

# Executive Summary

The objective of the annual statewide financial and compliance audit is to answer the following questions:

**Are the State's 1998 financial statements, as presented in the *Comprehensive Annual Financial Report*, accurate and presented in accordance with accounting principles established for governments?**

In our opinion, the 1998 financial statements accurately represent the State's financial activity and balances for the fiscal year in accordance with government accounting principles.

**Has the State complied with federal and other requirements that govern the way funds received from various sources can be spent?**

The State does well at complying with federal and other requirements. In general, state agencies and universities have policies and procedures in place to be sure that the State complies with requirements on how federal funds should be spent. This is important because the State received about \$17 billion in federal funds this year. The State must show compliance with the federal requirements in order to continue receiving this funding.

The statewide financial and compliance audit is done to provide this compliance assurance to the federal government. While this audit focuses on compliance with federal requirements, we also report information on compliance with state laws and requirements contained in bond covenants.

Although the agencies and universities are generally complying with the federal and other requirements, we did

find some instances of noncompliance and areas that need improvement. All of our findings, recommendations, and management responses are included in this report. The most widespread problem that we noted was in the area of contract administration.

## **Contract Administration Continues to Be a Concern**

After performing the statewide financial and compliance audit for several years, we have reached the conclusion that state agencies and universities are generally good at managing programs and services that they administer themselves. However, state agencies and universities do not perform as well at monitoring and enforcing contracts with outside parties.

The State must ensure that contracts are written and the performance of contractors is monitored so that the State gets the quality and amount of service for which it paid. This is complicated further when the services are being paid for with federal funds because the State maintains responsibility for making sure that all the federal requirements are followed even when someone else provides the service. In 1998 the State paid as much as \$10 billion in federal funds to contractors for various programs and services ranging from health and human services to business and economic development.

We found significant weaknesses regarding contract monitoring at three entities: Commission on Alcohol and Drug Abuse, Texas Education Agency, and the Department of Protective and Regulatory Services.

# Executive Summary

A majority of the significant contract issues for the above agencies fall into the following categories:

- Not identifying which contracts have the highest risk of noncompliance
- Not adjusting monitoring plans based on the highest risk contracts
- Late receipt and review of contractor reports
- Inadequate or nonexistent contract monitoring tracking systems
- Incomplete file documentation

(See the Summary of Most Significant Findings for further information on these issues.)

We found less significant, but similar issues at nine other agencies. These agencies were:

- Interagency Council on Early Childhood Intervention
- General Services Commission
- Department of Health
- Department of Housing and Community Affairs
- Department of Mental Health and Mental Retardation
- Texas Agricultural Experiment Station
- Texas Engineering Experiment Station
- The University of Texas M.D. Anderson Cancer Center
- Texas Workforce Commission

(See the Schedule of Findings and Questioned Costs for finding detail with management response.)

The instances noted of state agencies not holding contractors accountable shows that this responsibility

continues to be a concern for the State. The State Auditor's Office (SAO) has issued several reports over the past five years relating to contract administration. The Legislature has passed legislation aimed at improving contract administration. It is up to management of state agencies and universities to ensure that they make the changes necessary to provide effective contract administration in their organizations.

## Our Compliments for the Following Achievements

While the primary purpose of this report is to provide information on the areas for improvements, we do not want to overlook significant achievements made this year.

- The State is currently in the process of addressing the Year 2000 (Y2K) situation. The Y2K situation relates to problems concerning computer programs using only the last two digits to refer to a year. Computer programs would have difficulty distinguishing between 1900 and 2000 since both years would be "00" without corrections to the programs. Also, electronic equipment that uses date dependent computer chips (embedded systems) may fail.

As of August 31, 1998, all agencies and universities were aware of the Y2K situation and had completed an inventory of systems to be considered for correction. All programs, except for the Texas Child Support Enforcement System at the Office of the Attorney General, were in the process of being corrected.

# Executive Summary

According to the Office of the Attorney General, corrections have since been started and are well underway. The May 1999, status report from the State's Department of Information Resources shows that this system has been moved from "at risk" status to "watch" status.

The agencies and universities were still inventorying electronic equipment to be addressed for the Y2K situation.

Information about the status of Y2K situation is included in the *Comprehensive Annual Financial Report (CAFR)* and was audited by the SAO. The State of Texas was one of the few states to have this information audited.

- The Comptroller of Public Accounts (Comptroller) has worked with agencies and universities to ensure that the Uniform Statewide Accounting System (USAS) information agrees with their internal accounting systems. This has enabled the Comptroller to continue its progress toward utilizing USAS as the primary source for preparing the *CAFR*. The *CAFR* information for 141 entities was taken from USAS for fiscal year 1998. This is a 57 percent increase over fiscal year 1997.
- External auditors found that all of the 29 agencies and universities they audited complied with all significant bond covenant requirements. At the end of fiscal year 1998, the State had \$11 billion in bonds payable.

