During fieldwork, the audit staff conducted interviews with Department staff ranging from regional to executive levels. We also held discussions with various oversight agencies and legislative staff members.

Procedures and tests conducted:

Compliance with General Appropriations Act and USAS

The Department is responsible for ensuring compliance with more than 200 specific and general riders in the General Appropriations Act. The Department also is responsible for ensuring compliance with USAS requirements. We took the following steps to detect noncompliance with the General Appropriations Act and USAS requirements:

- Analyzed compliance with selected riders.
- Reviewed the function of both automated and manual compliance tracking.
- Analyzed transaction data provided by the Department (fiscal years 1998, 1999, and partial 2000) and extracted from USAS (fiscal years 1995 through 2000) to “target “ transactions that appeared to be in error.
- Randomly sampled transactions.
- Used auditor judgment to determine which transactions to review.
- Conducted detailed transaction reviews, which included obtaining transaction support and discussions with individuals to substantiate the appropriateness of transactions and associated coding of expenditures.
- Conducted tests to determine the possibility of duplicate payments for goods and services, grants in aid, and travel reimbursement.
- Analyzed expenditure transfers and the effects of these transfers on other accounts. Reviewed expenditure transfers for appropriateness, timeliness, and proper statutory authority.
- Performed detailed analysis of budgetary transfers to determine compliance with requirements set forth in various General Appropriations Act riders covering transfer limitations, statutory authority, notification requirements, and board approvals.

Verification of Fee Amounts, Other Revenue Collected by the Department, Deposits of Fees, and Accounting for Revenue in the Appropriate Accounts

We reviewed depository practices and fees collected through numerous interviews and discussions with staff in various programs responsible for collecting fees. Items reviewed included policies surrounding the collection and deposit of fees and the Department’s *1999 Fee Resource Manual*. We reviewed the processes of receipting, depositing, and recording monies and tested them as necessary.

Compliance With the Federal Cash Management Improvement Act (CMIA)

The State Auditor's Office previously performed work with regard to the Department's compliance with CMIA during its annual statewide financial audits and reported any findings in Financial and Compliance Audit reports. Therefore, the work we performed to determine compliance with CMIA during this audit was designed to address events that were outside the normal business activities of the Department. This included a review of the effect that the use of expenditure transfers has on compliance with the CMIA.

Appropriateness of the Allocation of Indirect Administration to Department Accounts

The State Auditor's Office performed work with regard to the Department's allocation of indirect costs during its statewide financial audit. Typically, the Department's indirect cost recovery plan (IDCRP) has been found to be adequate. At the time of this audit's fieldwork, the Department was in the process of completing its current IDCRP for use in fiscal year 2001. We reviewed the IDCRP and the associated full cost plan that allocates costs among all Department programs in detail. We reviewed the sources and consistency of information used. We also reviewed the overall methodology and assumptions used by the Department in the preparation of the plan.

<u>Criteria used</u>:

- State Auditor's Office Methodology Manual
- General Appropriations Act, 75th and 76th Legislatures
- Texas Administrative Code
- Code of Federal Regulations
- Information provided by the Inspector General
- Texas Health and Safety Code
- Department policy and procedure manuals
- Other standard audit criteria established during fieldwork

Statement of Compliance with Applicable Auditing Standards

Fieldwork was performed from May 2000 to January 2001. The audit was conducted in accordance with applicable professional standards, including Generally Accepted Government Auditing Standards. There were no significant instances of noncompliance with these standards.

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

- Dennis Ray Bushnell, CPA (Project Manager)
- Anthony Patrick, MBA
- Scott Boston, MPAdmin

- Elizabeth A. Scheller, CPA
- Anthony Chavez
- Leslie Ashton, CPA (Quality Control Reviewer)
- Joanna B. Peavy, CPA (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

Appendix 2:

Key Report Highlights

During the last 10 years, the State Auditor's Office and other entities have issued various reports noting opportunities for improvement similar to those presented in this report.

