A Review of

Financial Management at the Texas Commission on Private Security

January 2003

Report No. 03-015

State Auditor's Office

Lawrence F. Alwin, CPA
State Auditor

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Overall Conclusion

There was gross fiscal mismanagement from fiscal year 1998 through August 19, 2002, at the Texas Commission on Private Security (Agency). This led to the Agency's reported budget shortfall of $923,471 for fiscal year 2002 and an anticipated budget shortfall of $434,591 for fiscal year 2003.[1] During our testing of detailed expenditures, we did not identify any additional obligations that should have been included in the Agency's shortfall amounts. The $923,471 budget shortfall is a direct violation of Article IX, Section 6.04, of the General Appropriations Act (77th Legislature), which prohibits an agency from incurring obligations in excess of the amounts appropriated to it.

Criteria for Gross Fiscal Mismanagement

Texas Government Code, Section 2104.001, specifies four criteria that define gross fiscal mismanagement:

- Failure to keep adequate fiscal records
- Failure to maintain proper control over assets
- Failure to discharge fiscal obligations in a timely manner
- Misuse of state funds

The Agency met all four of the above criteria. See Chapter 1 of this report for additional details.

The opportunity to commit fraud and the ability to conceal it existed within the Agency's financial operations during our review period. The State Auditor's Office Special Investigations Unit is reviewing Agency records for evidence of fraud.

The specific causes the Agency cited for its reported budget shortfalls were not the primary underlying causes for these shortfalls:

- The Agency did pay some prior year expenses with current year appropriations, as it asserted. However, this does not explain *why* the budget shortfalls occurred but, instead, that they were a consequence of the Agency's poor management decision-making and mismanagement of its financial operations.
- Some operating expenses increased, as the Agency asserted. However, these increases contributed to the Agency's budget shortfalls only because management failed to establish detailed internal budgets to monitor expenditures and ensure that the Agency had sufficient funds to pay its expenses.
- As the Agency asserted, it did incur additional expenses for services outside of those normally expected. However, management failed to adjust other spending and manage these expenditures within the Agency's appropriated resources.

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[1] On August 19, 2002, the Agency reported it would have budget shortfalls of $706,427 in fiscal year 2002 and $205,166 in fiscal year 2003. On September 12, 2002, the Agency revised its budget shortfall estimates to $923,471 for fiscal year 2002 and $434,591 for fiscal year 2003. Our analysis indicates that the September 12, 2002, figures were actually associated with appropriation years, not fiscal years. (See page 6 for more information on appropriation and fiscal years.)

The primary underlying causes for the Agency's budget shortfalls were:

- Decisions Agency management made to spend funds without conducting adequate budget analysis. We found that many of the expenditures that led to the budget shortfalls were not *unanticipated* but, instead, were the direct result of decisions Agency management made. For example, the Agency spent almost $500,000 for its automated licensing system between fiscal years 1998 and 2002. The Agency was appropriated only $90,000 for this purpose.

- Lack of financial oversight. We could not find any evidence that, until just recently, Agency executive management or Commissioners asked for or were provided with information that would enable them to understand the financial position of the Agency.

The majority of the expenditure amounts the Agency reported in its September 2002 letters to the Legislature were accurate. However, its descriptions of these expenditures were not always accurate, and we found that some of the reported expenditures were questionable. In addition, the Agency continues to have outstanding debts from prior years. In November 2002, the Department of Public Safety (DPS) reported that the Agency still owed DPS $663,343 for criminal history and Federal Bureau of Investigation (FBI) fingerprint checks. The Agency used fees it received for these purposes for other operating expenses rather than for paying its obligation to DPS.

Background Information

The Agency licenses businesses and individuals working in the investigation and security industry. It also investigates complaints filed against investigation and security companies.

The Agency received $15,861,386 in state appropriations in fiscal years 1998–2003.

A chronology of events involving the Agency's budget shortfalls is included on page 19 of this report.

The Agency has prepared a remediation plan to correct its financial problems. However, this plan lacks certain analyses and actions necessary to balance the Agency's budget and prevent future financial problems. The plan lists strategies for reducing certain expenditures and generating additional revenue, but it does not quantify the impact of these strategies or calculate whether these actions will balance the fiscal year 2003 budget or reduce the prior year deficits. The plan does not include a balanced 2003 proposed budget or demonstrate how the Agency will pay its debt to DPS.

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Detailed Results

Chapter 1

Was there gross fiscal mismanagement at the Agency?

There was gross fiscal mismanagement from fiscal year 1998 through August 19, 2002, at the Texas Commission on Private Security (Agency). During this period, the Agency significantly mismanaged its fiscal responsibilities and put state funds and appropriated receipts at risk of loss and abuse.

