An Audit Report on

Internal Controls and Financial Processes at the Cosmetology Commission

February 2004

Report No. 04-019

State Auditor's Office

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State Auditor

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Overall Conclusion

There was gross fiscal mismanagement at the Cosmetology Commission (Commission) during fiscal years 2002 and 2003. During that time, the Commission significantly mismanaged its fiscal responsibilities and exposed state funds to the risk of loss and abuse. It did not maintain proper control over assets, did not discharge fiscal obligations in a timely manner, misused state funds, and did not keep adequate fiscal records. Most significantly, the Commission has not collected $2.8 million of the $4.8 million in penalties it assessed from September 1999 through June 2003 and has not followed statutory and regulatory requirements for the collection of administrative penalties. Control weaknesses in the Commission's financial operations could lead to future errors and violations of laws and regulations. In addition, the Commission had a budget shortfall at the end of fiscal year 2003 that caused it to place 38 employees (85 percent of its 44.5 full-time equivalent positions) on leave without pay and to receive an emergency deficiency grant from the Governor's Office.

Background Information

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

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

The Commission has serious weaknesses in all four of these areas, which shows that there was gross fiscal mismanagement at the Commission during fiscal years 2002 and 2003. See Chapter 1 for additional detail.

The Commission had two executive directors during the time period that we audited. Throughout our audit, the Commission had difficulty locating records and providing explanations for issues we identified. The current executive director was hired in July 2002 and has begun to take steps to address our findings. These steps include beginning to draft financial policies and procedures, as well as resuming administrative hearings to collect unpaid penalties. We have not audited the new procedures the Commission has developed and therefore cannot assure that they are adequate. Fully correcting the Commission's gross fiscal mismanagement will require both immediate action to correct certain deficiencies and the implementation of a long-term financial remediation plan.

Key Points

The Commission has not maintained proper control over assets.

- The Commission does not follow statutorily required procedures and has not collected at least $2.8 million (58 percent) of the $4.8 million in administrative penalties it assessed from September 1999 through June 2003 for violations of cosmetology laws and regulations. This reduces the incentive for cosmetologists to comply with laws and regulations.
- The Commission's procedures for handling revenue place state funds at a high risk of loss or impropriety. In 2003, the State Auditor's Office Special Investigations Unit reported

that a former temporary employee of the Commission had been indicted for the alleged theft of more than $1,000 in revenues. The control weaknesses we identified could allow this kind of impropriety to occur again.

- The Commission was not able to demonstrate compliance with its authorized capital budget for construction of buildings and facilities in fiscal year 2002. Our analysis indicated that the Commission overspent its capital budget for this item by $19,699 (59.3 percent).
- Control weaknesses in the Commission's expenditure processes could allow inappropriate transactions to be processed. For example, a single employee has the ability to add data for new employees, revise salaries, and generate state warrants. This creates a risk that the employee could create fictitious employees and generate payments to them. Although we found no instances of such payments, this increases the risk that inaccurate or inappropriate activity could occur without detection.

The Commission has not discharged fiscal obligations in a timely manner.

- The Commission underpaid TexasOnline subscription fees and did not make payments for these subscription fees in a timely manner.
- The Commission did not deposit 23.5 percent of revenue deposits we tested within three business days as required by the Texas Government Code.
- The Commission's failure to collect administrative penalties shows that it is not managing its finances in a timely way.

The Commission misused state funds.

- The Commission's former Chief Financial Officer circumvented the Commission's purchasing process to award a $1,000 contract to a personal associate. The Commission is currently pursuing recovery of these funds with the assistance of the Office of the Attorney General.
- As discussed above, our analysis indicated that the Commission overspent its capital budget for construction of buildings and facilities in fiscal year 2002 and used funds for a purpose other than those allowed by the General Appropriations Act (77th Legislature).
- As discussed above, the Commission has control weaknesses over revenue collection that place state funds at a high risk of loss and impropriety.

The Commission has not maintained adequate fiscal records.