Report Number	Release Date	Publisher Report Title	Finding Summaries	Status Reported by the Department (unaudited)
91-056	2/12/1991	State Auditor's Office *Review of the Strategic Planning and Management Information at the Texas Department of Health*	The Department has an abundance of data, but data management is not well coordinated to promote efficiency and effectiveness of Department activities. The management information system does not meet executive level needs for monitoring and decision-making.	An IRM position was established in 1994; many effective information systems have been developed since this report
N/A	5/23/1991	Tonn and Associates/Andersen Consulting *Texas Department Of Health Comprehensive Management Study Final Report*	The Department should establish an associate commissioner level position of Information Resources Manager to coordinate information resources and provide strategic direction to information systems development.	IRM position established in 1994
			The Department should implement various recommendations regarding review, establishment, and updating of fees.	Fully Implemented
			The Department should implement various recommendations regarding the establishment of an integrated information system strategy.	Fully Implemented
			The Department should develop an automated executive information system that can effectively disseminate information to appropriate management levels.	Fully Implemented
			The Department needs to define comprehensively the financial information needs of the entire organization and develop a plan to implement an accounting information system to meet the needs of all functional areas.	Partially Implemented
			The Commissioner and senior management reaffirms that Central Office management has ultimate authority over policy, scope of services, and regulatory requirements administered or delivered at the regional level.	Fully Implemented

Report Number	Release Date	Publisher Report Title	Finding Summaries	Status Reported by the Department (unaudited)
94007	8/1/1994	Texas Department of Health – Internal Audit Division *Review of Public Health Region 4/5 North*	Managers do not have adequate budget information to effectively implement mandated activities. This is a result of budget revisions being made without the involvement of the program managers. Purchasing procedures should be revised to improve internal controls. Access to the local area network (LAN) should be limited to improve internal controls.	Fully Implemented
94-143	8/1/1994	State Auditor's Office *An Audit Report on the Medicaid Vendor Drug Rebate Program*	The current billing system is inaccurate and inefficient. The Department has no controls to ensure the accuracy of rebates. The Texas Medicaid Vendor Drug Program lacks the resources it needs to effectively collect drug rebates. The current information system hampers the program's ability to quickly resolve disputes with manufacturers. The Program does not have an effective accounts receivable system. The Department lacks adequate cash receipt internal controls for processing drug rebate checks.	Fully Implemented (PRIMS: Pharmaceutical Rebates Information Management System)
95-007	10/1/1994	State Auditor's Office *A Review of Contract Monitoring of Purchased Services*	HIV programs and the programs under the Bureau of Maternal and Child Health do not have policy and procedure manuals to guide monitors in assessing the performance of service providers.	Fully Implemented (manuals are available)
95-106	3/22/1995	State Auditor's Office *A Letter to Management - 1994 Statewide Financial and Compliance Audit*	The Department lacks sufficient accounting procedures and fiscal controls to determine if it is in compliance with federal program requirements for the Maternal and Child Health Services Block Grant.	Fully Implemented
			The Department has not fully addressed the computer access and disaster recovery issues cited in fiscal years 1991 and 1993.	Partially Implemented
			The Department does not have documented procedures to consider unresolved subrecipient questioned costs.	Fully Implemented

Report Number	Release Date	Publisher Report Title	Finding Summaries	Status Reported by the Department (unaudited)
96-327	3/27/1996	State Auditor's Office *A Letter to Management - 1995 Statewide Financial and Compliance Audit*	The Department did not correctly calculate interest in accordance with the Federal Cash Management Improvement Act. The Department did not comply with federal requirements that limit the availability of funds for payments of obligations for the State Legalization Impact Assistance Grant.	Fully Implemented
96-051	2/21/1996	State Auditor's Office *An Audit Report on Management Controls at the Texas Department of Health*	The budget/accounting information systems do not readily provide adequate and timely information that managers need to plan, direct, monitor, and report on program activities. Issues reported in 1991 on the lack of coordination and integration of information systems have not been adequately addressed. Policy communication and the human resource information system need improvement.	Implementation in Progress Implementation in Progress Implementation in Progress – ongoing system improvement (PeopleSoft implementation in progress_
96-716	8/1/1996	State Auditor's Office *A Special Report on Positions Exempt from the Classification Plan*	The number of exempt positions should be reduced. A uniform system for collecting turnover data for positions exempt from the classification plan should be implemented.	Fully Implemented Statewide Recommendation
98-321	3/17/1998	State Auditor's Office *A Letter to Management - 1997 Statewide Financial and Compliance Audit*	The Department has no documented policies and procedures in the Vendor Drug Program for the detection and referral of potential fraud.	Procedures are in place, written policies were developed by the Health and Human Services Commission