Texas Government Code, Section 2104.001, specifies four criteria that define gross fiscal mismanagement. As Table 1 shows, the Agency met all four criteria.

Table 1 – The Agency met the four criteria for gross fiscal mismanagement.

Evidence of Gross Fiscal Mismanagement		
Texas Government Code, Section 2104.001 Criteria for Gross Fiscal Mismanagement	Summary of Evidence Confirming that the Agency Met the Criteria	Where to Find More Detailed Information in this Report
Failure to keep adequate fiscal records	The Agency failed to establish detailed internal budgets, maintain adequate accounting records, and enter all financial transactions into the Uniform Statewide Accounting System (USAS).	Chapter 2
Failure to maintain proper control over assets	The Agency incurred obligations in excess of its appropriations.	Chapter 2
	We could not find any evidence that, until recently, Agency management or the Commissioners asked for or were provided with information that would enable them to understand the financial position of the Agency.	Chapter 3
	The Agency failed to verify that its former chief financial officer (CFO) had the qualifications necessary to perform the duties of this position and, therefore, maintain proper control over assets.	Chapter 6
Failure to discharge fiscal obligations in a timely manner	The Agency paid some prior year expenses with current year appropriations.	Chapter 2
	In November 2002, the Department of Public Safety (DPS) reported that the Agency still owed DPS $663,343 for criminal history background checks and Federal Bureau of Investigation (FBI) fingerprint checks.	Chapter 7
Misuse of state funds	Our testing found several inappropriate or questionable expenditures.	Chapter 4
	The Agency used fees it received from applicants for criminal history background checks and FBI fingerprint checks for other operating expenses.	Chapter 7

The Agency's chief financial officer (CFO) resigned on August 12, 2002. On August 19, 2002, the Agency reported to the Legislature, the Office of the Governor, and the Legislative Budget Board's Budget and Planning Division that it would experience budget shortfalls. Since that time:

- The Agency has been working to address the deficiencies in its financial operations and has developed a remediation plan. (See Chapter 8 for our recommendations related to the plan.)
- On December 2, 2002, the Agency hired a new CFO. The new CFO is working to revise the Agency's Legislative Appropriations Request for the 2004–2005 biennium and to develop an internal operating budget for fiscal year 2003.
- The Comptroller of Public Accounts has provided financial expertise to assist the Agency in strengthening its financial operations.
- Deloitte & Touche, the Agency's contracted internal auditor, conducted a review of the Agency's financial management. It has not yet released its report.

Chapter 2

Were the reasons the Agency cited for its budget shortfall accurate?

The specific causes the Agency cited for its reported budget shortfalls were not the primary underlying causes for its budget shortfalls:

- The Agency did pay some prior year expenses with current year appropriations as it asserted; however, this does not explain *why* the budget shortfalls occurred. Rather, the need to pay prior year expenses with current year appropriations was a consequence of the Agency's poor management decision-making and mismanagement of its financial operations.[2]

- The Agency asserted that its operating expenses were greater than expected, and we found that some of its operating expenses did increase. However, these increases contributed to the Agency's budget shortfalls only because management failed to establish detailed internal budgets, maintain adequate accounting records, and enter all financial transactions into USAS to ensure that the Agency had sufficient funds to pay expenses. (Because the Agency held some bills and did not enter them into USAS, this system did not have complete information with which to detect the budget shortfalls.)

> **Reasons Agency Management Cited for the Budget Shortfalls**
>
> In its September 2002 letters to the Legislature, the Agency cited the following reasons for its budget shortfalls:
>
> - Prior year expenses were paid with current year appropriations.
> - Operating expenses were greater than expected.
> - Expenses arose for additional services outside those normally incurred.

- The Agency did incur additional expenses for services outside those normally incurred, as it asserted. For example, it paid:

  - $35,532 in fiscal year 2002 for a new assessment from the State Office of Risk Management. However, because the Agency received a special appropriation of $32,028 to pay this expense, it incurred an additional expense of only $3,504.
  - $45,000 in fiscal year 2001 to settle a lawsuit against the Agency.

  However, management failed to adjust other spending and manage these expenditures within the Agency's appropriated resources.