For more information on the accomplishments discussed, see the section titled Our Compliments.

## Summary of Our Audit Objectives and Scope

The objectives of the 1998 Statewide Financial and Compliance Audit were to:

- Determine whether the financial statements of the State present fairly the financial position, results of operations, and cash flows in accordance with generally accepted accounting principles.
- Fulfill audit requirements of the Single Audit Act of 1984 as amended in 1996 (federal compliance).
- Determine compliance with significant bond covenants.

The State Auditor's Office performed the following procedures:

- We tested accounts significant to the statewide financial statements. We also performed procedures to determine whether information reported in the financial statements was consolidated properly.
- We gained an understanding of the overall control environment and the financial controls over significant statewide and bond-related accounts. We also gained an understanding of administrative controls related to the federal programs examined. Audit work was conducted at 36 state entities.
- We determined compliance with federal program requirements in accordance with *Office of*

# Executive Summary

*Management and Budget (OMB) Circular A-133.* We conducted audit work that covers 32 federal programs and nearly 58 percent of the total federal assistance received during the year. *OMB Circular A-133* only requires the State to cover 50 percent of

federal assistance received each year.

- We contracted out the audit work on bond covenants to an external audit firm. We monitored and reviewed their work.

## Summary of Most Significant Findings

A summary of the most significant findings noted during the 1998 Statewide Financial and Compliance Audit is included below. The entire text of the findings, management responses, and corrective action plans can be found in the Schedule of Findings and Questioned Costs section of this report.

### State of Texas

Reference No. 99-555-97

#### Summary of Finding:

Eight of eleven universities included in the 1998 Financial and Compliance Audit are not observing certain federal requirements for reporting enrollment changes. As a result, the State of Texas is in material noncompliance with this one requirement of the *Federal Family Education Loans* program (CFDA 84.032). This program provides \$819 million in aid to Texas students.

Changes in the enrollment status are important because they determine when loans should start being repaid. We have reported noncompliance with this requirement for the State each year since 1995. If the reporting of enrollment changes is not resolved, the State is at risk of losing this federal funding in the future.

#### Summary of Management's Response and Corrective Action Plan:

Management of the universities agree and plan to correct this issue. See individual findings located in the Schedule of Findings and Questioned Costs for the detailed management responses.

**Material noncompliance** with federal requirements occurs when instances of noncompliance in a federal program are extensive enough to have a direct and significant impact on the program.

### Commission on Alcohol and Drug Abuse (Commission)

Reference No. 99-555-31

#### Summary of Finding:

A material weakness exists in controls over the Commission's monitoring of subrecipients. The Commission needs to enforce monitoring controls to ensure that providers are held accountable for spending funds properly and are achieving the performance measures in their contracts.

A **material weakness** in controls occurs when there is more than a low risk that noncompliance with applicable requirements (that are material in relation to the federal program being audited) may occur and not be detected in the normal course of operations.

#### Summary of Management's Response and Corrective Action Plan:

*The Commission will evaluate and strengthen the existing control environment and procedures for subrecipient monitoring. Changes in the Commission's information management system have enhanced management oversight and provider accountability. The Commission is*

**Subrecipient** means a non-federal entity that spends federal awards received from a pass-through entity to carry out a federal program, but does not include an individual that is a beneficiary of such a program.

*committed to making corrections to prevent the reoccurrence of any of these issues subsequent to February 1999.*

### Texas Education Agency (Agency)

Reference No. 99-555-89

Summary of Finding:

A material weakness exists in the Agency's controls over subrecipient monitoring. The Agency has not ensured that its subrecipients spent federal funds in accordance with federal requirements. If subrecipients are not spending funds as required, it could mean that students are not receiving the intended benefits of a program.

Summary of Management's Response and Corrective Action Plan:

*We appreciate it being noted in the audit report that no significant instances of noncompliance by subrecipients were found by the state auditors. Management agrees that a reassessment of current monitoring processes used by the Agency in different divisions is appropriate. A comprehensive monitoring plan will be developed that not only ensures compliance, but also makes the most effective and efficient use of limited Agency resources.*

Reference No. 99-555-95

Summary of Finding:

Because the Texas Education Agency (Agency) cannot ensure that its accounting system and annual financial report contains accurate information, the Agency has a material control weakness. The Agency's lack of controls in implementing its new general accounting system, Integrated Statewide Administrative System (ISAS), has significantly increased the risk that material errors could exist in financial data and not be detected.

A material error occurs when the omission or misstatement of information could affect the use and understanding of the financial statements.