Report Number	Release Date	Publisher Report Title	Finding Summaries	Status Reported by the Department (unaudited)
98-336	4/1/1998	State Auditor's Office *A Management Letter to the Department of Health on Purchases Subject to Local Control*	Management needs to clarify the authority, roles, and responsibilities of program, purchasing, and fiscal functions in the overall procurement process. The existing procurement information system is cumbersome. Although the Department generally follows its procurement policies and procedures, we found instances in which this was not the case. We noted instances in which purchases had been made before transactions were received and properly processed by the purchasing function. The Department did not process the payments for two purchases in a timely manner. Transactions were noted that did not appear to follow either state or Department procurement policies and procedures. Several of the transactions tested were incorrectly coded. Some were assigned incorrect object codes, and some were assigned incorrect purchase category codes.	ProCard, Region 2/3 pilot, other actions taken to address findings
98-062	8/26/1998	State Auditor's Office *An Audit of Management Controls at the Texas Department of Health, Licensing and Certification Division*	The Department should establish fees adequate to cover costs for nine programs that experienced a $412,844 revenue shortfall in fiscal year 1997.	Fully implemented by policy, procedure, and statutory reporting

Report Number	Release Date	Publisher Report Title	Finding Summaries	Status Reported by the Department (unaudited)
99-023	1/25/1999	State Auditor's Office *An Audit Report on the Maternal and Child Health Block Grant at the Texas Department of Health*	The Department's cash management policies and procedures did not maximize the use of federal funds to reduce expenditures of state appropriated funds as required by a rider in the General Appropriations Act (75th Legislature), Article 9, Section 106, Federal Funds/Block Grants, 1(c). The Department has significantly improved its contract administration but has not consistently carried out policies and procedures for monitoring contractors. The Department has not consistently provided programmatic follow-up site visits according to Department policies. The Department should improve procedures to ensure the accuracy of information included in the performance information database. The Department has developed and documented appropriate policies and procedures to manage human resources. However, audit tests indicate that inconsistencies exist in the implementation of policies and procedures.	Recommendations reviewed and action plan implemented
501-98-01	5/7/1999	Comptroller of Public Account *Post Payment Audit of Department of Health*	Transactions were identified in which the Department did not prepare purchase orders until after invoices were received from vendors. The Department did not pay some vendors within the allotted time required for receipt of discounts. Supporting documentation necessary to verify payment was missing. The Department failed to correct a procedural problem that allowed terminated employees to retain the ability to expend funds. The Department failed to submit documentation to the Comptroller to ensure that all individuals on file with the Comptroller were properly authorized or designated to approve Department expenditures.	Recommendations reviewed and action plan implemented

Report Number	Release Date	Publisher Report Title	Finding Summaries	Status Reported by the Department (unaudited)
99-045	8/9/1999	State Auditor's Office *A Review of General Automation Controls at Selected State Agencies and Universities: Phase II*	The Department of Health does not always adequately safeguard its automated resources from physical hazards and unauthorized access. A central oversight function for information resources does not exist. Software is developed independently in each program area.	Recommendations reviewed and action plan implemented
00-007	12/1/1999	State Auditor's Office *A Review of Management Controls at the Department of Health's Immunization Program*	Program managers do not have the information they need to determine if providers are using resources, money, and vaccine inventories as intended. Inconsistencies in the manner used to report vaccine inventories could result in inaccurate information. Organizational structure hinders accountability of program resources. Federal grants and awards were understated in the Department's annual financial report.	Recommendations reviewed and action plan implemented

Appendix 3:

Work Performed to Verify Information in the Department's Legislative Appropriations Request

STATE AUDITOR'S OFFICE

ROBERT E. JOHNSON BUILDING
1501 NORTH CONGRESS AVENUE, SUITE 4.224
AUSTIN, TEXAS 78701

LAWRENCE F. ALWIN, CPA
State Auditor

November 22, 2000

Mr. John Keel, CPA, Director
Legislative Budget Board
Robert E. Johnson Building
1501 North Congress Avenue – 5th Floor
Austin, Texas 78701

Dear Mr. Keel:

In your letter dated October 26, 2000, you requested that we verify the accuracy of information submitted by the Department of Health (Department) in its Legislative Appropriations Request (LAR) for the 2002-2003 biennium. Although we found several exceptions, based on our review of the LAR, we conclude that generally:

- **Appropriated Receipts** – the data submitted for actual fiscal year 1999 and estimated fiscal year 2000 were substantiated by Department documentation. The projections for fiscal years 2001-2003 appear reasonable.
- **Earned Federal Funds** – the amounts submitted for actual fiscal year 1999 and estimated fiscal year 2000 were supported by Department's documentation. The projections for fiscal years 2001-2003 appear reasonable.
- **Unexpended Balances** – the Department's reporting of actual unexpended balances carried forward from fiscal year 1999, and estimate for fiscal year 2000 carry-forwards appear reasonable and could be verified. The estimates for fiscal year 2001 also appear reasonable.