We found that many of the expenditures that led to the shortfall were the direct result of decisions Agency management made. For example:

- In fiscal year 1998, the Agency spent $89,000 to purchase License 2000, an automated, "off-the-shelf" licensing software. The Agency spent an additional $292,891 in fiscal years 1999, 2000, and 2001 on License 2000 for installation,

[2] The Uniform Statewide Accounting System (USAS) requires agencies to designate the appropriation year from which to pay an obligation. USAS does not automatically consider transactions in which agencies pay prior year expenses with current year appropriations to be erroneous.

customization, maintenance, and data conversion. The customization still did not enable License 2000 to fit the Agency's needs, and in fiscal years 2001 and 2002 the Agency implemented a new automated licensing system at a cost of $77,700. In total, the Agency spent almost $500,000 on these two licensing systems. The Agency was appropriated only $90,000 for the 1998–1999 biennium for the upgrade of its mainframe/mini-computer. The Agency received no other capital budget appropriations during this period; in fact, it overspent its capital budget authority by $105,950.[3]

- Although management knew the Agency did not receive funding for six additional full-time equivalents (FTE) the Legislature had granted the Agency, it still chose to fill these positions without taking into consideration how it would pay for the associated increase in total salaries. According to the Legislative Budget Board, it has documentation from the Agency requesting the additional FTEs, and this documentation states that the Agency had sufficient funds to support those additional FTEs. The Agency's FTE headcount increased from 40.25 in fiscal year 1999 to 45.00 in fiscal year 2002. As the FTE headcount increased, total salaries increased accordingly. In addition to increasing its FTE headcount, the Agency also hired temporary employees at a cost of $63,736 and paid overtime at a cost of $12,909 between fiscal years 2000 and 2002.

Furthermore, on October 26, 2000, the Agency sent a letter to the Office of the Governor's Budget and Planning Division requesting a deficiency grant to settle a lawsuit for $245,000. This letter lists reasons for the Agency's scarce resources (at that time) that differ from the reasons it cited in September 2002 for its budget shortfalls.

Gross fiscal mismanagement led to the Agency's reporting a budget shortfall of $923,471 for fiscal year 2002 and an anticipated budget shortfall of $434,591 for fiscal year 2003. The $923,471 budget shortfall is a direct violation of Article IX, Section 6.04, of the General Appropriations Act (77th Legislature), which prohibits an agency from incurring obligations in excess of the amounts appropriated to it.

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[3] Based on the operating budgets the Agency submitted to the Office of the Governor and Legislative Budget Board, the Agency spent $161,000 in fiscal year 1998 and $34,950 in fiscal fear 1999 for capital items. This amount exceeds the Agency's capital budget authority for the 1998–1999 biennium by $105,950.

Chapter 3

Were the Agency's executive management and Commissioners aware that the Agency was experiencing a deficit?

A lack of proper financial oversight contributed to the Agency's current financial problems. We could not find any evidence that, until recently, the Agency's executive management or Commissioners asked for or were provided with information that would enable them to understand and monitor the financial position of the Agency.

It appears that the Agency's executive management relied on the CFO at the time to handle the financial management of the Agency. The now-former CFO had approval authority for all expenditures. We were unable to obtain any form of internal budget documentation showing that executive management and/or the Commissioners were aware of the Agency's financial position and/or monitored it. A budget helps plan, monitor, and control expenditures. Regular, periodic analysis of monthly actual-to-budget spending variances decreases the risk of material errors and irregularities.

However, we did obtain copies of monthly cash statements the former CFO prepared. These statements compared revenue with expenditures and showed the cumulative percentage of funds disbursed. The CFO provided these statements to executive management each month. Some of these statements showed that the Agency spent more than it had generated in revenue. Although some of these statements reflected a deficit, they did not reflect the *extent* of the deficit because they did not show payables; instead, they showed only the amount of cash that came in and the amount of cash the Agency paid out.

Minutes from Commissioners' meetings show that the Commissioners focused their attention on licensing and enforcement cases and rule changes. Executive management did, however, inform the Commissioners about the Agency's serious automated licensing system problems and the amounts the Agency spent on the system.

The Commissioners reported to us that they repeatedly asked for better, more understandable financial information from the former CFO. In September 2001, the Commissioners formed an informal finance subcommittee to help enhance their understanding of the Agency's finances. This subcommittee did not meet until April 2002. In that month, a Commissioner on this subcommittee became aware of possible financial problems at the Agency; however, this Commissioner was not aware of the extent of these problems. In June 2002, the finance subcommittee met and discussed working toward developing an Agency budget, but the budget shortfalls were revealed shortly thereafter.

The Agency presented a draft 2003 operating budget to the Commissioners at their December 12, 2002, meeting. This budget showed a projected appropriation year 2003 operating deficit of $174,736 and estimated that, after the Agency paid some outstanding appropriation year 2002 payables, the amount of this deficit would increase to $249,953. The Commissioners did not question management about how the Agency planned to fund this deficit or pay the remaining appropriation year 2002 outstanding payables.

Was the expenditure information that the Agency provided to the Legislature accurate?