Summary of Management's Response and Corrective Action Plan:

*Management concurs. All future software development of ISAS will be the responsibility of our Information Systems Department. TEA reorganized its accounting functions and has taken appropriate personnel actions, including a separation, to address the issues underlying the SAO recommendations. A Financial Reporting and Control Coordinator has been appointed to provide new direction and oversee all financial activity in the accounting system. The coordinator and new Financial Reporting and Control Unit will focus additional resources on accomplishing required reconciliations and developing financial reporting procedures.*

## Department of Protective and Regulatory Services (Department)

Reference No. 99-555-82

### Summary of Finding:

A material weakness exists in the controls over monitoring of (1) subrecipients for the *Family Preservation and Support Services* program (CFDA 93.556) and, (2) vendors with compliance responsibilities for the *Foster Care - Title IV-E* program (CFDA 93.568). The Department needs to strengthen implementation of its monitoring controls to ensure that providers are held accountable for spending federal funds properly and for achieving the performance measures in their contracts.

### Summary of Management's Response and Corrective Action Plan:

*The Department will continue to improve its contract monitoring system. This will be accomplished by continuing to develop and maintain a statewide monitoring plan, utilizing a risk based approach to monitoring and recoupment, becoming current on the review of cost reports, and developing a database for disallowed costs and recoupments. Implementation is ongoing and targeted for completion by September 1, 1999.*

## Texas Southern University (University)

Reference No. 99-555-54

### Summary of Finding:

A material weakness continues to exist in the administration of Student Financial Aid (SFA) at Texas Southern University. Problems in the student financial aid process could ultimately result in a student having to delay or stop their education because funds are not available.

### Summary of Management's Response and Corrective Action Plan:

*Successful implementation of the University's Strategic Corrective Action Plan calls for the strengthening of student financial aid administration. The University will be entering a co-sourcing agreement in our effort to improve accountability and coordination with the reimbursement submission process, staffing sufficiency, and communication among the administrative areas that impact student financial aid.*

Reference No. 99-555-69

### Summary of Finding:

A material weakness in payroll policy and procedures places the University at risk of being required to reimburse federal dollars for unsupported payroll expenditure claims.

### Summary of Management's Response and Corrective Action Plan:

*The current administration recognizes that the control environment over payroll must be strengthened. Implementation of actions outlined in the detailed response to this audit comment will provide assurance that payroll charges to federal programs are accurate and allowable.*

## Our Compliments to Agencies With No Findings

We are pleased to report that the following entities had no findings in the areas tested. Management of these entities have established systems to ensure compliance with the state, federal, and/or bond regulations examined during the audit. While we recognize this accomplishment, it is important to understand that we may have only audited a very specific portion of the entity's operations. The scope of our audit work at these entities is described below.

### Commission for the Blind (Commission)

The primary focus of our audit was the Commission's compliance with the federal requirements for the *Rehabilitation Services - Vocational Rehabilitation Grant to States* program (CFDA 84.126), representing \$32,594,226 in expenditures for fiscal year 1998. We gained an understanding of the internal control structure including the general control environment. Specific procedures were used to test for compliance with the major federal program requirements.

### Comptroller of Public Accounts (Comptroller)

The primary focus of the audit work at the Comptroller's office was the statewide consolidation process. Consolidation work was conducted to determine if the *Comprehensive Annual Financial Report (CAFR)* was accurate and presented in accordance with generally accepted accounting principles. We gained an understanding of the internal control structure for the consolidation process. We also tested the accuracy of the compilation of the annual financial reports for more than 200 state agencies, universities, and component units. In addition, we audited tax revenue in the General Fund to determine if this account was fairly stated in the *CAFR*.

The Comptroller extracted the annual financial report information from the Uniform State Accounting System (USAS) to the *CAFR* for 141 agencies for fiscal year 1998. This is a 57 percent increase over fiscal year 1997 and demonstrates continued progress toward using USAS as the primary source to prepare the *CAFR*.

### Sam Houston State University (University)

The primary focus of our audit was the University's two largest student financial assistance programs: the *Federal Family Education Loans* program (CFDA 84.032) and the *Federal Pell Grant Program* (CFDA 84.063). We tested the administrative controls relating to the major federal programs. Specific procedures were used to test compliance with federal program requirements. The total dollar value of the *Federal Family Education Loans* program was \$15,267,634, and the total dollar value of the *Federal Pell Grant Program* was \$4,403,698.

### Texas A&M University (University)

The primary focus of our audit was on the University's Research and Development programs. Specific procedures were used to test compliance with federal requirements. The total dollar value of research and development programs was approximately \$36 million in fiscal year 1997 and 1998.



## Bond Compliance Audits

The following table lists (1) the names of the entities that had no findings for bond compliance audit work and, (2) the entities' total dollars audited. External auditors performed the bond compliance audit work.

