

An Audit Report on

# The Department of Health's Implementation of a Business Improvement Plan

March 2003

Report No. 03-023



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# The Department of Health's Implementation of a Business Improvement Plan

## Overall Conclusion

The Department of Health (Department) has not made significant progress in implementing important initiatives related to its core administrative support functions in its Business Improvement Plan. Since finalizing its plan in December 2001, the Department has spent more than a year performing tasks that have not significantly strengthened its administrative support functions. The lack of progress in implementing its Business Improvement Plan has contributed to serious ongoing weaknesses in the Department's financial operations.

The Department has not achieved the intent of the consultant's *Business Practices Evaluation Report* on which it based its Business Improvement Plan. In attempting to implement its plan, the Department has developed a reorganization proposal without conducting a functional review of its operations. Conducting this type of review was a critical recommendation in the *Business Practices Evaluation Report*. Rather than increase efficiency and consolidate operations, the Department's planned reorganization will add an additional layer of management to its organizational structure.

The Department's serious financial weaknesses significantly reduce the reliability of its financial information. These weaknesses have resulted in the Department's understatement of its accounts payable, its failure to reconcile its internal accounting system with the Uniform Statewide Accounting System (USAS), its underreporting of fiscal year 2002 total expenditures, and other financial management and bookkeeping errors. During the last ten years, more than a dozen audit reports by the State Auditor's Office and others have identified weaknesses in the Department's financial operations. These weaknesses continue to persist and significantly reduce the reliability of the Department's financial information. The condition of the Department's financial information prevents us from determining the effect of these weaknesses on the Department's budget.

### Background Information

In response to a requirement in the General Appropriations Act (77th Legislature), the Department contracted with a consultant to analyze its structure and operations in June 2001.

The Department formed its Business Improvement Plan by adopting 94 of the recommendations in the *Business Practices Evaluation Report* that the consultant prepared. Thus, the *Business Practices Evaluation Report* set the foundation for the Department's Business Improvement Plan.

## Key Points

**The Department has not achieved the intent of the *Business Practices Evaluation Report*.**

The Department has not performed the functional review that its *Business Practices Evaluation Report* recommended. This review is critical because it can identify efficiencies, eliminate unnecessary activities, and assess the appropriateness of staffing levels. Therefore, the Department is poised to implement a reorganization plan without ever having considered these critical factors.



**The Business Improvement Plan initiatives the Department has completed are considerably less complex than the initiatives on which it has not acted.**

The Department has fully implemented 37 (39 percent) of the 94 initiatives in its Business Improvement Plan. Of the remaining 57 initiatives, the Department chose to eliminate 7, and 50 initiatives are partially implemented or have been delayed.

**The Department's continuing financial weaknesses significantly reduce the reliability of its financial information.**

The Department still has not corrected most of the financial weaknesses we identified in our previous audit reports.

Examples of the financial weaknesses include the following:

- The Department understated in its Annual Financial Report the amount of its fiscal year 2002 accounts payable by at least \$136 million.
- The Department has not reconciled the information in its internal accounting system with the information in USAS. As a result, as of February 4, 2003, we estimated that the Department must make adjustments of \$318 million (with a net effect of \$122 million) to reconcile the cash balance recorded in USAS with the cash balance recorded in the Department's internal accounting system.
- The Department underreported in its Annual Financial Report its fiscal year 2002 total expenditures of federal funds by \$214 million.
- The Department's internal auditor has reported that the Department's internal accounting system lacks adequate system auditing, user function restrictions, and user account and maintenance controls.
- The Department still has not complied with federal requirements related to the indirect cost recovery plans. According to the U.S. Department of Health and Human Services, this puts the Department at risk for losing an estimated \$30 million in federal indirect costs reimbursements.
- The Department continues to incur a state interest liability to the federal government when it makes expenditure transfers that change a transaction's method of financing from federal to state funds. When we calculated the interest liability as the federal government instructed, we estimated it could be at least \$762,000 for fiscal year 2002. However, because the Department failed to provide complete information to the Comptroller of Public Accounts, this liability should be higher.
- The Department also continues to code expenditure vouchers incorrectly and use expenditure adjustments to correct bookkeeping errors. These issues impair the comparability of the Department's expenditure information.

## **Summary of Management's Responses and State Auditor's Follow-Up Comments**

The Department generally disagrees with our findings. Its detailed responses, which we present in Appendix 4, do not directly address a number of the issues we identified. The nature of the Department's objections to these issues demonstrates the degree to which the Department still does not recognize the importance of addressing these issues. The following summarizes the Department's responses to key issues in this report, as well as our specific follow-up comments addressing these key issues.

### Key Issue:

Did the State Auditor's Office (SAO) use outdated information to assess the implementation status of the Business Improvement Plan?

### Department's Assertion:

The SAO presents *Business Practices Evaluation Report* (BPE) status information as of September 2002 instead of February 2003.

### State Auditor's Follow-Up Comment:

Although we were prepared to issue a report on the status of the Department's progress in September 2002, our report was delayed at the Department's request to allow the Department's Fiscal and Administrative Improvement Response (FAIR) teams additional time to complete their work. Because of this delay, our assessment of the FAIR team's activities presented in Chapter 1 of this report was based on their work as of December 2002, not September 2002.

### Key Issue:

Did the Department make significant progress in implementing the Business Improvement Plan?

### Department's Assertion:

The Department believes it has made significant progress and is achieving the intent of the Business Improvement Plan.

### State Auditor's Follow-Up Comment:

Our overall conclusion that the Department has not made significant progress in implementing its Business Improvement Plan was based largely on the implementation status of initiatives for the Department's core administrative support functions. With regard to those functions, our disagreement stems from two points: (1) the Department's reorganization plan does not consider possible efficiencies, assess workloads, or analyze demand for services, and (2) regardless of the quality of this plan, the Department still has not implemented it.

Key Issue:

Did the Department perform functional reviews as defined by the *Business Practices Evaluation Report*?

The Department's assertion:

The functional reviews were performed by "Fiscal and Administrative Improvement Response" (FAIR) teams composed of individuals in administrative and program areas from both Austin and the regions/hospitals.

State Auditor's Follow-Up Comment:

The fact that the Department tasked the FAIR teams with performing the functional reviews demonstrates its failure to carry out the functional reviews as the *Business Practices Evaluation Report* had recommended. Specifically, the FAIR teams lacked the skills necessary to perform functional reviews and were not independent of the process. In addition, because Department management instructed the FAIR teams that there would be no jobs cut, this demonstrates that management had no intention of considering efficiencies that could be achieved through consolidation of support services.

The Department's response illustrates that it continues to misconstrue the methodology and purpose of a functional review. The Department states that "the functions we began reviewing were core administrative functions that did not require extensive analysis on that question; we knew they were necessary." This demonstrates the Department's fundamental lack of understanding of commonly accepted business process analysis methods. For example, even when functions are necessary, the activities within those functions must be reviewed to determine whether efficiencies can be gained. Because the FAIR teams lacked the skill sets the *Business Practices Evaluation Report* called for, their analyses were inconsistent and incomplete, and they cannot be sufficient to meet the goal for conducting functional reviews as set out in the *Business Practices Evaluation Report*.

Key Issue:

Did the Department make an attempt to reconcile the information in its internal accounting system with the information in USAS before this was brought to its attention by the State Auditor's Office and KPMG auditors?

The Department's assertion:

The Department was making significant efforts to reconcile the internal accounting system to USAS before the auditors raised this issue.

State Auditor's Follow-Up Comment:

The Department did not begin a concerted effort to reconcile its internal accounting system with USAS until after November 20, 2002. (This was after the Department had released its annual financial report based on USAS information, rather than on information in its internal accounting system.) As of November 20, 2002, the new internal accounting system had been in place for more than one year and the Department still had not conducted a reconciliation between this system and USAS.

Key Issue:

Was the new accounting system the cause of the financial problems at the Department?

The Department's assertion:

To some degree, the financial accounting problems in the past year resulted from implementation of a new financial system, the Health and Human Services Administrative System (HHSAS).

State Auditor's Follow-Up Comment:

The Department did not implement the new accounting system properly. The Department's internal auditor found that the Department implemented the new system with inadequate internal controls, system setup and testing, and training. In addition, pointing toward the new financial system as the cause of financial weaknesses is inaccurate because many of the Department's financial weaknesses existed long before the implementation of the new financial system.

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

This audit did not include a review of information technology. The Department's internal auditor has released a report on the Department's implementation of a new accounting system, and we intend to review that system in 2003.

## ***Summary of Objectives, Scope, and Methodology***

Our objectives were to answer the following questions:

- Has the Department implemented the initiatives stated in its Business Improvement Plan?
- Has the Department achieved the intent of the recommendations stated in the Business Improvement Plan?
- Has the Department implemented the recommendations in our prior audit report (*An Audit Report on Financial Management at the Department of Health*, SAO Report No. 01-021, March 2001)?

The scope of the audit covered various aspects of the Department's operations, including information systems and technology, budgeting, internal audit, human resources, grants and contract management, and accounting functions. We also reviewed ongoing issues in the Department's financial operations.

