

# **State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001**

May 2002

Report No. 02-555



**Lawrence F. Alwin, CPA  
State Auditor**

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# Key Points of Report

## State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001

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May 2002

### Overall Conclusion

The State's general purpose financial statements for the year ending August 31, 2001, are materially correct in accordance with accounting principles generally accepted in the United States. The Comptroller of Public Accounts continues to improve the use of the Uniform Statewide Accounting System as the primary source for the State's Comprehensive Annual Financial Report (CAFR). This helps ensure more accurate financial information for CAFR presentation.

The financial portion of the 2001 Statewide Single Audit included procedures to ensure the accuracy of the State's annual financial report. KPMG, LLP (KPMG) performed the federal portion of the 2001 Statewide Single Audit. KPMG issued its report, *State of Texas Federal Portion of the Statewide Single Audit Report For The Year Ended August 31, 2001*, under separate cover.

### Key Facts and Findings

- The Department of Health (Department) has taken steps to address issues reported in prior years that amount to a material weakness in its accountability for state resources and its ability to provide reliable financial information. However, the Department was not able to correct all of the issues during the period under audit. The Department has a plan to address the issues by May 2002.
- The Texas Education Agency and the Department of Human Services corrected control weaknesses noted in prior years.

### Contact

Joanna B. Peavy, CPA, Audit Manager (512) 936-9500



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# **Auditor's Report**

State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2001

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Lawrence F. Alwin, CPA  
State Auditor

February 21, 2002

## **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 Rick Perry, Governor  
and  
Members of the Texas Legislature  
State of Texas

Ladies and Gentlemen:

We have audited the financial statements of the State of Texas as of and for the year ended August 31, 2001, and have issued our report thereon dated February 21, 2002. Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 use of this wording does not align 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 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 Control Over Financial Reporting**

In planning and performing our audit, we considered the State's internal control over financial reporting 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 a matter at the Texas Department of Health involving the internal control and procedures over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention that relate 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. The accompanying schedule of findings and questioned costs describes the Texas Department of Health's reportable condition as item 02-555-01.

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. However, we consider the reportable condition at the Texas Department of Health to be a material weakness.

### Work Performed by Other Auditors

The State Auditor's Office did not audit the entities and funds listed in the table below. These entities were audited by other auditors.

<b>Entities Audited by Other Auditors</b>	<b>Scope of Work Performed</b>
Texas Guaranteed Student Loan Corporation	An audit was conducted of the consolidated balance sheets and the related statements of revenue and expenses and changes in retained earnings and cash flows for the years ended September 30, 2001 and 2000. An audit of the compliance requirements in the OMB Circular A-133 Compliance Supplement was conducted for the year ended September 30, 2001.
Texas Workers' Compensation Insurance Fund	An audit of the balance sheets and the related statements of income and comprehensive income, changes in capitalization and retained earnings, and cash flows was conducted for the years ended December 31, 2000 and 1999.
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, 2001 and 2000.
Texas Prepaid Higher Education Tuition Board	An audit of the general purpose financial statements was conducted for the year ended August 31, 2001.
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, 2001.
Department of Housing and Community Affairs	An audit of the general purpose financial statements was conducted for the year ended August 31, 2001.
Texas Lottery Commission	An audit of the general purpose financial statements was conducted for the year ended August 31, 2001.



<b>Entities Audited by Other Auditors</b>	<b>Scope of Work Performed</b>
Permanent University Fund	An audit of the investment assets and liabilities, the comparison summary of investment in securities, the related statements of operations, and the statements of changes in net investment assets was conducted for the years ended August 31, 2001 and 2000. An audit of the schedule of changes in cost of investments and investment income was conducted for the year ended August 31, 2001.
The University of Texas System Long-Term Fund	An audit of the assets and liabilities, the comparison summary of investment in securities, and the related statements of operations and changes in net assets was conducted for the years ended August 31, 2001 and 2000. An audit of the financial highlights for each of the five years in the period ended August 31, 2001 was also conducted.
The University of Texas System Short - Intermediate Term Fund	An audit was conducted of the statements of assets and liabilities as of August 31, 2001 and 2000, including the schedule of investment in securities as of August 31, 2001, and the related statements of operations and changes in net assets for the years ended August 31, 2001 and 2000.
The University of Texas System General Endowment Fund	An audit was conducted for the assets and liabilities and the summary of investment in securities as of August 31, 2001. An audit was also conducted for the related statement of operations and changes in net assets and the financial highlights for the period from inception (March 1, 2001) to August 31, 2001.
Permanent Health Fund	An audit of the assets and liabilities, and the comparison summary of investment in securities was conducted for the years ended August 31, 2001 and 2000. An audit of the related statements of operations and changes in net assets and financial highlights was conducted for each of the two years for the period ended August 31, 2001.