Agencies and Universities With No Bond Compliance Findings	
Agency or University Name	Total Amount of Bond Issues Outstanding as of August 31, 1998 ( amount in thousands)
Angelo State University	\$ 2,030
Criminal Justice, Department of	3,515
Economic Development, Department of	99,335
General Land Office and Veterans' Land Board	1,465,713
Higher Education Coordinating Board	593,357
Hospital Equipment Financing Council	10,900
Housing and Community Affairs, Department of	1,209,362
Lamar University - Beaumont	14,015
Lamar University Institute of Technology	1,721
Lamar University - Orange	1,217
Lamar University - Port Arthur	1,691
Midwestern State University	8,895
Military Facilities Commission	24,205
Public Finance Authority	3,064,439
Sam Houston State University	10,985
Southwest Texas State University	67,620
Stephen F. Austin State University	24,620
Texas A&M University System	720,228
Texas Southern University	30,825
Texas State Technical College	9,410
Texas State University System	49,990
Texas Tech University	105,162
Texas Tech University Health Sciences Center	18,793
Texas Woman's University	24,270
The University of Texas System	1,284,775
University of Houston System	115,985
University of North Texas	38,311
University of North Texas Health Science Center at Forth Worth	9,280
Water Development Board	2,219,385
<b>Total</b>	<b>\$ 11,230,034</b>

## Other Compliments

The State is currently in the process of addressing the Year 2000 (Y2K) situation. The Y2K situation relates to problems concerning computer programs using only the last two digits to refer to a year. Computer programs would have difficulty distinguishing between 1900 and 2000 since both years would be "00" without corrections to the programs. Also, electronic equipment that uses date dependent computer chips (embedded systems) may fail.

As of August 31, 1998, all agencies and universities were aware of the Y2K situation and had completed an inventory of systems to be considered for correction. All, except for one program, were in the process of being corrected. The Office of the Attorney General had not begun corrections on the Texas Child Support Enforcement System as of August 31, 1998.

The agencies and universities were still inventorying electronic equipment to be addressed for the Y2K situation.

For the 1998 fiscal year, the State of Texas was one of the few states to receive an audit opinion on the status of the Y2K situation.



## OFFICE OF THE STATE AUDITOR

TWO COMMODORE PLAZA  
206 EAST NINTH STREET, SUITE 1900  
AUSTIN, TEXAS 78701

LAWRENCE F. ALWIN, CPA  
State Auditor

February 24, 1999

### **Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed In Accordance With *Government Auditing Standards***

The Honorable George W. Bush, Governor  
and  
Members of the Texas Legislature  
State of Texas

Ladies and Gentlemen:

We have audited the general purpose financial statements of the State of Texas as of and for the year ended August 31, 1998, and have issued our report thereon dated February 24, 1999. During fiscal year 1998, the State implemented Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*, which requires the State to report investments at fair value rather than at cost. Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

We have chosen not to comply with a reporting standard that specifies the wording to be used in discussing restrictions on the use of the report. We believe this wording is not in alignment with our role as a legislative audit function.

#### **Compliance**

As part of obtaining reasonable assurance about whether the State's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

#### **Internal Controls Over Financial Reporting**

In planning and performing our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial

reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters that come to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

The reportable condition for the state is described in the accompanying Schedule of Findings and Questioned Costs as item 99-555-95. We consider the reportable condition 99-555-95 to be a material weakness.

### Work Performed by Other Auditors

The State Auditor's Office did not audit the following entities and funds, which are component units of the State for financial reporting purposes. These entities were audited by other auditors.

Entities Audited by Other Auditors	Scope of Work Performed
Texas Lottery Commission	An audit of the balance sheets and the related statements of operations and retained earnings and cash flows was conducted for the years ended August 31, 1998 and 1997.
Department of Housing and Community Affairs	An audit of the general purpose financial statements and an audit of the compliance requirements in the OMB Circular A-133 Compliance Supplement were conducted for the year ended August 31, 1998.
Texas Guaranteed Student Loan Corporation	An audit of the consolidated financial statements was conducted for the years ended September 30, 1998 and 1997; an audit of the compliance requirements in the OMB Circular A-133 Compliance Supplement was conducted for the year ended September 30, 1998.
Texas Workers' Compensation Insurance Fund	An audit of the balance sheets and the related statements of revenues and expenses, changes in capitalization and retained earnings, and cash flows was conducted for the years ended December 31, 1997 and 1996.
Texas Local Government Investment Pool	An audit of the statements of assets and liabilities and the related statements of operations and changes in net assets was conducted for the years ended August 31, 1998 and 1997.
Employees Retirement System	An audit of the general purpose financial statements and the combining financial statements of the pension plans was conducted for the year ended August 31, 1998.
Permanent University Fund	An audit of the statement of investment assets and liabilities was conducted as of August 31, 1998; an audit of the comparison summary of investments was conducted as of August 31, 1998 and 1997; audits of the statement of investment income, the statement of changes in net investment assets, and the schedule of changes in cost of investments were conducted for the year ended August 31, 1998.
Texas Prepaid Higher Education Tuition Board	An audit of the balance sheets and the related statements of revenues, expenses and changes in retained earnings, and cash flows was conducted for the years ended August 31, 1998 and 1997.