Our methodology consisted of collecting information, performing selected audit tests and other procedures, and analyzing and evaluating the results against established criteria.

**Table of Results and Recommendations**

The Department has not made significant progress in implementing important initiatives in its Business Improvement Plan. (Page 1)

The Department should:

- Conduct the functional review of the Department to ensure efficient and effective operations as recommended in the *Business Practices Evaluation Report*. The functional review should include an evaluation of the Department's activities, as well as an evaluation of the appropriateness of the staffing functions.
- Continue to implement its Business Improvement Plan in accordance with the intent of the *Business Practices Evaluation Report*.

The Department's continuing financial weaknesses significantly reduce the reliability of its financial information. (Page 5)

The Department should:

- Ensure that it reconciles information in its internal accounting system to USAS and internal subsystems in a timely manner.
- Verify that its internal accounting system contains accurate and complete information.
- Consider providing additional training on its internal accounting system.
- Comply with federal requirements regarding the submission of indirect cost recovery plans.
- Clarify the method for calculating the interest liability owed to the federal government.
- Provide complete information in the Cash Management Improvement Act Report it sends to the Comptroller.
- Determine why bookkeeping error adjustments are made and establish appropriate processes to ensure that adjustments are minimized.
- Properly train personnel to enter accounting codes. The Department should consider a pre-test to determine the need for training and a post-test to assist with the evaluation of training.

**Recent SAO Work**

Number	Product Name	Release Date
01-021	An Audit Report on Financial Management at the Department of Health	March 2001



# Contents

## ***Detailed Results***

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Chapter 1 The Department Has Not Made Significant Progress in Implementing Important Initiatives in Its Business Improvement Plan .....	1
Chapter 2 The Department’s Continuing Financial Weaknesses Significantly Reduce the Reliability of Its Financial Information .....	5

## ***Appendices***

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Appendix 1 Objectives, Scope, and Methodology.....	11
Appendix 2 The Department’s Current and Planned Organizational Structures.....	14
Appendix 3 Implementation Status of Initiatives in the Department’s Business Improvement Plan .....	16
Appendix 4 Management’s Responses .....	21

# Detailed Results

Chapter 1

## **The Department Has Not Made Significant Progress in Implementing Important Initiatives in Its Business Improvement Plan**

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The Department of Health (Department) has not made significant progress in implementing important initiatives from its Business Improvement Plan related to its core administrative support functions.<sup>1</sup> As a result, the Department has not significantly strengthened its operations, increased its efficiency, or consolidated administrative functions.

In response to a requirement in the General Appropriations Act (see text box), the Department contracted with a consultant to analyze its structure and operations in June 2001. The Department formed its Business Improvement Plan by adopting 94 of the recommendations in the *Business Practices Evaluation Report* that the consultant prepared. Thus, the *Business Practices Evaluation Report* set the foundation for the Department's Business Improvement Plan.

### **The Department Has Not Achieved the Intent of the *Business Practices Evaluation Report***

The changes the Department plans to make to its organizational structure will not make it more efficient or streamlined as the *Business Practices Evaluation Report* intended. To the contrary, the Department plans to introduce an additional layer of management to oversee the new Administrative Services Centers (Centers) in which it is planning to place administrative staff (see Appendix 2 for the Department's current and planned organizational structures). The total number of administrative staff will not change; instead, the Department will simply relocate staff into the Centers.

#### **In May 2001, the Legislature Required the Department to Implement a Business Improvement Plan**

Rider 2, page II-30, of the General Appropriations Act (77th Legislature) specifies that:

It is the intent of the Legislature that the Board of Health and the Department of Health shall develop and implement, with the assistance of the Health and Human Services Commission, a comprehensive business improvement plan for the Texas Department of Health. The plan shall include timelines, benchmarks, and projected outcomes for improvement of the department's systems and controls. The plan ... shall address elements including:

- a. finance and accounting;
- b. budgeting;
- c. contract and grant management;
- d. administrative information systems; and
- e. other elements determined appropriate by the State Auditor.

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<sup>1</sup> The important initiatives include the *consolidation* or centralization of budgeting, accounting, human resources, grants and contract management, purchasing, and information resources staff and functions.

The Department has not achieved the intent of the *Business Practices Evaluation Report* because:

- The Department did not implement one of the most significant initiatives in the *Business Practices Evaluation Report*—the initiative to establish a permanent implementation and re-engineering team—in a timely manner. The *Business Practices Evaluation Report* considered the implementation team a critical component to ensuring that the recommendations were implemented. Ultimately, however, the implementation team was unable to address any significant Business Improvement Plan initiatives because the Department understaffed this team.

The Department eventually created Fiscal and Administrative Improvement Response (FAIR) teams to assume the implementation team's responsibilities.

However, the FAIR teams lacked the skill sets that the *Business Practices Evaluation Report* specified the implementation team should have. In addition, because the Department asked the FAIR teams to review their own functions, these teams lacked the independence they needed to conduct their review as the *Business Practices Evaluation Report* intended. The *Business Practices Evaluation Report* anticipated significant resistance from within the Department because of the magnitude of change envisioned in the Business Improvement Plan; therefore, that report called for a permanent implementation and re-engineering team to conduct the unbiased functional reviews (see text box).

**Functional Review Outlined in the  
*Business Practices Evaluation Report***

The *Business Practices Evaluation Report* recommended that the Department conduct a functional review of agency activities, asking questions such as:

- Is the activity necessary?
- Why are the functions of the activity performed the way they are performed?
- Could the function be performed in a more efficient or effective manner?
- Is the function staffed appropriately?
- Should the function or activity more appropriately reside elsewhere in the agency?
- Should the function or activity more appropriately reside outside the agency?

Source: Texas Department of Health *Business Practices Evaluation Report*; August 31, 2001.

- Neither the implementation team nor the FAIR teams conducted the functional review of the Department's activities recommended by the *Business Practices Evaluation Report*. However, the Department still proceeded to develop its reorganization plan. As a result, the Department is poised to reorganize without having evaluated how efficiently administrative functions are performed or the appropriateness of staffing levels in relation to workloads.
- The Department planned for its reorganization under the premise that no positions would be eliminated, and it has no plans to reduce the total number of staff performing administrative tasks. If the need for positions is not considered in conjunction with a functional review, many of the potential benefits of reorganizing and consolidating, such as economies of scale and sharing of resources, will be extremely difficult to attain.

## **The Business Improvement Plan Initiatives the Department Has Completed Are Considerably Less Complex than the Initiatives on Which It Has Not Acted**

The Department has fully implemented 37 (39 percent) of the 94 initiatives in its Business Improvement Plan (see Appendix 3 for a full list of initiatives and their implementation status). Of the remaining 57 initiatives, the Department chose to eliminate 7, and 50 initiatives are partially implemented or have been delayed for one of the following reasons:

- The Department continues to research and analyze its options.
- The Department is awaiting approval of internal policies or procedures.

Six of the seven initiatives the Department chose to eliminate were designed to improve its organizational structure. The seven initiatives it eliminated were:

- Create an Office of Inspector General.
- Create an Executive Deputy Commissioner for Programs position.
- Create an Associate Commissioner for Regional Operations position.
- Separate its human resources and support functions.
- Eliminate its Executive Deputy Commissioner position.
- Eliminate its Deputy Commissioner for Programs position.
- Recommend statutory change to convert independent boards to advisory committees.

Examples of the initiatives the Department has completed include initiatives to:

- Develop policies to standardize administrative procedures.
- Assign a project team to identify the best way to extract information from existing systems.
- Be proactive in communications with public media, including issuing more frequent press releases.
- Develop a database of frequently asked legislative questions.
- Create a committee of automation customers.
- Conduct a comprehensive salary review.

## Recommendations

The Department should:

- Conduct the functional review of the Department to ensure efficient and effective operations as recommended in the *Business Practices Evaluation Report*. The functional review should include an evaluation of the Department's activities, as well as an evaluation of the appropriateness of the staffing functions.
- Continue to implement its Business Improvement Plan in accordance with the intent of the *Business Practices Evaluation Report*.

## **The Department's Continuing Financial Weaknesses Significantly Reduce the Reliability of Its Financial Information**

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During the last ten years, more than a dozen audit reports by the State Auditor's Office and others have identified weaknesses in the Department's financial operations. As we reported in March 2001, "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 condition of the Department's financial information prevents us from determining the effect of these weaknesses on the Department's budget.

### **The Reliability of the Department's Financial Information Is Diminished**

The reliability of the Department's financial information is significantly diminished by the following issues identified during fiscal year 2002:

- The Department understated in its Annual Financial Report the amount of its fiscal year 2002 accounts payable by at least \$136 million. The Department reported \$18 million in accounts payable. However, its accounts payable for the first 60 days of fiscal year 2003 totaled \$154 million. Additional information on this issue will be available in the *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002*, which the State Auditor's Office will release in May 2003.
- The Department has not reconciled the information in its internal accounting system with the information in USAS. As a result, as of February 4, 2003, we estimated that the Department must make adjustments of \$318 million (with a net effect of \$122 million) to reconcile the cash balance recorded in USAS with the cash balance recorded in the Department's internal accounting system. Reconciling the financial information in related systems is a critical control in ensuring the completeness and accuracy of financial information. Additional information on this issue will be available in the *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002*, which the State Auditor's Office will release in May 2003.