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**

We issued opinions on the following financial statements, which are consolidated into the general purpose financial statements of the State of Texas:

- The general purpose financial statements of the Teacher Retirement System of Texas for the fiscal year ended August 31, 2001 (see SAO Report No. 02-015, December 2001)
- The balance sheet of the Texas Permanent School Fund as of August 31, 2001, and the related statements of revenues, expenses and changes in fund balance, and cash flows for the fiscal year then ended (see SAO No. 02-334, February 2002)

This report is intended solely for the information and use of the Governor, the Legislature, audit committees, boards and commissions, management, and all federal awarding agencies 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

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# **Schedule of Findings and Questioned Costs**

State of Texas Financial Portion of the  
Statewide Single Audit Report for the  
Year Ended August 31, 2001

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Section 1:

## Summary of Auditor's Results

### Financial Statements

- |    |  |               |
|----|--|---------------|
| 1. | Type of auditor's report issued:   | Unqualified   |
| 2. | Internal control over financial reporting:                                     |               |
|    | (a) Material weakness identified?  | Yes           |
|    | (b) Reportable conditions identified not considered to be material weaknesses? | None Reported |
|    | (c) Noncompliance material to financial statements noted?                      | No            |

### Federal Awards

For fiscal year 2001, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report For The Year Ended August 31, 2001*, KPMG, dated February 12, 2002.

Section 2:

## Financial Statement Findings

This section identifies the reportable conditions, material weaknesses, and instances of noncompliance related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*. For fiscal year 2001, there is one financial statement finding. It is a repeat finding about the Department of Health's accountability and ability to provide reliable financial information. The finding originally appeared in the *2000 Single Audit Report* (SAO Report No. 01-555, April 2001).

*The 2000 Single Audit Report* contained two other financial statement findings which have both been resolved. (See table below.)

Agency	Reference	Description From <i>The 2000 Single Audit Report</i>	Status
Texas Education Agency	SAO Finding No. 01-555-52 Initial year written: 1996	A material weakness existed in the accounting and reporting controls at the Agency.	Resolved
Department of Human Services	SAO Finding No. 01-555-18 Initial year written: 2000	The Department overstated its total expenditures by at least \$46.7 million in its fiscal year 2000 annual financial report.	Resolved

## Department of Health

Reference No. 02-555-01  
(Prior Audit Issue SAO Report No. 01-021)

**Material weakness:** There is a risk that significant misstatements of amounts in the financial statements could occur and not be detected in a timely manner during the normal course of business.

Source: American Institute of Certified Public Accountants Statement of Position 98-3, March 17, 1998, Audits of States, Local Governments, and Not-for Profit Organizations Receiving Federal Awards

The Department of Health (Department) is working toward improving its accountability and ability to provide reliable financial information. However, the Department was not able to correct the following issues causing the material weakness, which was identified in March 2001 (*An Audit Report on Financial Management at the Department of Health*, SAO Report No. 01-021), before the end of fiscal year 2001.

- The Board of Health (Board) delegates its oversight responsibility by authorizing the Department to adjust appropriation transfers to meet financial obligations at the Department's discretion. As a result, the Department made million-dollar adjustments to approved appropriation transfers without additional review. The Department approved new policies in August 2001 that allow the Board to authorize adjustments up to a specific dollar (or percentage) limit. Procedures are currently being developed for implementation of these new policies.
- The Department may have incurred an interest liability under the federal Cash Management Improvement Act as a result of its handling of federal funds. The Department submitted a written request for a ruling from the U.S. Treasury Fiscal Management Service in July 2001 but has not received a response. This ruling is needed to resolve this issue.
- The Department's Indirect Cost Recovery Plan for fiscal year 2001 contained erroneous cost-recovery rates. Recalculated rates for fiscal year 2001 and 2002 were submitted for federal approval on July 1, 2001. The recalculated rates will not be effective until federal approval is received. The Department updated its procedure manual as of February 14, 2002, to ensure increased oversight of data and plan preparation.
- The Department makes various recurrent adjustments to its accounting systems to correct bookkeeping errors. The need to make recurrent corrections raises concerns about the accuracy of other accounting transactions. The Department's internal audit department reviewed expenditure transfers, identified the reason for those transfers, and made recommendations to improve the process. The Department converted to a new accounting system, the Health and Human Services Statewide Administrative System (HHSAS), as of September 1, 2001. A February 2002 internal audit report stated that a limited review of the Department's HHSAS implementation was conducted and it was determined that internal controls, system setup, and training were inadequate.
- Inadequate maintenance of user access for both the Department's and the State's accounting systems could result in intentional or unintentional damage to financial information. The State Auditor's Office verified that access to the Uniform Statewide Accounting System (USAS), the State's accounting

system, was appropriate as of November 2001. The internal audit department plans to complete a security access review of agency systems by the end of fiscal year 2002.

The Department was not able to correct all weaknesses between March and August 2001, but has a plan of action to address the issues by May 2002. The State Auditor's Office plans to conduct a detailed follow-up audit on the March 2001 findings in the spring of 2002.

Recommendation:

The Department should continue to implement its corrective action plan.

Management's Response:

*The FY 2001 Statewide Audit included a review and update of the key issues from the audit conducted in March 2001 (An Audit Report on Financial Management at the Department of Health, SAO Report No. 01-021). TDH met the timeliness, with one exception, outlined in its corrective action plan developed to address the findings from that audit. Many of those timelines had dates extending beyond the end of the fiscal year. The one outstanding item is scheduled for completion by May, 2002.*

*TDH will continue to keep the Board of Health and the SAO apprised of actions taken to improve the fiscal management of the agency.*

Section 3:

### **Federal Award Findings and Questioned Costs**

For fiscal year 2001, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001*, KPMG, dated February 12, 2002.

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