The majority of the expenditure amounts the Agency reported in its letters to the Legislature were accurate. However, we found that:

- The descriptions of these expenditures were not always accurate. Expenditure descriptions were generalized and did not describe all expenses included in the category of expense reported.
- Some of the reported expenditures were questionable. While the amounts of these expenditures are not material, these expenditures indicate weak controls or circumvention of controls and demonstrate the limited oversight regarding the Agency's expenditure process.
- The information the Agency provided to the Legislature was presented by appropriation year, not by fiscal year as the Agency reported. While the difference between these two methods will not result in material net differences in total expenditures, it can produce material differences in expenditures at the individual account level. Compiling expenditure information by appropriation year is one approach to totaling expenditures. However, compiling expenditures by fiscal year more closely reflects the structure of an agency's Annual Financial Report. It also better supports monitoring internal budgets and comparing budgeted expenditures to actual expenditures.

Examples of inaccurate expenditure descriptions include the following:

- On September 12, 2002, the Agency reported that it spent $145,472 in fiscal year 1999 to purchase computers. However, our testing indicated that the Agency actually spent only $29,090 of the $145,472 for the purchase of computers. The reported amount included $99,082 for the Agency's implementation of the License 2000 system. As discussed in Chapter 2, this licensing system did not work well, and the Agency has since begun using a new system. In addition, the reported amount also included $11,653 for the purchase of printers. The Agency spent the remainder of the $145,472 on other computer-related items, office supplies, and publications.
- On September 12, 2002, the Agency reported that it spent $52,795 in fiscal year 2002 to pay temporary-employment agencies. On September 16, 2002, the Agency reported that it spent those funds on temporary employees it specifically used to reduce the licensing backlog created when it implemented the new licensing system. However, our testing indicated that the Agency spent only $32,381 on temporary employees assigned to reduce the licensing backlog. The remaining $20,414 was spent on temporary employees for other Agency divisions, documenting services, and a $415 lump-sum payment to an employee. (This lump-sum payment is also discussed below as a questionable expenditure.)

The opportunity to commit fraud and the ability to conceal it existed with the Agency's financial operations during our review period. Our testing found several inappropriate or questionable expenditures. The amounts of these expenditures are not material, but these expenditures do demonstrate the Agency's poor financial practices. Examples of questionable expenditures included:

- $5,952 in payments for various computer hardware and software repairs. The repairs included downloading files, reconnecting wires, and hooking up Internet access. The Agency did not follow procurement law for these expenditures. In addition, at the time these repairs were made, the Agency had one full-time program analyst on staff.

- $14,629 in increased payroll costs for fiscal year 2002 that resulted from a reclassification of employees. It appears that the Agency may have been increasing employees' salaries through reclassifications of positions rather than through merits or promotions. This practice makes it appear that the Agency awarded few or no merits or promotions when, in fact, it did. For example, in fiscal year 2002 the Agency made 15 reclassifications that resulted in payroll cost increases of $14,629. In that same year, the Agency officially made no promotions and officially awarded six merits for a payroll cost increase of $6,199.

  We noted some reclassifications that were questionable and some instances in which there was evidence that the Agency made a reclassification and a merit increase at the same time for the same employee. For example, the payroll system indicated that the Agency increased the monthly pay of one employee by $340 through a reclassification and a merit increase, but a memo in the employee's personnel file specifically noted that the increase in pay was because of a promotion.

  The State Classification Office has reported that there is a statewide trend toward agencies' increasing employee salaries through reclassifications rather than merit increases and promotions (see *A Summary of the Texas State Workforce for Fiscal Year 2002*, SAO Report No. 03-703, December 2002).

- $415 for a lump-sum, final payroll payment to an employee. The Agency processed this payment as a vendor payment for temporary services instead of as a payroll transaction. As a result, the Agency violated Internal Revenue Service rules governing the reporting of wages.

- $100 for a one-time merit increase to an employee. This individual had been a full-time employee for approximately only 3 months at the time of the award. The individual was a temporary employee prior to this time. The payment was processed as a vendor payment for temporary services instead of as a payroll transaction. Therefore, the Agency violated Internal Revenue Service rules governing the reporting of wages. This payment also violated the statutory requirement that specifies that employees must be employed for six months before they can receive merit increases.

- $1,893 for spring-water service during fiscal years 2001 and 2002. The Agency recently discontinued this service.

Chapter 5

Is the Agency's remediation plan adequate to ensure that its financial problems will be corrected?

The Agency's remediation plan lacks certain analyses and actions necessary to balance its budget and prevent future financial problems. The plan lists strategies for reducing certain expenditures and generating additional revenue, but it does not quantify the impact of these strategies or calculate whether these actions will balance the fiscal year 2003 budget or reduce the prior year deficits. The plan does not include a balanced 2003 proposed budget or demonstrate how the Agency will pay its outstanding prior year debt to the Department of Public Safety (DPS). (See Chapter 7 for additional details on this debt.)