The Department's personnel did not know how to obtain a trial balance from the internal accounting system to begin the reconciliation process; therefore, the Department could not use the information in the internal accounting system to complete its fiscal year 2002 Annual Financial Report and had to use USAS information instead. The

#### **Health and Human Services Administrative System (HHSAS)**

The Department began using its internal accounting system, the Health and Human Services Administrative System, on September 1, 2001. According to a Department internal audit report (*Follow-up on HHSAS Implementation*, Report Number 200214), the Department spent \$16.7 million through June 30, 2002, to implement this system.

Department began an intense attempt to reconcile its internal accounting system with USAS only after the State Auditor's Office and KPMG, LLP, which performs the federal portion of the Statewide Single Audit, explained that this was a serious problem.

- The Department's fiscal year 2002 Schedule of Expenditures of Federal Awards (Schedule 1A in its Annual Financial Report) was underreported by a total of \$214 million. The Department prepared this schedule using cash receipts information from its internal accounting system rather than actual expenditures. Additional information on this issue is available in KPMG's *Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002*.
- An August 2002 Department internal audit report (*Report of Our Examination of the Department's Health and Human Services Statewide Administrative Systems (HHSAS) Security*, Report Number 200204) stated that "the new HHSAS system is operating with inadequate system auditing, improper user function restrictions, and inadequate user account and maintenance controls."

### **The Department Still Has Not Complied with Federal Requirements Related to Indirect Cost Recovery Plans**

In a letter dated January 16, 2003, the federal government stated that the Department has not provided indirect cost-recovery plans to support its indirect cost rates for fiscal years 2002 through 2004. According to the U.S. Department of Health and Human Services, the continued noncompliance with this requirement could put the Department at potential risk for losing an estimated \$30 million in federal indirect costs reimbursements.

### **The Department Has Not Corrected Issues Identified in Our Prior Audit**

The Department also has not corrected financial weaknesses we identified in a previous audit report (*An Audit Report on Financial Management at the Department of Health*, SAO Report No. 01-021, March 2001). These issues include the following:

**The Department continues to incur a state interest liability to the federal government.** During fiscal year 2002, the Department incurred an interest liability of \$9,837 because it made expenditure adjustments that changed a transaction's method of financing from federal to state funds. As we stated in our prior report, "the Department uses expenditure transfers to maximize its overall funding by using General Revenue funds and carrying forward federal funds for later use."

The \$9,837 interest liability was calculated from the date the transfer occurred; it was not calculated from the date the Department drew down the funds from the federal government, as instructed by the U.S. Department of the Treasury Financial Management Services (see text box). When we calculated the interest liability as the federal government instructed, we estimated it could be \$762,000 (for the one transfer included in the Department's fiscal year 2002 *Cash Management Improvement Annual Report*).

**Excerpt from June 10, 2002, Letter from the U.S. Department of the Treasury Financial Management Services**

The transactions described in the audit finding created a state interest liability to the federal government, beginning on the date the state actually drew down the funds for the associated expenditures. ... The resulting federal interest liability should be remitted as a prior period adjustment on the next annual report.

In addition, the Department did not provide information regarding 15 other expenditure transfers to the Comptroller of Public Accounts (Comptroller); therefore, an interest liability has not been calculated on those transfers. Through these 15 expenditure transfers, the Department changed the method of financing for \$7 million in expenditures from federal funds to state funds.

**The Department continues to use expenditure adjustments to correct bookkeeping errors.** During fiscal year 2002, the Department made expenditure adjustments totaling more than \$248 million. We previously reported that the recurrent adjustments made to the Department's accounting information decreased the reliability and consistency of information provided to internal and external decision-makers.

**Excerpt from *An Audit on Financial Management at the Department of Health*, (SAO Report No. 01-021, March 2001)**

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.

We reviewed 42 (8 percent) of the 530 expenditure adjustments the Department made in fiscal year 2002. The 42 adjustments we reviewed totaled \$189 million, which represented 76 percent of the \$248 million in total adjustments. Our review found that:

- The Department made 12 adjustments totaling \$2 million that changed a transaction's method of financing from federal to state funds (discussed above).
- The Department made 17 adjustments totaling \$87 million to correct bookkeeping errors. For example, we noted a single expenditure transfer of nearly \$21.9 million that the Department indicated was "paid with wrong class code." The modification of transactions throughout the fiscal year decreases the consistency and comparability of information 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 Department continues to code expenditure vouchers incorrectly.** The Department incorrectly coded 29 (43 percent) of the 67 expenditure vouchers we tested. For example, the Department incorrectly coded vouchers totaling \$4.5 million that it used to pay the consultant who assisted with the implementation of its new accounting system. Rather than correctly coding these vouchers as “Consultant Services, Computer,” the Department erroneously coded them as “Other Professional Services.” These types of errors impair the comparability of the Department’s expenditures and weaken the reliability of the information the Department presents to decision makers and other users.

Two factors have contributed to the Department’s continuing inability to code expenditure vouchers correctly:

- After the Department implemented its new internal accounting system in September 2001, the number of staff responsible for entering expenditure vouchers into this system increased from approximately 20 to more than 200.
- Although the Department provided staff with training on the new internal accounting system, it did not provide staff with adequate training on expenditure coding that its Business Improvement Plan required.

**The Department has addressed budget transfer issues we identified in our prior report and has implemented procedures to ensure appropriation transfers are made within the limits of the Board of Health’s (Board) approval.** Through June 2002, the Department completed eight appropriation transfers totaling more than \$4.7 million. Rider 4, page II-31 of the General Appropriations Act (77th Legislature) permitted these transfers.

In addition, the Department has implemented procedures to ensure that it makes appropriation transfers within the limits of Board approval. We reviewed the appropriation transfers the Board approved on June 2001, September 2001, and June 2002. Additionally, we verified that the appropriation transfers were made in compliance with Rider 4.

The Department also complied with Rider 3, page II-31 of the General Appropriations Act (77th Legislature) regarding Medicaid transfer authority.

## **Recommendations**

The Department should:

- Ensure that it reconciles information in its internal accounting system to USAS and internal subsystems in a timely manner.
- Verify that its internal accounting system contains accurate and complete information.
- Consider providing additional training on its internal accounting system.

- Comply with federal requirements regarding the submission of indirect cost recovery plans.
- Clarify the method for calculating the interest liability owed to the federal government.
- Provide complete information in the Cash Management Improvement Act Report it sends to the Comptroller.
- Determine why bookkeeping error adjustments are made and establish appropriate processes to ensure that adjustments are minimized.
- Properly train personnel to enter accounting codes. The Department should consider a pre-test to determine the need for training and a post-test to assist with the evaluation of training.

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# Appendices

Appendix 1

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

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### **Objectives**

Our objectives were to answer the following:

- Has the Department of Health (Department) implemented the initiatives stated in its Business Improvement Plan?
- Has the Department achieved the intent of the recommendations stated in the Business Improvement Plan?
- Has the Department implemented the recommendations in our prior audit report (*An Audit Report on Financial Management at the Department of Health*, SAO Report No. 01-021, March 2001)?

### **Scope**

The scope of the audit covered various aspects of the Department's operations, including information systems and technology, budgeting, internal audit, human resources, grants and contract management, and accounting functions. We also reviewed ongoing issues in the Department's financial operations.

We did not review the Department's implementation of a new internal accounting system. The Department's internal auditor has released a report on the subject, and we intend to review that system in 2003.

### **Methodology**

During fieldwork, the audit team conducted interviews with Department personnel ranging from staff to executive levels. We also held discussions with various oversight agencies.

Information collected and reviewed to accomplish our objectives included the following:

- The Department's policies and procedures
- The Department's fiscal year 2001 and 2002 financial information obtained from the Uniform Statewide Accounting System (USAS)
- The Department's vouchers
- The Department's Internet and intranet sites
- The minutes from several Department group meetings

Procedures, tests, and analyses performed included the following:

- Analyzed fiscal year 2001 and 2002 transaction data from USAS.
- Conducted detailed transaction reviews, which included obtaining transaction support and interviewing Department staff to substantiate the appropriateness of transactions and associated coding of expenditures.
- Analyzed expenditure transfers and the effects of these transfers on other accounts. Reviewed expenditure transfers for appropriateness and timeliness.
- Performed a 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.
- Reviewed the Department's policies and procedures to determine whether the policies met the intent of the initiatives reviewed.

Criteria used to accomplish our objectives included the following:

- General Appropriations Act, 75th, 76th, and 77th Legislatures
- Texas Department of Health *Business Practices Evaluation Report*, August 31, 2001
- Code of Federal Regulations
- The Department's Business Improvement Plan
- Information provided by the U.S. Department of the Treasury Financial Management Services
- Texas Health and Safety Code
- Department policy and procedure manuals
- Other standard audit criteria established during fieldwork

### **Other Information**

We conducted fieldwork from March 2002 through December 2002. We conducted this audit in accordance with generally accepted government auditing standards.