- Throughout our audit, missing or inadequate documentation made it difficult for the Commission to provide information in response to our requests.
- The Commission does not reconcile the cash balance in its State Treasury account to identify errors or discrepancies. Without proper and timely reconciliations, errors or misappropriation of funds could go undetected. Reconciliations are also an important part of ensuring that management has accurate information for managing the budget. This is particularly important because the Commission experienced a budget shortfall at the end of fiscal year 2003.

- We found errors in or missing supporting documentation for 63.7 percent of the expenditures we randomly sampled. Based on that, we estimate that nearly $1.3 million of the Commission's expenditures from September 2001 through May 2003 could be in error or missing adequate support.

- The Commission could not locate any supporting documentation for journal vouchers that resulted in accounting entries totaling more than $1.6 million. It also lacked approval documentation for 83 percent of the journal vouchers for which it had partial supporting documentation.

- The Commission's fiscal year 2002 Annual Financial Report contained significant errors, and the Commission lacked documentation to support certain items in that report. These errors resulted in understatements totaling $111,203. In addition, the Commission did not report accounts receivable in the Annual Financial Report. As discussed above, because the Commission is not collecting all administrative penalties, the total amount of accounts receivable could have been $1,923,600 or higher.

- The Commission does not consistently assess administrative penalties in compliance with its own regulations. The result of these errors is that the Commission overcharged licensees $25,725 for some offenses and undercharged licensees $56,600 for other offenses.

- Weaknesses in the Commission's information technology controls have resulted in lost financial information and could allow the entry of duplicate inspection and violation reports.

Summary of Management's Response and Auditor Follow-up Comments

The Commission generally agrees with our findings and recommendations. However, we have provided specific follow-up comments in Appendix 2 to further clarify the Commission's responses. Our follow-up comments note that, in 2002, we recommended to the Commission that it request an audit. In addition, we reiterate that it is the Commission's responsibility (not the responsibility of the Office of the Attorney General) to schedule administrative hearings. Our follow-up comments also reinforce our contention that failure to collect administrative penalties reduces the incentive to comply with laws and regulations. We also note that the Commission was not able to show us documentation that clearly demonstrates that it did not exceed its capital budget for construction of buildings and facilities.

Summary of Information Technology Review

We reviewed selected application controls over the Commission's licensing and enforcement system. We found that the Commission lost financial information when its server crashed because it did not test to ensure that backups were working properly prior to upgrading its server. Furthermore, because the Commission did not update a table in its licensing and enforcement system when it changed its schedule of administrative penalties set in the Texas Administrative Code, it charged the incorrect amount for certain administrative penalties from September 1999 through June 2003.

set in the Texas Administrative Code, it charged the incorrect amount for certain administrative penalties from September 1999 through June 2003.

Summary of Objective, Scope, and Methodology

Our objective was to determine whether the Commission's processes and operations ensure that it is meeting statutory responsibilities, safeguarding resources, and complying with applicable laws and regulations. To accomplish that objective, we:

- Determined whether the Commission's operational processes are effective and efficient.
- Determined whether the Commission is complying with applicable laws and regulations.
- Determined whether the Commission's financial processes ensure accurate, complete, and reliable financial information.

Our audit covered licensing, enforcement, and financial processes from fiscal years 2000 to 2003. Testing of transactions focused on fiscal years 2002 and 2003 and included licenses, revenues, expenditures, and journal vouchers. We also tested compliance with laws and regulations.

The audit methodology consisted of collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with the Commission's management and staff.

Recent SAO Work		
Number	**Product Name**	**Release Date**
04-002	A Special Investigations Unit Report Regarding the Cosmetology Commission	September 2003
00-023	2000 Small Agency Management Control Audit	March 2000

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Detailed Results

Chapter 1

There Was Gross Fiscal Mismanagement at the Commission During Fiscal Years 2002 and 2003

There was gross fiscal mismanagement at the Cosmetology Commission (Commission) during fiscal years 2002 and 2003. During that time, the Commission significantly mismanaged its fiscal responsibilities and exposed state funds to the risk of loss and abuse.