This report, insofar as it relates to those entities, is based solely on the reports of the other auditors.

### **Other Work Performed by the State Auditor's Office**

In December 1998, we released *An Audit of the Financial Statements of the Teacher Retirement System of Texas for Fiscal Year Ended August 31, 1998* (SAO Report No. 99-018). *An Audit at the Office of the Fire Fighters' Pension Commissioner* (SAO Report No. 99-037) and *A Management Letter Regarding an Audit of the Permanent School Fund's Financial Statements for the Period Ending August 31, 1998* (SAO No. 99-340) were released in May 1999.

This report is intended solely for the information and use of the Governor, the Legislature, audit committees, boards and commissions, management, and all federal and pass-through entities from which federal assistance was received. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Lawrence F. Alwin, CPA  
State Auditor



## OFFICE OF THE STATE AUDITOR

TWO COMMODORE PLAZA  
206 EAST NINTH STREET, SUITE 1900  
AUSTIN, TEXAS 78701

LAWRENCE F. ALWIN, CPA  
State Auditor

February 24, 1999

### Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With *OMB Circular A-133*

The Honorable George W. Bush, Governor  
and  
Members of the Texas Legislature  
State of Texas

Ladies and Gentlemen:

#### Compliance

We have audited the compliance of the State of Texas with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended August 31, 1998. The State's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of management at each state entity. Our responsibility is to express an opinion on the State's compliance based on our audit.

The State of Texas general purpose financial statements include the operations of the Texas Guaranteed Student Loan Corporation and the Texas A&M University System Research Foundation, which received \$16,565,135 and \$57,326,817, respectively, in major federal programs which are not included in the Schedule of Findings and Questioned Costs during the year ended August 31, 1998. Our audit, described below, did not include the operations of the Texas Guaranteed Student Loan Corporation and the Texas A&M University System Research Foundation because these entities engaged other auditors to perform an audit in accordance with *OMB Circular A-133*.

Except as discussed in the following paragraph, we conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and *OMB Circular A-133* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State's compliance with those requirements.

We have chosen not to comply with a reporting standard that specifies the wording to be used in discussing restrictions on the use of the report. We believe this wording is not in alignment with our role as a legislative audit function.

As described in item 99-555-97 in the accompanying Schedule of Findings and Questioned Costs, the State did not comply with one federal requirement regarding the reporting of enrollment changes that are applicable to its *Federal Family Education Loans* (CFDA 84.032) program. Compliance with such requirement is necessary, in our opinion, for the State to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the State complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended August 31, 1998. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with *OMB Circular A-133*, and which are described in the accompanying Schedule of Findings and Questioned Costs as items:

1	11	21	34	46	61	70	79	88
2	12	22	35	47	62	71	80	89
3	14	23	36	48	63	72	81	90
4	15	26	37	49	64	73	82	91
6	16	27	41	51	65	74	83	92
7	17	29	42	55	66	75	84	93
8	18	30	43	56	67	76	85	94
9	19	31	44	57	68	77	86	95
10	20	32	45	59	69	78	87	96

*(Only the last digit(s) of each finding reference number is listed. The first five digits of each reference number are 99-555.)*

## Internal Controls Over Compliance

Management at each state entity is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with *OMB Circular A-133*.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters that come to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts,

and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs. Reportable conditions include all the items listed on the previous page in the compliance section of this report and also items:

5	24	33	39	50	53	58
13	28	38	40	52	54	60

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions listed above, we consider items 31, 54, 69, 82, 89, and 95 to be material weaknesses.

### Work Performed By Other Auditors

The State Auditor's Office did not audit several of the entities and funds that are component units of the State. These entities were audited by other auditors, as stated in the Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.

### Other Work Performed by the State Auditor's Office

In December 1998, we released *An Audit of the Financial Statements of the Teacher Retirement System of Texas for Fiscal Year Ended August 31, 1998* (SAO Report No. 99-018). *An Audit at the Office of the Fire Fighters' Pension Commissioner* (SAO Report No. 99-037) and *A Management Letter Regarding an Audit of the Permanent School Fund's Financial Statements for the Period Ending August 31, 1998* (SAO No. 99-340) were released in May 1999.