During the review, we met with Department's management to discuss the scope and methodology for the review. We also met with Legislative Budget Board staff to discuss preliminary results. These results were later discussed with Department management.

The State Auditor's Office performed this limited review based on agency records and as well as information from the Uniform State Accounting System (USAS). The information has not been subject to the tests and confirmations performed in an audit, and we are not expressing an opinion on the Department's internal controls or financial statements.

The attachment contains additional information regarding the results of this review. If you have any questions regarding the results of the review, please feel free to contact the Audit Manager, Joanna B. Peavy, CPA at (512) 936-9500.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

cc: Dr. Charles E. Bell, M.D., Executive Deputy Commissioner, Department of Health
Mr. Ben Delgado, Deputy Commissioner for Administration, Department of Health
Mr. Mark Scott, CPA, Internal Audit Director, Department of Health

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Estimation/forecasting methods used by the Department

Overall, the assumptions the Department uses in its estimation methods, many of which are based on institutional knowledge, appear to be reasonable. The Department uses several different estimation methods. These methods are generally not formally documented. The use of different methodologies increases the risk of inconsistency and may decrease the comparability of amounts from one biennium to the next. Estimation methods used by the Department include:

- **Annualization** – The Department obtains actual amounts at a point in time. From this amount a monthly rate is determined then multiplied by twelve to calculate the annual amount.
- **Actual amounts at a point in time** - actual amounts are obtained near the end of the fiscal year. For example, actual expenditures as of mid-July were used for some estimates when the Department concluded that most of the activities surrounding these programs were complete.
- **Educated guesses** - The Department uses its knowledge of a program to make an educated guess. For example, for Fund 666 - Appropriated Receipts, the Department estimates expenditures for fiscal year 2002-03 at $2,042,405 each. The Department knows it can not expend more than it receives, therefore, the amount used is less than forecasted revenues of $2,270,000. However, the Department has not been able to provide an explanation why the estimated expenditures would be $227,595 lower than revenues.
- **Choosing not to forecast** - The Department does not consider certain line items large enough to include in the forecasts. However, for the line items illustrated below, the items not forecasted totaled over $970 thousand.

Items considered too small to forecast

Fund 666 Appropriation Receipts	Actual 1999	Estimated 2000	Estimated 2001-2003
3719 Fees/Copies or Filing of Records	$ 39,883	$ 0	$ 0
3722 Conf, Semin, & Trning Regis Fees	259,193	0	0
3740 Grants/Donations	672,362	0	0
	$ 971,438	$ 0	$ 0

Overstating estimated expenditures

Expenditures reported by the Department are usually based on actual expenditures plus encumbrances. However, Department staff explains that the encumbrance system is not easy to use. Some program staff do not release encumbrances, making funds available for other purposes. This encumbrance process increases the risk that expenditures will be overstated and available funds appear obligated.

The following two examples illustrate how the Department overstated estimated expenditures:

- Fund 5047 GR Dedicated - Permanent Funding Rural Health Facility Capital Improvement
  The Department reports in the LAR estimated fiscal year 2000 expenditures of $2,277,982. Sole support for this estimate consists of encumbrances in the amount of $348,731. Furthermore, as of November 6, 2000, the Department has not recorded any expenditures in USAS for this program. The Department's staff characterizes the amount as unrealistic and claims not to be able to obtain correct information from the Center for Rural Health, which is responsible for the fund.

- Fund 5021 – Certification of Mammography
  For fiscal year 2000, the Department estimates expenditures for this program at $439,568. As of November 6, 2000, only $193,639 of expenditures has been processed by USAS. Internal Department reports shows less than $10 encumbered for this program. The Department's staff acknowledged that the program will not expend the amount estimated and that they do not spend a lot of time estimating expenditures for such a small program.