Texas Government Code, Section 2104.001, specifies four criteria that define gross fiscal mismanagement. As Table 1 shows, the Commission has serious weaknesses in all four areas, which shows that there was gross fiscal mismanagement at the Commission during fiscal years 2002 and 2003.

Table 1

Evidence of Gross Fiscal Mismanagement		
Criteria for Gross Fiscal Mismanagement (Texas Government Code, Section 2104.001)	**Summary of Evidence Confirming that the Commission Met the Criteria**	**Where to Find More Detailed Information in this Report**
Failure to maintain proper control over assets	The Commission did not collect at least $2.8 million of $4.8 million in penalties it assessed.	Chapter 2-A
	The Commission's procedures for handling revenues create a high risk of loss and impropriety.	Chapter 2-B
	The Commission was not able to demonstrate compliance with its authorized capital budget. Our analysis indicated that the Commission overspent its capital budget for construction of buildings and facilities by $19,699 (59.3 percent).	Chapter 2-C
	Control weaknesses over expenditures create a risk that inappropriate transactions could be processed.	Chapter 2-D
Failure to discharge fiscal obligations in a timely manner	The Commission did not pay the Department of Information Resources for at least $6,000 in TexasOnline subscription fees it owed; it also did not make required monthly payments on time.	Chapter 3-A
	The Commission did not deposit 23.5 percent of revenue transactions we sampled within three business days of receipt as required by statute.	Chapter 3-B
	The Commission's failure to collect administrative penalties shows that it is not managing its finances in a timely manner.	Chapter 2-A
Misuse of state funds	The Commission's former Chief Financial Officer circumvented existing controls to award a $1,000 contract for programming services and training. The Commission is currently pursuing recovery of these funds with the assistance of the Office of the Attorney General.	Chapter 4
	As discussed previously, our analysis indicated that the Commission overspent its capital budget for construction of buildings and facilities by $19,699 (59.3 percent).	Chapter 2-C
	The Commission has control weaknesses that provide opportunity for the misuse of state funds.	Chapter 2-B

Evidence of Gross Fiscal Mismanagement		
Criteria for Gross Fiscal Mismanagement (Texas Government Code, Section 2104.001)	**Summary of Evidence Confirming that the Commission Met the Criteria**	**Where to Find More Detailed Information in this Report**
Failure to maintain adequate fiscal records	The Commission does not reconcile its State Treasury balance to identify or prevent errors in its cash balance.	Chapter 5-A
	Weaknesses in the Commission's financial processes do not ensure that the Commission generates accurate and reliable expenditure and revenue information. We estimate that nearly $1.3 million of the Commission's expenditures from September 2001 through May 2003 could be in error or missing adequate support.	Chapter 5-B
	The Commission lacks support for fiscal year 2002 and 2003 journal vouchers totaling more than $1.6 million.	Chapter 5-C
	The Commission reported inaccurate financial information in its fiscal year 2002 Annual Financial Report and could not support all the information it reported. These errors resulted in understatements totaling $111,203.	Chapter 5-D
	The Commission did not report accounts receivable in the Annual Financial Report. Because the Commission is not collecting all administrative penalties, the total amount of accounts receivable could have been $1,923,600 or higher.	Chapter 5-D
	Inadequate oversight and management of the Commission's enforcement function has resulted in the assessment of incorrect penalty amounts. The result of these errors is that the Commission overcharged licensees $25,725 for some offenses and undercharged licensees $56,600 for other offenses.	Chapter 5-E
	Weaknesses in the Commission's information technology controls have resulted in lost financial information and could allow the entry of duplicate inspection and violation reports.	Chapter 5-F

Chapter 2

The Commission Has Not Maintained Proper Control over Assets

The Commission has not maintained proper control over its assets. Most significantly, it has not collected $2.8 million of the $4.8 million in administrative penalties it assessed from September 1999 through June 2003 and has not followed statutorily required procedures for collecting administrative penalties. Control weaknesses in the Commission's processes for handling revenues also place state funds at a high risk of loss and impropriety. The indictment of a former temporary employee of the Commission for the alleged theft of more than $1,000 in revenues during 1999 and 2000 underscores the need for proper control over revenues.