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

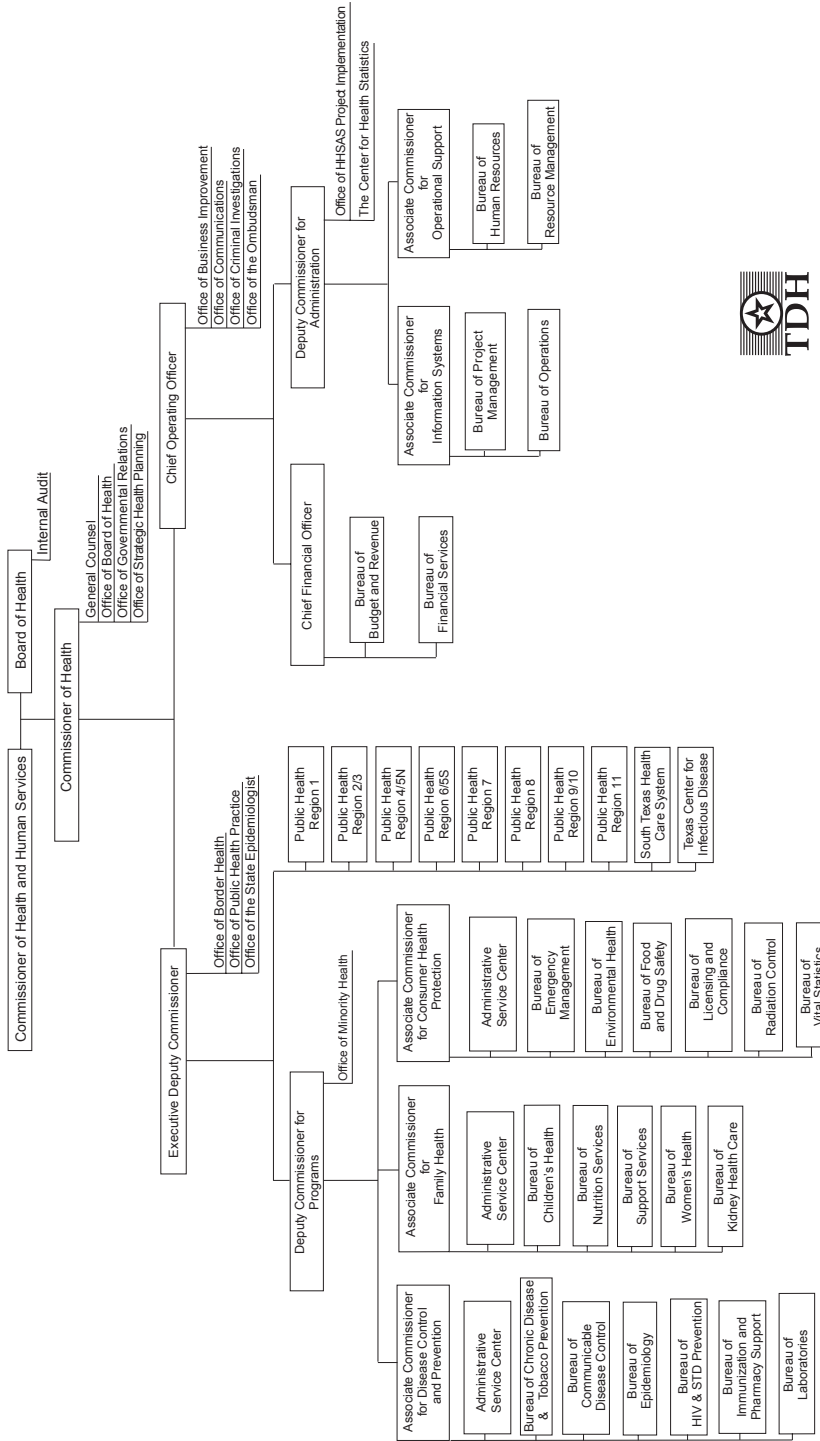
- John Young, MPAff, Project Manager
- Angelica Martinez, Assistant Project Manager
- John Quintanilla
- Juan Sanchez

- Dennis Bushnell, CPA (Quality Control Reviewer)
- Joanna B. Peavy, CPA (Audit Manager)
- Frank Vito, CPA (Audit Director)

# The Department's Current and Planned Organizational Structures

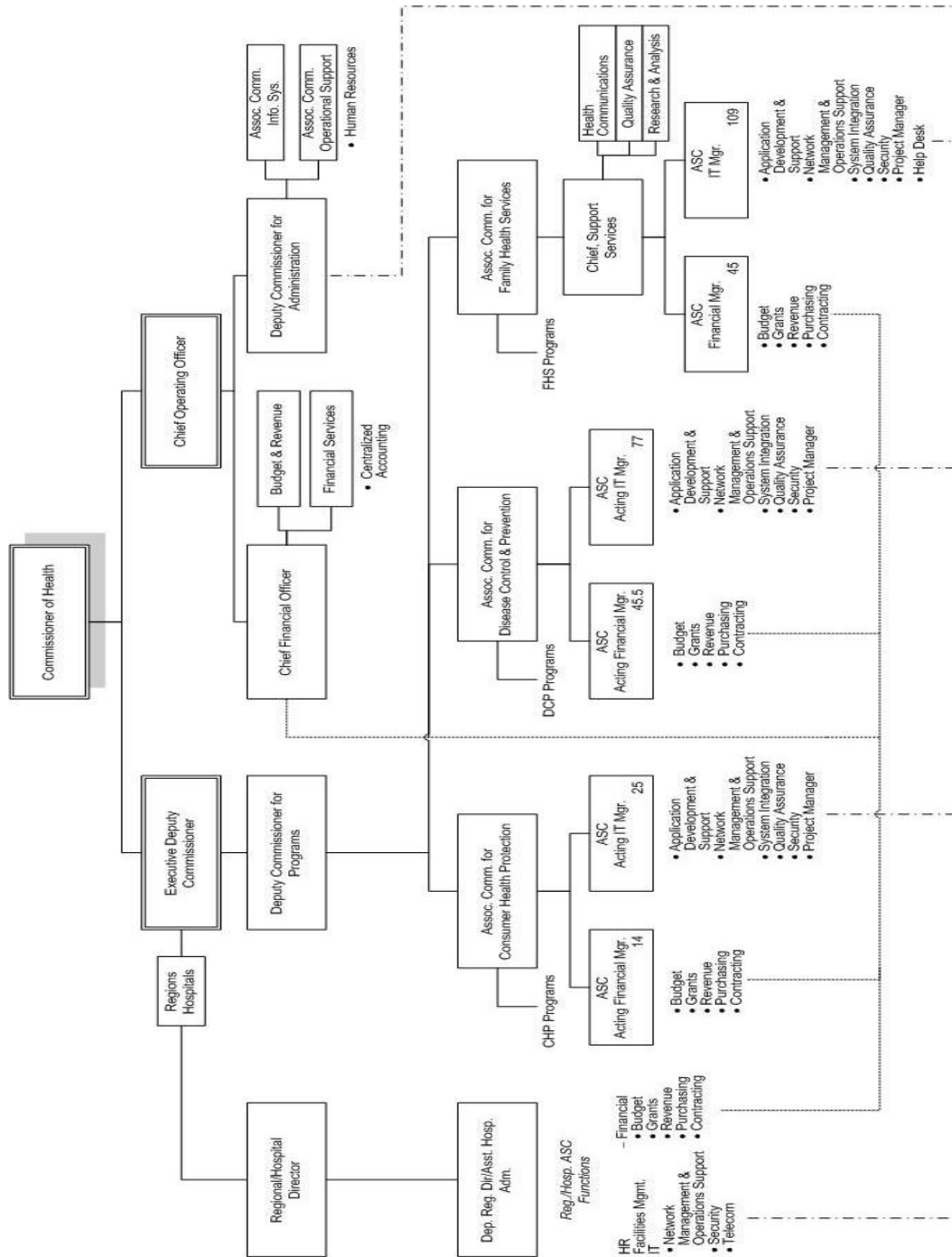
Below is the Department's current organizational structure.

## Texas Department of Health Organizational Chart January 2003



<http://www.tdh.state.tx.us/orgchart.htm>  
D-12

Below is the Department's planned organizational structure.





## Implementation Status of Initiatives in the Department's Business Improvement Plan

The information in the following table details status information as of September 2002.