Attachment # 1 **Texas Department of Health Legislative Appropriation Request Review**

Page 2

Errors in the LAR preparation process

Fiscal year 1999 ending balance for miscellaneous receipts was understated by 34.8%. A clerical error caused this understatement when the incorrect amounts were transferred between the Departments supporting worksheets. This understatement caused the estimates for fiscal year 2000-2003 beginning and ending balances to be understated as well.

Additionally, the understatement in ending balance further causes the misstatement of a line item comprising miscellaneous receipts. The line item captioned "third party reimbursements" is understated by $267,530. Included in "third party reimbursement" is an amount that is not readily identifiable or tracked by the agency's accounting system. This forced or "plugged" amount is required to ensure the mathematical integrity of the schedule. Any correction in ending balance requires a corresponding correction for "third party reimbursements". Beginning and ending balances would require correction for 2001-2003. Necessary corrections for fiscal years 1999 and 2000 are highlighted in the illustration below.

Reported amounts vs. proposed adjusted amounts

Appropriated Receipts, Miscellaneous Agency 501	Actual 1999		Estimated 2000	
	LAR	Proposed Adjusted	LAR	Proposed Adjusted
Beginning Balance (Unencumbered):	763,409	763,409	499,261	766,791
Estimated Revenue:				
3614 Counsel/Care/Treat-out Patient	349,543	349,543	370,000	370,000
3719 Fees/Copies or Filing of Records	39,883	39,883		
3722 Conf, Semin, & Train Regis Fees	259,193	259,193		
3740 Grants/Donations	672,362	672,362		
3802 Reimbursements – Third Party	6,732,967	7,000,497	**2,100,000**	**2,100,000**
Subtotal:	8,053,948	8,321,478	2,470,000	2,470,000
Total Available:	8,817,357	9,084,887	2,969,261	3,236,791
Less:				
Expended/Budgeted/Requested	8,219,510	8,219,510	2,444,347	2,444,347
Transfer – Employee Benefits	85,657	85,657	103,000	103,000
Art IX Sec 195 (98-99 GAA)	6,365	6,365		
Art IX Sec 9-11.06 (00-01 GAA)			13,200	13,200
Other (BRP)	6,564	6,564	7,400	7,400
Total Deductions:	8,318,096	8,318,096	2,567,947	2,567,947
Ending Fund/Account Balance	499,261	766,791	401,314	668,844
% Balance is understated	**34.8%**		**39.9%**	

Under reported earned federal funds

Actual earned federal funds for fiscal year 2000 are 35% higher than originally estimated by the Department in the LAR. For fiscal year 2000, the Department projected earned federal funds of $4.8 million. Actual earned federal funds were $6.5 million. The Department's staff states that the estimated expenditures can not be adjusted, as the Department is not allowed to make a baseline request that exceeds amounts expended in the prior year.

System limitations

The Department's accounting system does not provide direct support for expenditures from appropriated receipts. Many of these receipts and associated expenditures are accounted for in the General Revenue Fund, however for LAR purposes reported separately. The LAR presentation requires that the Department obtain total expenditures from the Department 's accounting system, account for various known items such as gifts, and then back into the remaining line items such as "reimbursement and payments". As such, direct support from the Department's accounting system or USAS is not available.

Agreed upon presentation
Fund 5040, GR Dedicated – Tobacco Settlement Receipts does not tie to actual USAS or Department data. According to the Department's most recent updated LAR, Fund 5040 reports carry-forward amounts of $18,052,370 from fiscal 2000 to 2001. This total does not reflect the actual and current amount.

Fund 5040 is comprised of several different appropriations, the largest component being a line item appropriation of $35 million to the South Texas Hospital for fiscal year 2000. However, of the initial $35 million appropriation, $32 million has been lapsed according to USAS reports. Estimated expenditures for this item as reported by the Department in the LAR amount to $219,474. Subtracting the lapsed appropriation and estimated expenditures from the initial appropriation leaves a carry-forward amount just exceeding $2 million. The Department asserts that this reported carry-forward is partly meant to reflect the likelihood of the eventual approval of Department plans for the hospital. Department staff, executive management, as well as LBB staff are aware of the reporting anomalies for this item. The breakdown of reported and actual amounts is illustrated below:

Fund 5040 – South Texas Hospital

	Reported – 11/1 Adjusted LAR	Actual per USAS
Expenditures	$219,474	$219,474
Lapses	$19,633,595	$32,736,465
Carry-forward	$15,146,931	$2,044,061

Scope of review
The State Auditor's Office performed this limited review based on agency records, as well as information from the Uniform State Accounting System (USAS). The information has not been subject to the tests and confirmations performed in an audit and we are not expressing an opinion on the Department's internal controls or financial statements.