> **Mission of the Commission**
>
> The Cosmetology Commission is dedicated to the establishment and enforcement of standards to ensure the best quality cosmetology services are provided to the people of Texas. It also protects public health and safety by ensuring continued improvement of cosmetology education in Texas.
>
> The Commission received $4,386,107 in appropriations for the 2002–2003 biennium. Its number of full-time equivalent positions was capped at 44.5.

The Commission also cannot demonstrate that it complied with its capital budget in fiscal year 2002. Our analysis indicates that the Commission exceeded its capital budget for construction of buildings and facilities by $19,699. Furthermore, control weaknesses associated with the Commission's expenditure process create a risk that inappropriate financial transactions could be processed.

Chapter 2-A

The Commission Has Not Collected $2.8 Million in Penalties and Has Not Followed Statutory and Regulatory Requirements for Collecting Penalties

The Commission has not collected at least $2.8 million (58 percent) of the $4.8 million in administrative penalties it assessed from September 1999 through June 2003 for violations of cosmetology laws and regulations. In addition to resulting in lost revenue, not collecting administrative penalties reduces the incentive for cosmetologists to comply with laws and regulations.

As Table 2 shows, the amounts of administrative penalties the Commission assessed and collected generally increased from 2000 to 2003.[1]

Table 2

Administrative Penalties Assessed and Collected by the Commission

Fiscal Year	Administrative Penalties Assessed	Administrative Penalties Collected
2000	$874,250	$382,910
2001	$1,257,100	$663,007
2002	$1,635,050	$613,865
2003	$1,424,700	$953,663

Source: Unaudited information from the Commission's Kodiak licensing and enforcement system

[1] Table 2 is based on a full year of data for fiscal year 2003; therefore, the data in this table does not fully correspond with the $2.8 million not collected from September 1999 through June 2003. It is not possible to calculate a collection rate from the data in Table 2 because collected amounts may include payments for penalties assessed before fiscal year 2000.

The Commission has not followed statutorily required procedures for collecting administrative penalties. Texas Occupations Code, Section 1602.505, requires the Commission to schedule a hearing with the State Office of Administrative Hearings (SOAH) if an individual does not pay a penalty. The Office of the Attorney General, which had performed functions involved in setting up dockets for hearings with SOAH, notified the Commission in March 2001 that it would no longer provide staff for or bear the cost of this function. Following this decision, from May 31, 2001, through October 6, 2003, the Commission did not take violators who failed to pay penalties to SOAH. When we began our audit in June 2003, the Commission was taking steps to resume the hearings process. These steps included the development of policies and procedures and the preparation of mailings to advise violators of their outstanding penalties. On October 6, 2003, the Commission resumed SOAH hearings.

As a result of suspending the hearings process at SOAH, the Commission was not consistently using one of its available enforcement tools, which is to block license renewal for individuals who have not paid their penalties. Texas Occupations Code, Section 1602.407, gives the Commission the authority to refuse to renew licenses to individuals who violate cosmetology laws and regulations.

Chapter 2-B

The Commission's Procedures for Handling Revenues Create a High Risk of Loss and Impropriety

The Commission's procedures for handling revenues place state funds at risk for loss and impropriety. For example, the employee who performs data entry into the Uniform Statewide Accounting System (USAS) for cash receipts also has access to both safes containing payments. In addition, all accounting employees have access to the combination to a safe in which payments (including unendorsed checks for the payment of administrative penalties) are stored until they are deposited. Because the Commission also is not complying with the statute that requires revenues to be deposited within three business days (discussed in more detail in Chapter 3-B), there is an increased risk of loss or impropriety. In addition, the Commission does not perform a reconciliation of its State Treasury balance (discussed in more detail in Chapter 5-A). This reconciliation is an important tool for identifying errors or possible impropriety.