Status of the Department's Business Improvement Plan Initiatives		
Initiative	Functional Area	State Auditor's Office Comments
<b>Initiatives the Department Has Eliminated</b>		
73. Create Office of Inspector General.	Human Resources	
75. Create Executive Deputy Commissioner for Programs.	Human Resources	
76. Create Associate Commissioner for Regional Operations.	Human Resources	
81. Separate human resources and support functions.	Human Resources	
82. Eliminate Executive Deputy Commissioner position.	Human Resources	
85. Eliminate Deputy Commissioner for Programs position.	Human Resources	
89. Recommend statutory change to convert independent boards to advisory committees.	Other	
<b>Initiatives for Which the Department Has Delayed Implementation</b>		
8. Complete SAIAF peer review.	Internal Audit	The State Agency Internal Audit Forum (SAIAF) released its Quality Assurance Review Report of the Department of Health on January 3, 2003.
17. Implementation team to present plan for functional review of agency.	Implementation Team	The implementation team did not perform functional reviews. The implementation team's responsibilities were shifted to the Fiscal and Administrative Improvement Response (FAIR) teams.
22. Develop plan for management training.	Human Resources	
27. Review performance journal process and implement modifications.	Human Resources	The Department shows this initiative as partially implemented in the December 2002 status report. This was not audited.
30. Formalize policy and procedure for budget process.	Budgeting and Accounting	
31. Centralize all budget and accounting policy and procedure.	Budgeting and Accounting	
32. Chief Financial Officer should review and refine budget development process.	Budgeting and Accounting	
33. Explain revised budget development process to agency management.	Budgeting and Accounting	
34. Produce monthly budget reports by program.	Budgeting and Accounting	The Department shows this initiative as implemented in the December 2002 status report. This was not audited.
35. Establish policy and procedure for regular budget monitoring.	Budgeting and Accounting	

Status of the Department's Business Improvement Plan Initiatives		
Initiative	Functional Area	State Auditor's Office Comments
<b>Initiatives for Which the Department Has Delayed Implementation (continued)</b>		
36. Hold program managers accountable for budget monitoring and reporting.	Budgeting and Accounting	
37. Consolidate Budget and Accounting staff.	Budgeting and Accounting	
41. Chief Financial Officer to review all federal fund expenditure policies.	Budgeting and Accounting	
45. Contract with expert to assess cost allocation methodology.	Budgeting and Accounting	
46. Cost allocation assessment complete and results included on the LAR.	Budgeting and Accounting	
47. Adopt cost allocation methodology.	Budgeting and Accounting	
48. Identify all direct and indirect administrative costs.	Budgeting and Accounting	
49. Coordinate with LBB to determine best method of providing administrative cost information to Leg.	Budgeting and Accounting	
50. Central office purchasing to establish all purchasing policy and procedure.	Contracting and Purchasing	
52. Centralize all grant and contract management policies and procedures.	Contracting and Purchasing	
53. Centralize grant and contract management staff.	Contracting and Purchasing	
56. Centralize all human resources policies and procedures.	Human Resources	
57. Consolidate all human resources staff.	Human Resources	The Department shows this initiative as partially implemented in the December 2002 status report. This was not audited.
63. Link managers' performance evaluation to adherence with information technology policy, standards, and procedures.	Human Resources	The Department shows this initiative as partially implemented in the December 2002 status report. This was not audited.
78. Consolidate all grant management functions under Chief Financial Officer.	Contracting and Purchasing	
79. Consolidate all purchasing functions under Chief Financial Officer.	Contracting and Purchasing	
80. Create Center for Health Statistics.	Human Resources	
<b>Initiatives the Department Has Partially Implemented</b>		
11. Advertising and publications cleared through Public Information Office.	Public Information and Customer Service	
14. Screen all requests for legislative action.	Public Information and Customer Service	
15. Establish permanent implementation and reengineering team.	Implementation Team	
16. Ensure compliance with Rider 2 by reporting progress on implementation of recommendation.	Implementation Team	The Department inaccurately reported the status of this initiative in its June 2002 status report.

Status of the Department's Business Improvement Plan Initiatives		
Initiative	Functional Area	State Auditor's Office Comments
<b>Initiatives the Department Has Partially Implemented (continued)</b>		
20. Develop central toll-free number.	Public Information and Customer Service	The Department shows this initiative as implemented in the December 2002 status report. This was not audited.
23. Use UT survey as management tool to target areas that need improvement.	Human Resources	
25. Consolidate grievance processes.	Human Resources	
26. Create Ombudsman function within Office of Equal Opportunity.	Human Resources	The Department shows this initiative as implemented in the December 2002 status report. This was not audited.
29. Implement PeopleSoft™.	PeopleSoft	This initiative was not audited at this time. The Department's internal auditor has completed an internal audit report covering this area. In addition, we will audit this area in fiscal year 2003.
40. Develop plan to train budget staff on expenditure coding.	Budgeting and Accounting	
42. Conduct internal audit to review budgeting and expenditure of appropriated funds.	Internal Audit	
51. Consider hybrid purchasing structure for regions.	Contracting and Purchasing	The Department shows this initiative as implemented in the December 2002 status report. This was not audited.  The Department has made purchases under a hybrid-purchasing structure; however, the Department is still reviewing a permanent policy.
54. Hold designated personnel accountable for meeting contract renewal dates.	Contracting and Purchasing	
58. Develop agency-wide approach to systems development and hardware software procurement.	Information Resource	
59. Adopt a system for reporting to executive staff of implementation of systems policy and procedure.	Information Resource	
61. Information Resources Steering Committee performs constant review of systems operations.	Information Resource	
62. Mandate standardization of application development, documentation, and procurement.	Information Resource	
65. Standardized Systems Development Life Cycle process must be followed on all software development.	Information Resource	
67. Immediate access to all local area networks granted to Information Systems staff.	Information Resource	
74. Have Communications Office, Government Relations, and Office of the Board of Health report to Chief Operating Officer.	Human Resources	The Department did not implement the initiative as recommended in the <i>Business Practices Evaluation</i> Report. Only the Office of Communications reports to the COO.

Status of the Department's Business Improvement Plan Initiatives		
Initiative	Functional Area	State Auditor's Office Comments
<b>Initiatives the Department Has Partially Implemented (continued)</b>		
84. Eliminate Office of Policy and Planning.	Human Resources	
86. Clarify central office authority for regulatory functions.	Other	
88. Plan to upgrade and consolidate licensing systems.	Other	
<b>Initiatives the Department Has Implemented</b>		
1. Hold personal meetings to keep legislature and staff informed of TDH activities.	Public Information and Customer Service	
2. Produce detailed audit reports to TDH executive management, Board, and State Auditor's Office.	Internal Audit	
3. Survey Internal Audit customers on report format, content, and length.	Internal Audit	
4. Audit reports become agenda items for discussion at executive staff meeting.	Internal Audit	
5. Produce quarterly reports on implementation status of all audit recommendations.	Internal Audit	
6. Board Chair and Commissioner should meet with State Auditor.	Public Information and Customer Service	
7. Request SAIAF peer review.	Internal Audit	
9. Be proactive in communications with public media including issuing more frequent press releases.	Public Information and Customer Service	
10. Strengthen media communication policy.	Public Information and Customer Service	
12. Staff Government Relations Office with people who know TDH.	Human Resources	
13. Develop database of frequently asked legislative questions.	Public Information and Customer Service	
18. Link implementation team to HHSC.	Implementation Team	
19. Status report on implementation of TDH customer service plan.	Public Information and Customer Service	
21. Comprehensive salary review.	Human Resources	
24. State guiding principles in personnel policy manual.	Human Resources	
28. Compile monthly reports from agency and publish on Intranet.	Implementation Team	
38. Chief Financial Officer to hold monthly budget meetings with bureau chiefs.	Budgeting and Accounting	Meetings are held quarterly rather than monthly.
39. Provide legislative leadership with advance notice of transfers and other budget issues.	Budgeting and Accounting	

Status of the Department's Business Improvement Plan Initiatives		
Initiative	Functional Area	State Auditor's Office Comments
<b>Initiatives the Department Has Implemented (continued)</b>		
43. Prepare annual financial report internally.	Budgeting and Accounting	Rather than use one of its 150 accountants, the Department hired an additional accountant to complete the annual financial report during fiscal year 2002.
44. Chief Financial Officer must meet personally with legislative staff.	Budgeting and Accounting	
55. Review contract administration "waiver" process.	Contracting and Purchasing	
60. Deputy Commissioner for Administration to chair Information Resources Steering Committee.	Information Resource	
64. Information Resources Manager should approve all new technology positions or reclassifications in the agency.	Human Resources	
66. Increase Internal Audit coverage of information technology policy and procedure.	Internal Audit	
68. All communication with Department of Information Resources and Legislative Budget Board regarding information technology issues must be coordinated with the Information Resources Manager's Office.	Information Resource	
69. Create a committee of automation customers.	Information Resource	
70. Hire Chief Operating Officer (COO).	Human Resources	The Department did not implement the initiative as recommended in the <i>Business Practices Evaluation Report</i> . The COO is not responsible for all areas noted in the initiative. The Offices of Strategic Planning, Government Relations, and Board of Health report to the Commissioner of Health.
71. Elevate Office of Equal Opportunity to report to Chief Operating Officer.	Human Resources	
72. Establish strategic planning as independent function.	Human Resources	
77. Elevate Chief Financial Officer to Deputy Commissioner level.	Human Resources	
83. Eliminate Chief of Staff position.	Human Resources	
87. Examine whether licensing functions should be consolidated.	Other	
90. Complete review of mail/remittance process and implement changes.	Other	
91. Assign project team to identify the best way to extract information from existing systems.	Other	The Department established the team, but extraction of information has not begun.
92. Project team report complete.	Other	
93. Design management reports.	Other	
94. Revise organizational chart.	Human Resources	