For example, the plan mentions changing the Agency's enabling legislation to allow the Commission to set its own fees and refers to fee increases, but it does not quantify the additional revenue anticipated from these changes. The plan also recommends changes to Texas Occupations Code, Chapter 1702, to allow the Agency to collect an administrative fee along with all professional fees. Again, however, the plan does not include an estimate of how much additional revenue this change would generate. We noted that the plan also does not include strategies for taking advantage of potential federal funding and grants.

The plan's analysis of expenditures is equally vague. For example, it discusses leaving positions that are vacant (through current or future attrition) unfilled unless critical shortages occur, restricting travel budget for investigation staff, and discontinuing the use of an armored car for deposits. These are the only proposed expenditure reductions in the plan, and they are not quantified.

The plan does specify many needed new controls and oversight mechanisms that could prevent future financial mismanagement. However, clarifying the following controls would further strengthen the remediation plan's proposed fiscal controls:

- The plan does not clearly define the Commissioners' role and level of involvement in monitoring the financial position of the Agency. The plan calls for the Commission Chair to receive monthly USAS reports, but it does not address the roles the remaining Commissioners should play.

- The plan does not address who within the Agency has authority to approve requisitions for purchases of goods or services (based on a dollar amount threshold or through specific division budgets). The former CFO had authority to approve all expenditures, regardless of the amount or type of purchase.

Specific recommendations to address these weaknesses are included in Chapter 8.

Chapter 6

Did fraud or illegal acts occur at the Agency?

The State Auditor's Office Special Investigations Unit (SIU) is reviewing Agency records for evidence of fraud. SIU will notify the Legislative Audit Committee about any fraud or illegal acts that are discovered.

The SIU identified applications the former CFO submitted for state employment that contained inconsistencies in education credentials. The applications reflected college credit and a BBA degree in accounting from a university outside of Texas. The university listed on the applications could not confirm the applicant's college credit or enrollment. The Agency did not have documentation indicating that it verified the applicant's qualifications.

Chapter 7

What was the financial effect on DPS when the Agency did not pass through funds from licensing fees as required?

In November 2002, DPS reported that the Agency still owed DPS $663,343 from the prior year for criminal history background checks and FBI fingerprint checks. This amount includes:

- $103,279 for a contract the Agency has with DPS through which DPS conducts criminal history checks on the Agency's license applicants. The Agency is supposed to pay DPS for this service using General Revenue appropriated from applicants' license application fees.[4]
- $560,064 for FBI fingerprint checks on applicants. Applicants pay the Agency a $25 fee for an FBI fingerprint check when they apply for licensure. The Agency is supposed to retain $1 of that fee and pass the remainder on to DPS. DPS then retains $2 and passes the remainder on to the FBI. However, the Agency used some of the revenue it received from these fees to pay operating expenses instead of passing these funds along to DPS.

According to the Agency, after the former CFO resigned, it found a number of bills from DPS that the former CFO had been holding and had not entered into USAS. These bills include unpaid amounts for both the initial criminal history checks and fingerprint checks. DPS has sent the Agency bills to collect these funds, but the Agency has not yet paid those bills.

[4] The contract with DPS to conduct criminal history checks is for a fixed amount, regardless of the number of criminal history checks performed.

Chapter 8

The Agency Should Improve and Implement Its Financial Remediation Plan

The Agency's fiscal mismanagement was severe and put its ability to fulfill its mission at risk. The Agency is at a critical juncture and must make a determined effort to correct the deficiencies in its financial operations. Left uncorrected, the financial management deficiencies will continue to hinder the Agency's ability to adequately manage its financial operations and provide services. By taking immediate action and implementing a long-term financial remediation plan, the Agency will be able to report reliable financial information, use state funds efficiently, and more effectively serve the citizens of Texas.

To this end, the Agency should:

- Improve its financial remediation plan. Specifically, the Agency should:
  - Develop specific, quantified budget scenarios to show the expenditure cuts or revenue increases necessary to balance the fiscal year 2003 budget and pay outstanding fiscal year 2002 obligations.
  - Detail the potential effect of proposed budget cuts on services.
  - Identify and apply for available federal funding and grants.
  - Analyze the potential savings of automating manual processes. This analysis should consider the fiscal impact of accepting payment for license fees through TexasOnLine, the e-government Web portal for the State of Texas.
  - Better define the role of the Commissioners in monitoring the financial position of the Agency and in overseeing the implementation of the financial remediation plan.
  - Develop a purchase requisition process that defines who has the authority to approve potential purchases.
- Implement its financial remediation plan to repair its financial health and ensure that it can provide reliable and useful information.

Management's Responses

Texas Commission on Private Security

January 14, 2003

EDL/03/01/154

State Auditor's Office
Lawrence F. Alwin, CPA
PO Box 12067
Austin, Texas 78711

Regarding: Financial Review of the Texas Commission on Private Security

Dear Mr. Alwin,

I would like to thank the State Auditor's Office for providing its report of the past financial management of the Texas Commission on Private Security and suggestions made to improve future financial management.