In 2003, the State Auditor's Office Special Investigations Unit reported that a former temporary employee of the Commission had been indicted for the alleged theft of more than $1,000 in revenues (see *A Special Investigations Unit Report Regarding the Cosmetology Commission,* SAO Report No. 04-002, September 2003). The control weaknesses discussed here could allow this kind of impropriety to occur again.

Chapter 2-C

The Commission Cannot Demonstrate that It Complied with Its Authorized Capital Budget in Fiscal Year 2002

The Commission's Fiscal Year 2002 Capital Budget

Rider 1, pages VIII-14 and 15, the General Appropriations Act (77th Legislature), limited the Commission's fiscal year 2002 and 2003 capital budget to $97,233. That amount was authorized for:

- $33,233 for construction of buildings and facilities.
- $64,000 for a telephone system.

The Commission was not able to demonstrate compliance with its authorized capital budget of $33,233 for construction of buildings and facilities in fiscal year 2002. The Commission asserts that the additional expenses constitute separate projects not related to the capital budget. However, the Commission was not able to provide documentation to support its assertion.

Our analysis indicated that the Commission overspent its capital budget for construction of buildings and facilities by $19,699 (59.3 percent) without obtaining the required prior approval of the Governor and the Legislative Budget Board. (See the text box for additional details on the Commission's capital budget.) In doing so, the Commission violated the General Appropriations Act (77th Legislature), which required agencies to obtain the approval of the Governor and the Legislative Budget Board to exceed the amount of a capital budget line item by more than 25 percent. The Commission paid for this expenditure using funds from General Revenue.

In addition, our analysis indicated that the Commission incorrectly accounted for these expenditures by charging them to its general appropriations instead of to its capital budget. The Commission's inability to demonstrate that it has complied with its capital budget for construction of buildings and facilities indicates it has problems with record-keeping and accounting for significant transactions.

Chapter 2-D

Control Weaknesses over the Commission's Expenditures Create a Risk that Inappropriate Transactions Could Be Processed

Control weaknesses in the Commission's expenditure processes could allow inappropriate transactions to be processed. For example, one employee responsible for the human resources function had access to enter, revise, review, and approve transactions in USAS. (We previously reported this issue in fiscal year 2000.) This employee also had the ability to add data for new employees, revise salaries, and generate state warrants. This creates a risk that the employee could create fictitious employees and generate payments to them. We conducted several tests to detect inappropriate payments to employees and found no instances of such payments. However, this situation increased the risk that inaccurate or inappropriate activity could occur without detection.

In addition, one former employee still had the ability to enter and approve transactions in USAS. The Commission corrected this weakness after we brought it to the Commission's attention.

Chapter 3

The Commission Has Not Discharged Fiscal Obligations in a Timely Manner

The Commission is not discharging fiscal obligations in a timely manner. For example, the Commission underpaid the Department of Information Resources (Department) for TexasOnline subscription fees and did not make payments on time. The Commission also is not complying with a state law requiring agencies to deposit revenues within three business days of receipt. As discussed in Chapter 2, the fact that the Commission is not collecting administrative penalties shows that it is not managing its finances in a timely manner. The Commission had a budget shortfall at the end of fiscal year 2003, which further demonstrates the difficulty the Commission has in meeting its fiscal obligations (see the text box for more details).

The Commission's Fiscal Year 2003 Budget Shortfall

The Commission faced a budget shortfall during the last week of fiscal year 2003. As a result, the Commission asserts that it put 38 employees (85 percent of its 44.5 full-time equivalent positions) on leave without pay for periods ranging from two hours to 4.5 days. The Commission also received a $47,000 emergency deficiency grant from the Governor's Office to help cover its budget shortfall.

Chapter 3-A

The Commission Underpaid TexasOnline Subscription Fees and Did Not Make Payments in a Timely Manner

As of May 2003, the Commission had underpaid the Department by more than $6,000 in TexasOnline subscription fees because it excluded late license renewals from the formula it used to calculate its subscription fee payments. Comptroller of Public Accounts' Accounting Policy Statement 029 requires the Commission to pay the Department a monthly TexasOnline subscription fee of $2 for each license renewal, regardless of the method the licensee uses to renew.