This report is intended solely for the information and use of the Governor, the Legislature, audit committees, boards and commissions, management, and all federal and pass-through entities from which federal assistance was received. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Lawrence F. Alwin, CPA  
State Auditor



## Description of Issue Categories

The following information describes the categories used in Control Issues by Agency and University and Federal Compliance Issues by Agency and University. These tables summarize internal controls and issues identified in the Schedule of Findings and Questioned Costs.

## Internal Controls

The Committee of Sponsoring Organizations of the Treadway Commission has defined internal control as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

*Government Auditing Standards*, issued by the Comptroller General of the United States, associates internal controls with financial and financial-related audits and management controls with performance audits. Management controls are defined as:

The plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

From these control definitions, the State Auditor's Office developed a Key Accountability Control Systems Model. This model provides the definitions for the following areas, which can be found in *A Guide to Assessing Risk in Key Accountability Control Systems* (SAO Report No. 97-075, July 1997).

### Control Environment and Risk Assessment

The control environment reflects the overall attitude, awareness, and actions of the board, management, and others concerning the importance of and emphasis on controls within the organization. Risk assessment processes should be designed to identify factors that threaten the achievement of goals and to determine how risks should be managed. Issues under this category are related to the following control systems:

- Integrity and Ethical Values
- Risk Assessment
- Management Philosophy and Operating Style
- Managing Change
- Commitment to Competence
- Compliance with Laws and Regulations

## Policy Management

Policy management includes the systems, policies, and procedures for determining what the entity should be doing and how it should do it. Systems, policies, and procedures must be established and maintained to promote achievement of entity objectives and to limit risks that could jeopardize achieving objectives. Issues under this category are related to the following control systems:

- Planning and Budgeting
- Policies and Procedures
- Human Resources/Organizational Structure

## Performance Management

Performance management includes the systems, policies, and procedures that measure and monitor results. Issues under this category are related to the following control systems:

- Effectiveness and Efficiency of Operations
- Performance Measurement Systems

## Information Management

Information management includes the systems, policies, and procedures that provide appropriate, accurate, and timely information as needed to achieve entity objectives. Issues under this category are related to the following control systems:

- Information Flow and Communication
- Automation

## Resource Management

Resource management includes the systems, policies, and procedures used to safeguard and appropriately allocate and use the entity's resources. Issues under this category are related to the following control systems:

- Assets
- Revenues
- Liabilities
- Expenditures

## Compliance

### Federal Compliance

There are many rules and regulations governing the accountability and use of federal awards designed to ensure that they are used for their intended purpose and in an efficient manner. The federal government, through the *Office of Management and Budget Circular A-133*, has categorized these into 14 types of compliance requirements. The first 13 types of compliance requirements may be applicable to all federal programs at agencies and universities. The fourteenth type, Special Tests and Provisions, contains various other requirements unique to individual federal programs. Findings relating to each of the following federal compliance requirements are located in the Current Federal Compliance Issues by Agency and University. The federal compliance requirements are briefly described below.

- a. Activities Allowed or Unallowed specifies the activities that can or cannot be paid for with the federal funds provided for that program. Specific activities allowed or unallowed in each federal program are found in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program.
- b. Allowable Costs/Cost Principles ensures that costs are reasonable and necessary for the performance and administration of Federal programs. Costs must be allocable to the federal awards under the provisions of cost principles.
- c. Cash Management specifies the federal rules for when and how federal funds are drawn from the U.S. Treasury to finance federal awards. These rules minimize the time that elapses between the transfer and disbursement of funds from the U.S. Treasury by grantees and subgrantees. They also specify the terms and conditions in which an interest liability would be incurred.
- d. Davis-Bacon Act establishes wages for laborers and mechanics employed by contractors or subcontractors to work on federally financed construction contracts in excess of \$2,000. These contracts must pay wages not less than prevailing wage rates established by the U.S. Department of Labor.
- e. Eligibility specifies the criteria for determining the individuals, groups of individuals, or subrecipients that can participate in the federal programs and the amounts for which they qualify. Only eligible individuals can participate in federal programs.
- f. Equipment and Real Property Management specifies how equipment and real property is to be used, managed, and disposed of under federal programs.
- g. Matching, Level of Effort, Earmarking includes requirements for grantees to provide matching contributions, requirements for level of service or expenditures to be maintained from period to period, and earmarked minimum and/or maximum amounts that may be used for specific activities of the program.
- h. Period of Availability of Federal Funds is a specified time period during which the non-federal entity may use the federal funds. Federal requirements determine

whether federal funds were obligated within the period of availability and that such obligations were liquidated within the required time period.