The agency has taken actions to implement new internal controls as well as enhancements to existing policies. A new Chief Financial Officer has been hired and is reviewing and revising agency procedure to assure that standard state business practices are met in all phases of the agency's financial operations.

Please find enclosed the agency's first response to your offices' financial management report. We are also amending our remediation plan utilizing suggestions provided in your report. The Commission is committed to continue to review and monitor financial procedures and policies to assure accountability of state resources.

Should you have any questions or comments, please do not hesitate to contact me at 238.5869.

Sincerely,

Cliff Grumbles,
Executive Director

CG: kwj.

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The Texas Commission on Private Security's response to the State Auditor's Office review of financial management.

Chapter One

Was there gross fiscal mismanagement at the Agency?

This Agency acknowledges that financial errors did occur and has taken and continues to take corrective actions designed to improve financial management.

On December 2, 2002, The Commission hired a new Chief Financial Officer. He is reviewing and redesigning several of our financial reports to make them understandable and available to all Commissioners and staff.

The new CFO is working on redesigning expenditure procedures, strengthening the purchasing controls and implementing safeguards within the administrative and purchasing functions.

Segregation of financial responsibilities has been established that includes an enhancement of the review system of financial activities by both the Executive Director and the Commissioning Board.

The new CFO has revised the Fiscal Year 03' operating budget, reviewed and revised the LAR for fiscal year 04'-05, and has begun to prepare monthly and cumulative financial reports for the agency Commissioners, Director and Division Chiefs.

In August 2002, the severity of the situation was discovered and, at this time, the accuracy of the previous financial information presented came into question. The Agency reacted to the errors made by the financial officer and continues to review and revise internal procedures.

In September of 2002, the Agency requested assistance from the Comptroller of Public Accounts. The Comptroller's office provided a staff person for approximately two months.

The Agency requested their internal auditor, Deloitte & Touché, to conduct a review of the Commission's financial management. This report has not been received by the Texas Commission on Private Security, but is expected in January 2003.

The Agency has developed and submitted a remediation plan. The State Auditor's Office offered some recommendations to improve the submitted remediation plan. These recommendations will be included in the amended plan. We welcome the input from the appropriate oversight agencies in the compilation of this remediation plan.

Chapter two

Were the reasons the Agency cited for its budget shortfall accurate?

The majority of the reasons that the Agency cited for its budget shortfall were accurate, however, additional information should be taken into consideration.

Information produced by the existing computer system at that time, could not be certified by the State Auditors Office, and it was recommended through a report submitted by KPMG, that we purchase a new computer system. The upgrade to server vs. mainframe satisfied the Y2K issues and would allow for new technological capabilities. In 1998 the project began with the purchase of new software for $89,000. In fiscal years 1999, 2000 & 2001 the agency spent $292,891 for installations, customization, of the new software, conversion of data from the old system and software maintenance. These expenditures were necessary to continue the project and management's decision to expend these funds were based on a belief of that the agency had adequate funds.

Based on these recommendations and after our proposal was submitted and approved by DIR and GSC, the Executive Director and Commissioners moved forward with this purchase.

The cost of the conversion was greater than anticipated, enhancements that were made, were necessary to make this a functional system.

The system as it stands now provides the agency with the technical support necessary to meet the demands of the regulated community.

A secondary factor that severely impacted the financial status of the Agency was the filling of six additional fulltime equivalent (FTE) positions the Legislature had granted.

The problem that presented itself was the fact that the Agency had an understanding that resources were available to fund these additional positions.

This situation was particularly aggravated in the following biennium, when the Agency failed to request from the Appropriations Committee additional funding to satisfy this budgetary shortfall.

As of August 2002, the Agency has not filled any vacant positions, with the exception of the replacement of the Chief Financial Officer.

The two above referenced situations were the main causes of the budget shortfall.

The addition of the new Chief Financial Officer has brought about more stringent expenditure controls and oversight. These implemented changes produce more reliable data for the Agency to utilize when making financial decisions and appropriation requests from the Legislature. The Chief Financial Officer has taken actions to ensure that financial controls are in place to prevent the circumstances that led to this current shortfall.

Accurate data and understandable reporting methods adopted by the Agency will provide the Commissioners with more detailed financial information allowing them to be better informed and more responsive to the needs of the Agency.

Chapter 3

Were the Agency's executive management and Commissioners aware that the Agency was experiencing a deficit?

The Commissioners and executive management were not aware of the extent of the deficit, this came about by inaccurate and incomplete reporting from the former CFO, that reporting did not show payables and only reflected the amount of cash that came in and the amount of cash that the Agency paid out.