## Management's Responses

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### *TDH Management Response February 28, 2003*

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

*The Texas Department of Health (TDH) believes that "achieving the intent" of the Business Practices Evaluation (BPE) is a process, and we are well underway in that process. In our opinion, the intent of the BPE is stated in Elton Bomer's August 31, 2001 letter: "Changes must be endorsed, implemented, and maintained beginning at the highest level and throughout the Department." From Commissioner Sanchez through agency management and throughout TDH, we are changing and improving operations to more effectively fulfill our public health mission.*

*Similarly, with regard to our progress in implementing BPE recommendations, we immediately began that process; we have continued to implement the important business improvement initiatives; and we intend to go beyond the specific BPE recommendations in making improvements. The February 28, 2003 BPE status report shows the significant extent of our progress on all the initiatives, including the more complex ones. Currently, we have implemented in full or in part 86% of the 94 BPE initiatives. The SAO presents BPE status information as of September 2002. Since the SAO review in the summer of 2002 and their limited followup in the fall, TDH has continued to implement the important initiatives identified by the SAO, including the consolidation or centralization of budgeting, accounting, human resources, grants and contract management, purchasing, and information resources staff and functions.*

*With regard to financial operations, we acknowledge many of the points made by the SAO. In several areas noted in the SAO draft report, such as incorrect information in the Annual Financial Report (AFR), we have taken corrective action on both the specific situations and also the underlying systems. To some degree, the problems in the past year resulted from implementation of a new financial system, the Health and Human Services Administrative System (HHSAS). Implementation of HHSAS is one of the critical business improvement items addressed in both the financial audit and the BPE. Both maintained that HHSAS be implemented as a critical first step to improving financial management at TDH. Implementation of HHSAS is an objective for all HHSC agencies, and TDH's decision to move forward with the system in 1999 made us the test site. We have learned what can make implementation smoother, and the steps we have taken will both address those situations in our agency and better prepare the other HHSC agencies.*

*In some areas, corrective action is underway to strengthen our financial operations. In other areas, we disagree with the SAO assessment. Our detailed response to the SAO comments and recommendations provides specific information, including actions to be taken.*

## **Management's Response to Detailed Results in the SAO Report**

### **Regarding Implementation of Important Initiatives in the Business Improvement Plan**

*TDH began implementing initiatives in the Business Practices Evaluation (BPE) as soon as possible, and in some cases even before the review team issued the report. Naturally, the first ones to be implemented were the ones that were less complex. We began work on the more complex and important business improvement initiatives, and we have continued to implement them.*

*The SAO presents BPE status information as of September 2002 (Appendix 3 of the SAO report). TDH has continued to implement BPE initiatives, and as of February 28, 2003 we have implemented in full or in part 86% BPE initiatives – 81 of the 94. (See the TDH Appendix attached.) Many of the initiatives in progress or implemented in full are the important and more complex ones identified by the SAO, such as the consolidation or centralization of budgeting, accounting, human resources, grants and contract management, purchasing, and information resources staff and functions. TDH's February 28, 2003 BPE status report shows the details of our progress on BPE initiatives. A comparison of the SAO information as of September 2002 with the current status illustrates the extent of TDH's progress. For example, the SAO calculates that as of September 2002, there was full implementation of 37 (39%) of the 94 BPE initiatives and partial implementation of 23 (24%). As a result of our continued work, as of the end of February 2003, we have fully implemented 53 (56%) BPE initiatives. Another 28 (30%) have been partially implemented. Our work making improvements will not end with addressing the BPE initiatives. We intend to go beyond the specific BPE recommendations in making improvements.*

*The work done in the past 15 months has strengthened TDH's operations and has significantly contributed to the job of breaking down the organizational "silos." Important changes include standardizing key administrative policies, developing standards for information technology, and consolidating certain administrative operations and centralizing others. We strengthened the business improvement team in December 2002 with a Director and an individual with expertise in information systems.*

*With regard to achieving "the intent" of the BPE, we disagree with the SAO interpretation. In our opinion, "achieving the intent" of the BPE involves a process, and we are well underway in that process. The intent as described in Elton Bomer's August 31, 2001 letter is that "Changes must be endorsed, implemented, and maintained beginning at the highest level and throughout the Department." From Commissioner Sanchez through agency management and throughout TDH, we are changing and improving operations to more effectively fulfill our public health mission.*

*The SAO appears to base their conclusion on TDH's delay in establishing the permanent business improvement team and an assumption that TDH did not conduct a "functional review" as called for by the BPE. In our opinion, we have conducted functional reviews and continue to do so.*

*Rather than start with a functional review of the entire agency – a complex task by any measure – we started with functional reviews of the fundamental administrative systems identified in the BPE as needing improvement. In the spring of 2002, the Chief Financial Officer, the Deputy Commissioner for Administration and the Deputy Commissioner for Programs initiated a comprehensive set of functional reviews of critical administrative operations, including budgeting, accounting, revenues, human resources, grants and contract management, purchasing, and information resources.*

*The functional reviews were performed by “Fiscal and Administrative Improvement Response” (FAIR) teams composed of individuals in administrative and program areas from both Austin and the regions/hospitals. The composition of the FAIR teams is in itself a sign of our commitment to change, to breaking down the “silos” and to achieving the intent of the BPE. We involved the staff who perform the functions because we believe that developing understanding at that level is the best way to achieve successful change. We took action to begin consolidation or centralization of various functions to set the direction and maintain momentum, and we will undertake additional analyses to achieve the efficiencies expected from these kinds of changes. To provide the external perspective, TDH engaged a consultant, Deloitte and Touche, to evaluate how effectively the FAIR teams’ recommendations addressed the issues identified by the SAO and the BPE.*

*The BPE suggests some questions that could be used in a functional review, with the first one relating to whether the activity is necessary. The functions we began reviewing were core administrative functions that did not require extensive analysis on that question; we knew they were necessary. Five other questions related to how, and with what resources, functions are performed. The external consultants indicated that TDH had addressed four of these five topics:*

- 1) The FAIR teams’ gap analyses addressed why functions are performed the way they are.*
- 2) Through the gap analyses and the identification of best practices, the FAIR teams considered whether the function could be performed more efficiently or effectively.*
- 3) Certain FAIR teams, such as the Human Resources team, addressed the issue of whether the function is staffed appropriately.*
- 4) The FAIR team recommendations addressed whether the function should reside elsewhere in the agency.*

*The fifth question asked whether the function should reside outside the agency. While the FAIR teams did not address this specifically, TDH has participated in HHSC activities relating to the consolidation of administrative functions.*

*A centerpiece recommendation of the FAIR teams – but not their only deliverable – was the creation of Administrative Service Centers (ASCs). We view the ASCs as an appropriate and effective method of consolidating administrative staff in a way that also provides efficient customer service in the agency. The SAO indicates that the ASCs will “add another layer of management” in the department, but this is not necessarily the case. In our opinion, the ASCs provide us with the means of enhancing standardization and control while remaining responsive to the customers*



who receive our services. We view the creation of the ASCs as what may be a transitional step to reach the goals of a more streamlined and efficient organization. In assessing the possibility of further centralization, we will continue to consider how changes will affect our customers.

TDH plans to begin a second phase of functional reviews of administrative operations, including contract administration, monitoring and payments. The subjects of these reviews will take into account issues that arise from the legislative session and areas that the business improvement office may identify during its evaluation of the ASCs. These functional reviews will address the questions recommended by the BPE and SAO. Additionally, our continued work on administrative improvements through the ASCs will include performing the kinds of analyses, including workload assessments, recommended by the SAO.

Finally, the business improvement office also performed functional reviews, and will continue to do so. Early reviews related to specific administrative operations, including:

- The process used to distribute payroll checks for employees in TDH regions, resulting in more timely delivery of the checks and a more streamlined process using fewer administrative personnel.
- The system for managing use of ProCards, resulting in a significant reduction in the number of cards used, improved timeliness of payment, reduced interest payments, and improved controls over card use.

TDH developed a plan for conducting functional reviews, including reviews of program operations. The business improvement office has begun these reviews.

### ***TDH Response to the SAO Recommendations on Business Improvement***

#### ***Conduct the functional review of the Department***

TDH has conducted and will continue to conduct functional reviews of agency operations. The FAIR teams reviewed administrative operations. The business improvement office has begun functional reviews of certain program operations. We will continue to seek guidance from the SAO on the scope and methodologies that should be used in performing the most effective functional reviews.

#### ***Continue to implement the Business Improvement Plan in accordance with the intent of the BPR.***

TDH will continue to implement what we believe to be the intent of the BPE and will even go beyond the BPE recommendations in making improvements in agency operations.