- i. Procurement and Suspension and Debarment specifies the policies and procedures to use when obtaining goods and services with federal funds. In addition, these requirements specify that the non-federal entity obtain the required certifications for certain contracts and sub-awards.
- j. Program Income specifies how program income must be used. Program income is income received that is directly generated by the federally-funded project during the grant period.
- k. Real Property Acquisition and Relocation Assistance provides for uniform and equitable treatment of persons displaced by federally assisted programs from their homes, businesses, or farms.
- l. Reporting requires recipients to use the standard financial reporting forms. The required reports for federal awards should include all activity of the reporting period, should be supported by applicable accounting or performance records, and should be fairly presented in accordance with program requirements.
- m. Subrecipient Monitoring requirements specify that a pass-through entity is responsible to subrecipients for the following: identifying the federal award information, monitoring, ensuring audits are performed, and evaluating activities.
- n. Special Tests and Provisions specify various other requirements unique to individual federal programs. These requirements are found in the laws, regulations, and the provisions of contract and grant agreements pertaining to individual programs.

### **State Compliance**

Entities must also comply with state laws and regulations such as the HOME program applications, cash management, and purchasing. Findings related to state compliance are listed in Control Issues by Agency and University.

### **Bond Compliance**

Contractual promises within bond resolutions, known as covenants, set forth repayment schedules of principal and interest and other restrictions to protect the bondholders' investments such as a lack of procedures to monitor interest payments, loan collections, investment transactions, and expenditures. Findings related to bond compliance are summed in Control Issues by Agency and University.

## Accounting and Reporting

Accounting and reporting includes issues that could affect the accuracy and completeness of the financial statements, such as promoting adherence to generally accepted accounting principles, ensuring the accuracy of financial reports, and ensuring timely correction of reconciling items and adjustments within the accounting records. Findings related to accounting and reporting are listed in Control Issues by Agency and University.

## Summary of Current Issues

Control Issues by Agency and University											
Agency or University	Agency or University No.	Internal Controls					Compliance			Accounting and Reporting	Totals <sup>1</sup>
		Control Environment and Risk Assessment	Policy Management	Performance Management	Information Management	Resource Management	Federal	State	Bonds		
Aging, Department on	340	1	2	0	1	1	1	0	0	0	6 <sup>1</sup>
Agricultural Experiment Station, Texas	556	7	6	0	3	7	15	0	0	2	40 <sup>1</sup>
Alcohol and Drug Abuse, Commission on	517	6	9	4	9	8	5	0	0	1	42 <sup>1</sup>
Attorney General, Office of the	302	1	1	1	1	1	2	0	0	0	7 <sup>1</sup>
Early Childhood Intervention, Interagency Council on	532	3	3	0	0	3	3	0	0	1	13 <sup>1</sup>
Education Agency, Texas	701	4	7	3	4	6	8	0	0	5	37 <sup>1</sup>
General Services Commission	303	1	1	0	0	1	1	0	0	1	5 <sup>1</sup>
Health, Department of	501	4	3	1	2	4	6	0	0	0	20 <sup>1</sup>
Housing and Community Affairs, Department of	332	3	3	1	1	1	5	1	0	0	15 <sup>1</sup>
Human Services, Department of	324	0	4	0	4	1	5	0	0	2	16 <sup>1</sup>
Mental Health and Mental Retardation, Department of	655	2	2	0	0	0	2	0	0	0	6 <sup>1</sup>
Natural Resource Conservation Commission	582	3	2	0	1	0	2	0	0	1	9 <sup>1</sup>
Protective and Regulatory Services, Department of	530	3	2	1	1	4	4	0	0	1	16 <sup>1</sup>
Rehabilitation Commission	330	0	1	0	0	1	1	0	0	1	4 <sup>1</sup>
Stephen F. Austin State University	755	1	2	0	1	0	1	0	0	0	5 <sup>1</sup>
Sul Ross State University	756	1	1	0	1	0	1	0	0	0	4 <sup>1</sup>
Texas A&M International University	761	1	1	0	0	0	1	0	0	0	3 <sup>1</sup>
Texas A&M University - Corpus Christi	760	2	2	0	2	0	2	0	0	0	8 <sup>1</sup>
Texas A&M University - Kingsville	732	6	7	0	7	4	6	0	0	0	30 <sup>1</sup>
Texas Engineering Experiment Station	712	1	2	0	1	2	4	0	0	0	10 <sup>1</sup>
Texas Southern University	717	8	9	0	5	8	7	0	0	0	38 <sup>1</sup>
The University of Texas at San Antonio	743	3	2	0	3	0	4	0	0	0	12 <sup>1</sup>
The University of Texas Health Science Center at San Antonio	745	1	1	0	1	0	1	0	0	0	4 <sup>1</sup>
The University of Texas M.D. Anderson Cancer Center	506	3	3	1	1	3	2	1	0	1	15 <sup>1</sup>
University of Houston	730	1	0	0	0	1	0	1	0	1	4 <sup>1</sup>
Workforce Commission, Texas	320	0	3	0	1	4	4	0	0	3	15 <sup>1</sup>
<b>Total</b>		<b>66</b>	<b>79</b>	<b>12</b>	<b>50</b>	<b>60</b>	<b>93</b>	<b>3</b>	<b>0</b>	<b>20</b>	<b>384</b>

<sup>1</sup> The total equals the number of control systems affected, not the number of findings.