In addition, the CFO did not present the payables or inform management of what the Agency truly owed.

After discovery of this deficit immediate actions were taken that included notification of the agencies contracted internal audit firm, Deloitte & Touché, notification to the governor's office and notification of various oversight authorities.

A request was made to the Comptrollers office for assistance, and the Agency proceeded to hire a new CFO.

The new CFO has taken direct action to redesign the Agency's reporting procedures both internal and external. The CFO now meets monthly with the Agency's division chiefs to review the agencies financial status. The CFO is reporting to the Commission at the quarterly meetings. The CFO is now segregated from the administrative division; however he retains oversight authority for expenditures proposed by any division.

In addition to the purchasing controls the CFO is reviewing administrative duties to separate authorization controls. The CFO has been in contact with the agency's ACO and is implemented additional controls at the Comptroller for daily review.

During the time period of the review, the Agency had five persons who filled the position of Executive Director. Each of these persons while working through the transition periods, reviewing previous decisions made, and preparing for the current decisions to be made relied on the information provided to them by the CFO.

The position of the CFO remained filled by the same person during the time period in question. The Commissioners relied on limited and now known to be inaccurate data they received from the CFO.

The Agency has implemented new tracking and reporting methods on all financial transactions which will prevent reliance on one individual in the agency for accurate data. The new CFO has implemented new budgetary and purchasing controls. He is in the process of developing financial reports for the Commissioners that will reflect monthly and cumulative financial data in accordance with general accepted accounting principles and requirements.

Chapter 4

Was the expenditure information that the Agency provided to the Legislature accurate?

As stated in the Auditor's report, the majority of the expenditure amounts the Agency reported to the Legislature was accurate.

It was reported that some expenditure descriptions were generalized this occurred when the agency used the term "computer expenses" when in fact that amount was for computers and computer system related expenses.

Agency staff received assistance from the Comptrollers office on expenditure coding. All purchase expenditure are being reviewed as they occur to prevent this error in the future.

The three tier purchase approval system which is currently in place is designed to prevent the type of questionable expenditures reflected in the Auditor's report.

Per the request of the Auditor's representative, we are responding to the following specific expenditures questioned:

Regarding the $415.00 lump sum payment to an agency employee; the Agency acted upon notification from the Auditor's of this situation where an employee was paid as a vendor instead of as an employee. The agency has taken corrective action by re-issuing the W2c to the employee and is in the process of completing 941c and W3c to be filed with the Internal Revenue Service.

Regarding the $100.00 merit increase issued to an employee with less than 6 months service; the agency has requested the funds back from the employee.

Not all the temporary employees worked directly in the License Division; some were assigned tasks in other divisions so that skilled permanent employees could be used to assist in the license division.

The controls systems now in place will not allow anyone in the Agency to employ or to contract with outside sources independently. This refers to auditor's comment regarding a payment made to two persons for $5,952, in 1998.

Chapter 5

Is the Agency's remediation plan adequate to ensure that its financial problems will be corrected?

The Agency is in the process of revising its remediation plan based on suggestions made by the Auditor's office. This plan will be provided by January 24, 2003.

The revised remediation plan will address all the questions raised in the current audit report.

Since August 2002 the Agency has implemented a hiring freeze with the only exception being the hiring of a new financial officer.

By implementation of certain expenditure restrictions, including the hiring freeze, the Agency has significantly reduced the anticipated FY 03 shortfall.

The Agency continues to seek ways to reduce costs.

In October of 2002 the Agency relocated its Austin headquarters through a contract initiated by TBPC. This resulted in rent savings through the end of FY 2003. However, these savings were lost in moving expenses. The rent is scheduled to increase in FY 04.

The Agency had in place oversight of the financial function however; flawed reporting by the former CFO inhibited that process. The Agency now receives monthly reports from the CFO. The CFO meets with the Commission's finance sub-committee quarterly and presents a report at the Commission's regularly scheduled meetings.

The Commissioners will receive accurate and timely financial data to allow them to create sound fiscal policy.

The agency has implemented a new purchase request procedure which requires approval by a division chief and must be reviewed by the Purchaser, approved by the Chief of Administration and the CFO. In the event the request exceeds $500.00, the additional approval of the Executive Director is required.

Chapter 6

Did fraud or illegal acts occur at the Agency?

There is no indication of fraud by the Agency at this time. We are looking forward to the report from the Special Investigations Unit of the State Auditor's Office.

In reference to the comment in the Auditor's report; a review of the personnel file of the former CFO, does not contain any copies or original transcripts to show attendance or graduation from a college or university.

***Chapter** 7*

What was the financial effect on DPS when the Agency did not pass funds from licensing fees through as required?

We feel that it is not our place to address the financial situation of another state agency. We have met with representatives of DPS to discuss our current circumstances, and agreed to keep them informed of our progress in remediation.