#### ***Regarding TDH Financial Operations***

We acknowledge many of the points made by the SAO regarding our financial operations. In several areas noted in the SAO draft report, such as incorrect

*information in the Annual Financial Report (AFR), we have taken corrective action on the specific point and also in the systems that led to the situations. To some degree, as we discuss below, the problems in the past year resulted from implementation of a new financial system, the Health and Human Services Administrative System (HHSAS).*

*Following is a summary of key issues relating to TDH financial operations and corrective actions.*

*A new system (HHSAS)*

*Several of the SAO findings are the result of implementing a new financial system. These include:*

- Reconciliation of the internal accounting system to USAS*
- Understatement of accounts payable (in the AFR), and*
- Underreporting of fiscal year 2002 total expenditures (in the AFR).*

*HHSAS is one of the critical business improvement items addressed in both the financial audit and the BPE. Both maintained that HHSAS be implemented as a critical first step to improving financial management at TDH. Implementation of HHSAS is an objective for all HHSC agencies, and TDH's decision to move forward with the system in 1999 made us the test site. We have learned what can make implementation smoother, and the steps we have taken will both address those situations in our agency and better prepare the other HHSC agencies.*

*Reconciliations*

*SAO states that we did not begin a serious attempt to reconcile the internal accounting system until the issue was brought to our attention by SAO and KPMG. In fact, TDH was making significant efforts regarding this issue even before that time. We had contacted potential contractors and were working with our purchasing staff to bring these individuals on board to help reconcile our books by the end of December 2002. We discussed this issue with the SAO in November, told them of our plan and the target date of December 20<sup>th</sup> and met with them regularly so that they could begin auditing as we completed reconciling specific appropriations. We have worked with the Comptroller's Office on a similar process to catch up 2003, and we are implementing a process to keep this current.*

*One of the challenges in the reconciliation process has been recording into HHSAS entries made directly into USAS (by another agency). The difficulty results from the additional detail required by HHSAS. Two items remain not reconciled for FY 2002:*

- 1) The Suspense Fund is off by \$6,000 out of a balance of \$79,000 for AY 01, and*

2) *Unappropriated General Revenue for AY 02 has an unidentified balance of \$11,838 out of a balance of \$10.9 million. We are continuing to work these items.*

*It is also important to note that strides were taken to correct this situation before November but without much success due to the lack of understanding of the new system. HHSC and TDH are planning a HHSAS users group similar to the USAS users group, which will allow the health and human service agencies to learn from each others' experiences.*

#### *The AFR*

*The AFR preparation was brought back in-house at the last moment for FY 2001 as recommended by the SAO. This report was prepared by the Bureau Chief, who was the only individual within the agency experienced in preparing an AFR. The FY 2001 report was developed from the legacy system. Staff were unclear regarding the impact of the new financial system on development of the AFR and thus underestimated the time necessary to complete this report. This one-time shortcoming should not occur in the future.*

#### *Needs in staffing/skills/other areas*

*We have reorganized our staff and are working to fill critical positions with the appropriate skill sets to address these areas of concern. Additionally, we are reviewing all positions with a fiscal classification throughout the agency to determine the appropriateness of those classifications.*

*TDH has taken several steps to improve security of the financial systems. These include modifying the system to require users to change passwords and converting our contract development system to the Citrix system. Additionally, staff review and remove access privileges each week from individuals who have terminated from the agency. We are currently in the process of implementing a security check similar to the Comptroller's Office to review access privileges and to account for any other changes to an individual's job within the agency.*

*TDH recently employed Maximus to assist us with the FY 2004 Indirect Cost Plans. Staff are revising the FY 2002 and FY 2003 plans based on conversations with the federal government. All three plans will be submitted to the Department of Health & Human Services February 28, 2003.*

#### *Interest liability incurred from expenditure transfers*

*We will work with the SAO to understand the basis of the \$9,837 figure in the audit report. TDH calculated the interest liability incurred from expenditure transfers between state and federal funds at \$4,913 during FY 2002. We made an informed decision regarding this transfer. Depending upon how interest was calculated, the potential interest ranged from a minimum of \$500 to a maximum of \$50,000, but allowed TDH to invest \$1.8 million in federal funds in a program that had already seen significant reductions. TDH has worked closely with the Comptroller's Office in reporting of this*

*expenditure transfer and we will continue to follow their guidance. This may be an issue the Comptroller's Office and SAO need to resolve between themselves, because it is a broader statewide issue.*

*It was TDH's executive management's intent to report all previous transfers. In investigating this finding, we have determined that the transfer noted by the SAO in their March 2001 report was not reported in our Cash Management Improvement Act (CMIA) report, nor were approximately 14 other transfers done between December 2000 and August 2001. We will ensure all of these are reported in the 2003 CMIA report (the first available opportunity to make this correction).*

#### *Expenditure Adjustments*

*Expenditure adjustments are a necessary business practice. We previously provided an explanation to the SAO on our expenditure adjustments.*

*Following is a summary of corrective actions intended to strengthen TDH financial operations.*

*Actions already taken include employing contractors to assist with backlogs in reconciliations and with development of indirect cost plans; replacement of the General Ledger Manager, the Fiscal Director and the Bureau Chief of Financial Services; and FAIR team reviews of certain accounting practices.*

*In the immediate term, we are taking a number of actions to address financial operations issues, including:*

- Executing an interagency contract with the Comptroller's Office to assist with hiring of key personnel, review of position classifications and coordination of training for USAS.*
- Coordination with the Comptroller's Office to provide specialized training on USAS, including object codes; transaction codes; and uses and interpretations of reports and inquiry screens.*
- Reviewing the process for reconciliations to ensure it is well defined, understood by staff and completed monthly.*
- Reviewing the skill sets necessary for certain key positions and working to fill them with qualified individuals.*
- Implementation by March 2003 of FAIR team policies and procedures regarding voucher payment and coding.*
- Implementation of the 2003 indirect cost allocation plan, which will be submitted on February 28, 2003. Contract monitoring will be considered a direct cost and will be funded from the program strategies.*
- Reviewing, with participation by the business improvement office, payment processing to contractors.*

*Longer term solutions will include additional training for staff on HHSAS and continued development of effective reports.*

*In other areas, we disagree with the SAO assessment. Specific comments are provided in our responses to the SAO recommendations.*

### ***TDH Response to the SAO Recommendations on Financial Operations***

*Ensure that internal accounting information is reconciled to USAS.*

*We have initiated the corrective actions described above to address this issue.*

*Verify that the internal accounting system contains accurate information.*

*We have taken corrective action on the specific point and also in the systems that led to the situations.*

*Consider providing additional training on the TDH internal accounting system.*

*We are working with the Comptroller's Office to arrange for training to address our specific needs.*

*Comply with federal requirements regarding the submission of indirect cost recovery plans.*

*We disagree with this SAO recommendation. TDH submitted the information for 2002-2003 on time, and we subsequently identified needed corrections. We will submit the changes by February 28, 2003. We will submit the appropriate information for the 2004 plan by the February 28, 2003 due date.*

*Clarify the method for calculating interest liability owed the federal government.*

*We disagree with this SAO recommendation. TDH incurred a state interest liability to the federal government from a change in a transaction's method of financing from federal to state. The situation occurred in a Title V grant for which a reconciliation had never been required. When reconciling this grant over a 10-year time period, an error was discovered, and TDH found it necessary to make an adjustment to fill a resulting shortfall in program funding. The SAO states that we are not calculating interest exactly as the federal government instructed. We emphasize that TDH is following the Comptroller's guidance on this issue. In our discussions with the SAO on this subject, they recommended involving federal government representatives in resolving this issue. We will involve federal government representatives in resolving this issue.*

*The SAO also recommends that TDH complete a cost-benefit analysis before changing the method of financing from federal to state funds. We believe this type of change happened only once in the last year, and we did evaluate the potential interest charges.*

Provide complete information to the Comptroller.

*We have initiated the corrective actions described above to address this issue.*

Determine why bookkeeping error adjustments are made and take action to minimize adjustments.

*The SAO states that TDH uses expenditure adjustments to “correct bookkeeping errors.” We believe this mischaracterizes the expenditure adjustments we have performed for business purposes.*

*Additionally, expenditure transfers may be necessary under a process for handling expenditures paid from Tobacco Settlement receipts. This issue has statewide applicability beyond TDH. We will take steps to resolve this issue by involving the Comptroller’s Office.*

Properly train personnel to enter accounting codes.