Appendix 4:

Programs That Are Required to Collect Fees to Cover Expenses

(Per General Appropriations Act Rider 6, 75th and 76th Legislatures)

				Excess Revenues/(Costs)	
Program	Revenues	Costs	Percentage of Costs Covered	Programs Meeting at Least 90% of Costs	Programs Not Meeting at Least 90% of Cost
Food and Drug Retail Fee	$ 1,397,989	$ 1,336,659	104.6%	$ 61,330	$
Oyster Sales	280,761	225,089	124.7%	55,672	
Food and Drug Registration	3,865,511	4,023,511	96.1%	(158,000)	
Glue and Paint Sales Permit	267,284	292,346	91.4%	(25,062)	
Food Service Worker Permit	162,400	303,608	53.5%		(141,208)
Tattoo Studios	177,523	223,521	79.4%		(45,998)
Narcotic Treatment	169,580	222,442	76.2%		(52,862)
Renderers Licensing	28,292	47,586	59.5%		(19,294)
Milk Industry Products	883,270	1,967,779	44.9%		(1,084,509)
Meat Inspection	104,675	97,789	107.0%	6,886	
Lead-Based Paint Certification Program	219,056	636,203	34.3%		(417,147)
Tanning Facility Fees	277,996	395,465	70.3%		(117,469)
Medical Device Wholesale	261,715	442,711	59.1%		(180,996)
Food, Drug and Cosmetic Salvage	71,300	174,299	40.9%		(102,999)
Frozen Desserts	85,584	202,744	42.2%		(117,160)
Asbestos Removal Licensure	3,908,522	1,708,276	228.8%	2,200,246	
Workplace Chemical List	624,835	435,869	143.4%	188,966	
Certification of Mammography Systems	286,520	322,972	88.7%		(36,452)
Bedding Tax and Bedding Permit Fees	348,404	109,862	317.1%	238,542	
Code Enforcement Officers	75,869	64,023	118.5%	11,846	
Hazardous Substance Manufacture	157,500	404,813	38.9%		(247,313)
Sanitarian Registration	24,855	64,749	38.4%		(39,894)
Migrant Labor Camp Inspection	4,400	24,123	18.2%		(19,723)
Youth Camp Inspection	20,770	203,344	10.2%		(182,574)
Radioactive Materials and Devices	6,529,539	6,877,076	94.9%	(347,537)	
Hospital Licensing	1,227,778	1,525,275	80.5%		(297,497)
Emergency Management	1,553,056	3,692,155	42.1%		(2,139,099)
Home Health Services	2,650,788	2,320,815	114.2%	329,973	
Health Service Providers	1,230	6,027	20.4%		(4,797)
Athletic Trainers	139,801	161,330	86.7%		(21,529)
Special Care Facilities	5,575	7,382	75.5%		(1,807)
Abortion Clinics	82,075	97,199	84.4%		(15,124)
Ambulatory Surgical Centers	215,300	135,915	158.4%	79,385	
Birthing Centers	25,000	123,526	20.2%		(98,526)
Perfusionists Licensing	47,297	51,488	91.9%	(4,191)	
Medical Radiologic Technologist Certification	343,126	307,761	111.5%	35,365	
Medical Physicists	67,786	40,831	166.0%	26,955	
Hearing Aid Dispensers	111,029	100,311	110.7%	10,718	
Marriage and Family Therapists	262,441	175,171	149.8%	87,270	
Massage Therapists	864,144	568,102	152.1%	296,042	
Respiratory Care Practitioners	473,954	213,522	222.0%	260,432	
Professional Counselors	627,394	603,248	104.0%	24,146	
Dispensing Opticians and Contact Lens Dispensers	44,672	105,608	42.3%		(60,936)
Endstage Renal Disease	512,261	439,859	116.5%	72.402	
Speech Pathologists and Audiologists	358,301	325,302	110.1%	32,999	
Dietitians	153,617	121,889	126.0%	31,728	
Social Workers	676,099	449,941	150.3%	226,158	
Council on Sex Offender Treatment	52,270	142,825	36.6%		(90,555)
Vital Statistics	3,721,482	3,448,547	107.9%	272,935	
				$ 4,015,206	$ (5,535,468)

Source: Department of Health *1999 Fee Resource Manual*

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