At the meeting to discuss the debt to the Department of Public Safety, it was also discussed that the Department of Public Safety is considering not renewing the existing contract, when it comes up for renewal in August of 2003.

Chapter 8

The Agency should improve and implement its financial remediation plan.

The Agency is in the process of revising its remediation plan based on suggestions made by the Auditor's office. This plan will be provided by January 24, 2003.

We welcome input from all the appropriate oversight agencies in the compilation of this remediation plan.

The agency is pursuing the suggestion of obtaining federal grants, through Criminal Justice Department, Texas A&M University and Department Of Justice. The agencies designation prevents qualification for most grants but we will continue to monitor grant sources for applicable funding.

The agency has met with Texas Online representatives with the goal of becoming operations for license renewals by November of 2003. At this time it is too early to predict potential savings realized by this automation.

As discussed previously the agency has in place a purchase requisition procedure that articulates responsibility for expenditures to assure accountability of state resources.

Chronology of Events

Table 2 presents a chronology of events at the Texas Commission on Private Security (Agency).

Table 2

Chronology of Events	
Date	**Event**
August 19, 2002	The Agency informed the Legislature that it would experience budget shortfalls of $706,427 in fiscal year 2002 and $205,166 in fiscal year 2003. The Agency reported that the primary reasons for the shortfalls included: ▪ Unanticipated expenses. ▪ Increasing expenses and decreasing revenue. ▪ The need to pay prior year expenses with current year appropriations.
August 28, 2002	In response to a request from the House Appropriations Committee, the Comptroller of Public Accounts reported that: ▪ The Agency's actual budget shortfall for fiscal year 2002 was $830,024. ▪ The extent of the Agency's need to pay prior year expenses with current year appropriations was not as significant as the Agency had originally asserted.
September 12, 2002	The Agency submitted revised budget shortfall information to the Legislature. It specified that it would experience budget shortfalls of $923,471 in fiscal year 2002 and $434,591 in fiscal year 2003.[a] The Agency reported that the primary reasons for the shortfalls included the following: ▪ The Agency paid $436,442 in fiscal year 2001 payables with fiscal year 2002 funds. ▪ The Agency filled six new full-time positions although it did not have funding to pay the salaries associated with those positions. ▪ The Agency's operating expenses increased because of its attempt to reduce its licensing backlog. ▪ Several other expenses (lease, postage, a new State Office of Risk Management assessment) also increased.
September 16, 2002	The Agency clarified the information it submitted to the Legislature on September 12, 2002. It restated some of the descriptions of its expenses and some of the expenditure amounts. For example: ▪ In its letter dated September 12, 2002, the Agency specified that it paid KPMG $73,725 for financial and accounting services. In its letter dated September 16, 2002, the Agency specified that it paid KPMG this amount for a financial management review. ▪ In the letter dated September 16, 2002, the Agency added another fiscal year 1999 expense: $76,352 for temporary employees it hired to reduce its licensing backlog.

[a] Our analysis indicates that the figures reported on September 12, 2002, were actually associated with appropriation years, not fiscal years.

Appendix

Objectives, Scope, and Methodology

Appendix 1-A

Objectives

Our objectives were to determine the following:

- What caused the Agency's reported budget shortfalls for fiscal year 2002 and fiscal year 2003? Was the Agency's assertion that certain unanticipated or increased operating expenses contributed to the shortfall valid?
- Did the Agency make inappropriate payments?
- Was there evidence of fraud?

Appendix 1-B

Scope

This work was not an audit and, therefore, some information in this report has not been submitted to audit procedures. Our scope included reviewing Agency expenditures from fiscal year 1998 through fiscal year 2002. We also reviewed expenditure amounts detailed by the Agency in its September 2002 letters to the Legislature. This review did not include an assessment of the Agency's information technology systems.

Appendix 1-C

Methodology

The review methodology consisted of collecting information, performing selected audit tests and other procedures, and analyzing and evaluating the results against established criteria. We conducted fieldwork between October and November 2002.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Tom Craddick, Speaker of the House, Chair
The Honorable David Dewhurst, Lieutenant Governor, Vice Chair
The Honorable Teel Bivins, Senate Finance Committee
The Honorable Bill Ratliff, Senate State Affairs Committee
Chair, House Appropriations Committee
Chair, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Texas Commission on Private Security

The Honorable George Craig, Acting Chairman
The Honorable Joan T. Neuhaus
The Honorable C. S. “Dusty” Rhodes
The Honorable Charlene Ritchey
The Honorable Linda J. Sadler
The Honorable Michael Samulin
The Honorable Jim G. Bray, Jr.
The Honorable Jacob M. Monty
The Honorable Marshall Caskey
Mr. Cliff Grumbles, Executive Director