*We have initiated the corrective actions described above to address this issue.*

**TDH Appendix – Status of BPE Initiatives**

**Implementation Status of Initiatives in the Department’s Business Improvement Plan**

*The information in the following table details status information of the Department’s implementation of BPE initiatives as of February 28, 2003.*

<b>Status of the Department’s Business Improvement Plan Initiatives</b>		
<b>Initiatives for Which the Department Has Delayed Implementation</b>		
<b>Initiative</b>	<b>Functional Area</b>	<b>TDH Comments</b>
36. Hold program managers accountable for budget monitoring and reporting.	Budgeting and Accounting	
46. Cost allocation assessment complete and results included on the LAR.	Budgeting and Accounting	
47. Adopt cost allocation methodology.	Budgeting and Accounting	
48. Identify all direct and indirect administrative costs.	Budgeting and Accounting	
49. Coordinate with LBB to determine best method of providing administrative cost information to the legislature.	Budgeting and Accounting	
86. Clarify central office authority for regulatory functions.	Other	

<b>Status of the Department’s Business Improvement Plan Initiatives</b>		
<b>Initiatives for Which the Department Has Partially Implemented</b>		
<b>Initiative</b>	<b>Functional Area</b>	<b>TDH Comments</b>
11. Advertising and publications cleared through the Office of Communications.	Public Information and Customer Service	Implementation in progress
15. Establish permanent implementation and reengineering team.	Implementation Team	Implementation in progress
22. Develop plan for management training.	Human Resources	Implementation in progress
27. Review performance journal process and implement modifications.	Human Resources	Implementation in progress
30. Formalize policy and procedure for budget process.	Budgeting and Accounting	Implementation in progress
31. Centralize all budget and accounting policy and procedure.	Budgeting and Accounting	Implemented in part
32. Chief Financial Officer should review and refine budget development process.	Budgeting and Accounting	Implementation in progress
33. Explain revised budget development process to agency management.	Budgeting and Accounting	Implementation in progress
35. Establish policy and procedure for regular budget monitoring.	Budgeting and Accounting	Implementation in progress
40. Develop plan to train accounting staff on expenditure coding.	Budgeting and Accounting	Implementation in progress

**Initiatives for Which the Department Has Partially Implemented (con't)**

<b>Initiative</b>	<b>Functional Area</b>	<b>TDH Comments</b>
41. Chief Financial Officer to review all federal fund expenditure policies.	Budgeting and Accounting	Implementation in progress
42. Conduct internal audit to review budgeting and expenditure of appropriated funds.	Internal Audit	Implementation in progress
45. Contract with expert to assess cost allocation methodology.	Budgeting and Accounting	Implementation in progress
50. Central office purchasing to establish all purchasing policy and procedure.	Contracting and Purchasing	Implementation in progress
52. Centralize all grant and contract management policies and procedures.	Contracting and Purchasing	Implementation in progress
54. Hold designated personnel accountable for meeting contract renewal dates.	Contracting and Purchasing	Implementation in progress
57. Consolidate all human resources staff.	Human Resources	Implementation in progress
58. Develop agency-wide approach to systems development and hardware software procurement.	Information Resource	Implementation in progress
59. Adopt a system for reporting to executive staff of implementation of systems policy and procedure.	Information Resource	Implementation in progress
61. Information Resources Steering Committee performs constant review of systems operations.	Information Resource	Implementation in progress
62. Mandate standardization of application development, documentation, and procurement.	Information Resource	Implementation in progress
63. Link managers' performance evaluation to adherence with IT policy, standards, and procedures.	Human Resources	Implementation in progress
65. SDLC process must be followed on all software development.	Information Resource	Implementation in progress
67. Immediate access to all local area networks granted to Information Systems staff.	Information Resource	Implementation in progress
74. Have Communications Office, Government Relations, and Office of the Board of Health report to Chief Operating Officer.	Human Resources	Implemented in part
79. Consolidate all purchasing functions under Chief Financial Officer.	Contracting and Purchasing	Implementation in progress
84. Eliminate Office of Policy and Planning.	Human Resources	Implemented in part
88. Plan to upgrade and consolidate licensing systems.	Other	Implementation in progress



<b>Status of the Department's Business Improvement Plan Initiatives</b>		
<b>Initiatives for Which the Department Has Implemented</b>		
<b>Initiative</b>	<b>Functional Area</b>	<b>TDH Comments</b>
1. Hold personal meetings to keep legislature and staff informed of TDH activities.	Public Information and Customer Service	Immediate and ongoing
2. Produce detailed audit reports to TDH executive management, Board, and State Auditor's Office.	Internal Audit	Immediate and ongoing
3. Survey Internal Audit customers on report format, content, and length.	Internal Audit	9/1/2001
4. Audit reports become agenda items for discussion at executive staff meeting.	Internal Audit	11/1/2001
5. Produce quarterly reports on implementation status of all audit recommendations.	Internal Audit	5/1/2002
6. Board Chair and Commissioner should meet with State Auditor.	Public Information and Customer Service	11/30/2001
7. Request SAIAF peer review.	Internal Audit	10/2/2001
8. Complete SAIAF peer review.	Internal Audit	1/3/2003
9. Be proactive in communications with public media including issuing more frequent press releases.	Public Information and Customer Service	Immediate and ongoing
10. Strengthen media communication policy.	Public Information and Customer Service	4/18/2002
12. Staff Government Relations Office with people who know TDH.	Human Resources	2/1/2002
13. Develop database of frequently asked legislative questions.	Public Information and Customer Service	11/30/2001
14. Screen all requests for legislative action.	Public Information and Customer Service	6/1/2002
16. Ensure compliance with Rider 2 by reporting progress on implementation of recommendation.	Implementation Team	12/1/2001
17. Implementation team to present plan for functional review of agency.	Implementation Team	9/1/2002
18. Link implementation team to HHSC.	Implementation Team	1/25/2002
19. Status report on implementation of TDH customer service plan.	Public Information and Customer Service	5/31/2002
20. Develop central toll-free number.	Public Information and Customer Service	9/6/2001
21. Comprehensive salary review.	Human Resources	5/31/2002
23. Use UT survey as management tool to target areas that need improvement.	Human Resources	12/12/2002
24. State guiding principles in personnel policy manual.	Human Resources	
25. Consolidate grievance processes.	Human Resources	10/1/2002
26. Create Ombudsman function within Office of Equal Opportunity.	Human Resources	10/1/2002
28. Compile monthly reports from agency and publish on Intranet.	Implementation Team	5/31/2002

<i>Initiatives for Which the Department Has Implemented (con't)</i>		
<i>Initiative</i>	<i>Functional Area</i>	<i>TDH Comments</i>
29. Implement PeopleSoft™.	PeopleSoft	12/9/2002
34. Produce monthly budget reports by program.	Budgeting and Accounting	11/12/2002
37. Consolidate Budget and Accounting staff.	Budgeting and Accounting	12/1/2002
38. Chief Financial Officer to hold monthly budget meetings with bureau chiefs.	Budgeting and Accounting	3/1/2002
39. Provide legislative leadership with advance notice of transfers and other budget issues.	Budgeting and Accounting	Immediate and ongoing
43. Prepare annual financial report internally.	Budgeting and Accounting	11/20/2001
44. Chief Financial Officer must meet personally with legislative staff.	Budgeting and Accounting	Immediate and ongoing
51. Consider hybrid purchasing structure for regions.	Contracting and Purchasing	12/1/2002
53. Centralize grant and contract management staff.	Contracting and Purchasing	1/10/2003
55. Review contract administration "waiver" process.	Contracting and Purchasing	8/31/2002
56. Centralize all human resources policies and procedures.	Human Resources	1/10/2003
60. Deputy Commissioner for Administration to chair Information Resources Steering Committee.	Information Resource	3/22/2002
64. Information Resources Manager should approve all new technology positions or reclassifications in the agency.	Human Resources	3/8/2002
66. Increase Internal Audit coverage of information technology policy and procedure.	Internal Audit	Immediate and ongoing
68. All communication with Department of Information Resources and Legislative Budget Board regarding information technology issues must be coordinated with the Information Resources Manager's Office.	Information Resource	Immediate and ongoing
69. Create a committee of automation customers.	Information Resource	3/5/2002
70. Hire Chief Operating Officer (COO).	Human Resources	10/1/2001
71. Elevate Office of Equal Opportunity to report to Chief Operating Officer.	Human Resources	11/1/2001
72. Establish strategic planning as independent function.	Human Resources	12/1/2002
77. Elevate Chief Financial Officer to Deputy Commissioner level.	Human Resources	2/1/2002
78. Consolidate all grant management functions under Chief Financial Officer.	Contracting and Purchasing	1/10/2003
80. Create Center for Health Statistics	Human Resources	12/1/2002
83. Eliminate Chief of Staff position.	Human Resources	11/1/2001
87. Examine whether licensing functions should be consolidated.	Other	5/31/2002

<i>Initiatives for Which the Department Has Implemented (con't)</i>		
<i>Initiative</i>	<i>Functional Area</i>	<i>TDH Comments</i>
90. Complete review of mail/remittance process and implement changes.	Other	10/1/2001
91. Assign project team to identify the best way to extract information from existing systems.	Other	2/28/2002
92. Project team report complete.	Other	4/9/2002
93. Design management reports.	Other	9/1/2002
94. Revise organizational chart.	Human Resources	11/1/2001

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The Honorable David Dewhurst, Lieutenant Governor, Vice Chair  
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### **Department of Health**

Dr. Eduardo Sanchez, Commissioner of Health



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