Federal Compliance Issues by Agency and University																
Agency or University	Agency or University No.	Compliance Requirements														Total <sup>1</sup>
		Activities Allowed or Unallowed	Allowable Cost/Cost Principle	Cash Management	Davis-Bacon Act	Eligibility	Equipment and Real Property Management	Matching, Level of Effort, Earmarking	Period of Availability of Funds	Procurement Suspension Debarment	Program Income	Real Property Acquisition and Relocation Assistance	Reporting	Subrecipient Monitoring	Special Tests and Provisions	
Aging, Department on	340	0	0	1	0	0	0	0	0	0	0	0	0	0	0	1 <sup>1</sup>
Agricultural Experiment Station, Texas	556	1	2	3	0	0	1	1	2	2	0	0	1	2	0	15 <sup>1</sup>
Alcohol and Drug Abuse, Commission on	517	0	1	0	0	0	0	0	0	1	0	0	1	1	1	5 <sup>1</sup>
Attorney General, Office of the	302	0	1	0	0	0	0	0	0	0	0	0	0	0	1	2 <sup>1</sup>
Early Childhood Intervention, Interagency Council on	532	0	1	1	0	0	0	0	0	0	0	0	0	1	0	3 <sup>1</sup>
Education Agency, Texas	701	0	0	1	0	1	0	0	0	0	0	0	4	2	0	8 <sup>1</sup>
General Services Commission	303	0	0	0	0	0	0	0	0	0	0	0	0	1	0	1 <sup>1</sup>
Health, Department of	501	1	1	1	0	0	0	1	0	1	0	0	0	1	0	6 <sup>1</sup>
Housing and Community Affairs, Department of	332	0	0	0	0	0	0	0	0	1	0	0	0	3	1	5 <sup>1</sup>
Human Services, Department of	324	0	0	1	0	1	0	0	0	0	0	0	1	0	2	5 <sup>1</sup>
Mental Health and Mental Retardation, Department of	655	0	0	0	0	0	0	0	0	0	0	0	0	1	1	2 <sup>1</sup>
Natural Resource Conservation Commission	582	0	0	0	1	0	0	0	0	0	0	0	1	0	0	2 <sup>1</sup>
Protective and Regulatory Services, Department of	530	0	1	0	0	1	0	0	0	1	0	0	0	1	0	4 <sup>1</sup>
Rehabilitation Commission	330	0	0	1	0	0	0	0	0	0	0	0	0	0	0	1 <sup>1</sup>
Stephen F. Austin State University	755	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1 <sup>1</sup>
Sul Ross State University	756	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1 <sup>1</sup>
Texas A&M International University	761	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1 <sup>1</sup>
Texas A&M University - Corpus Christi	760	0	0	0	0	0	0	0	0	0	0	0	0	0	2	2 <sup>1</sup>
Texas A&M University - Kingsville	732	0	0	0	0	1	0	0	0	0	0	0	1	0	4	6 <sup>1</sup>
Texas Engineering Experiment Station	712	0	0	1	0	0	0	0	0	1	0	0	0	2	0	4 <sup>1</sup>
Texas Southern University	717	0	3	0	0	0	0	0	0	0	0	0	0	0	4	7 <sup>1</sup>
The University of Texas at San Antonio	743	0	0	0	0	0	0	0	0	0	0	0	1	0	3	4 <sup>1</sup>
The University of Texas Health Science Center at San Antonio	745	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1 <sup>1</sup>
The University of Texas M.D. Anderson Cancer Center	506	0	0	0	0	0	0	0	0	1	0	0	0	1	0	2 <sup>1</sup>
University of Houston	730	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0 <sup>1</sup>
Workforce Commission, Texas	320	0	1	2	0	0	0	0	0	0	0	0	0	1	0	4 <sup>1</sup>
<b>Total</b>		<b>2</b>	<b>11</b>	<b>12</b>	<b>1</b>	<b>4</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>8</b>	<b>0</b>	<b>0</b>	<b>10</b>	<b>17</b>	<b>23</b>	<b>93</b>

<sup>1</sup> The total equals the number of compliance requirements affected, not the number of findings.