The Commission deposited the funds it should have paid the Department to the Commission's General Revenue account as professional fees. From the time that the Commission began using TexasOnline through May 2003, the Commission paid $88,150 in TexasOnline subscription fees to the Department. In addition, the Commission did not make six required monthly payments for TexasOnline subscription fees to the Department on time during fiscal year 2003.

Chapter 3-B

The Commission Is Not Complying with Statutory Deposit Requirements

The Commission does not comply with Texas Government Code, Section 404.094, which requires agencies to deposit all revenues within three business days of receipt. The Commission did not deposit 23.5 percent of revenue deposits we tested within three business days. The average delay past the deadline was five days. Our work showed that the depository interest lost due to noncompliance was insignificant. However, not depositing revenues promptly increases the risk that funds could be lost or misappropriated.

Chapter 4

The Commission Misused State Funds

We identified two instances in which the Commission misused state funds. Specifically:

- The Commission's former Chief Financial Officer circumvented the purchasing process and awarded a $1,000 contract for programming services and training to a personal associate in January 2003. The Commission is currently pursuing recovery of the funds with the assistance of the Office of the Attorney General. The individual who awarded this contract is no longer employed by the Commission.

- As discussed in Chapter 2-C, our analysis indicated that the Commission overspent its capital budget for construction of buildings and facilities by $19,699 (59.3 percent) and, therefore, used state funds for a purpose other than intended by the General Appropriations Act (77th Legislature).

In addition, weak controls over revenue provide opportunity for the misuse of state funds. As discussed in Chapter 2-B, the Commission has control weaknesses over revenues that could allow the misuse of state funds. The indictment in August 2003 of a former temporary employee of the Commission for the alleged theft of more than $1,000 in revenue underscores the importance of correcting these control weaknesses.

These instances show that the Commission has circumvented controls, used funds in a manner that violates the General Appropriations Act, and has control weaknesses that provide opportunities for loss of funds and other improprieties.

The Commission Has Not Maintained Adequate Fiscal Records

The Commission has not maintained adequate fiscal records to allow for prudent financial management and proper safeguarding of state funds. For example, the Commission does not reconcile its cash balance in the State Treasury to identify errors or discrepancies, which could allow errors or misappropriation of funds to go undetected. We also found that the Commission:

- Made errors in processing and recording transactions totaling up to $1.3 million and lacked adequate documentation that some of these transactions were approved.
- Lacked adequate support to account for all revenues.
- Lacked adequate documentation for $1.6 million in journal vouchers.
- Had errors in its 2002 Annual Financial Report resulting in $111,203 in understatements.
- Did not report an estimated $1.9 million in accounts receivable.
- Lacked support for some information reported in its Annual Financial Report.

We noted that the Commission developed policies and procedures after we brought their absence to its attention. However, we have not audited these new procedures and therefore cannot provide assurance that they are adequate.

Such an environment creates a high risk that funds could be lost due to impropriety or error, and in fact there has been such impropriety at the Commission. In addition, inadequate information technology controls at the Commission led to the incorrect assessment of administrative penalties, noncompliance with the Commission’s own regulations, and the loss of financial information.

Chapter 5-A

The Commission Does Not Perform Cash Reconciliations of Its State Treasury Balance

The Commission does not reconcile the cash balance in its State Treasury account to identify errors or discrepancies. Without proper and timely reconciliations, errors or misappropriation of funds could go undetected.

Reconciliation of the State Treasury balance is also an important part of ensuring that management has accurate information for managing the budget. Without reconciliations, budget reports may not reflect the true financial position of the Commission because, in addition to errors, all transactions may not be reflected in USAS. The budget shortfall the Commission experienced in fiscal year 2003 underscores the importance of monitoring the budget because it indicates that the Commission has limited resources, and therefore unrealized revenues or unexpected expenses can have a significant impact on operations.

Chapter 5-B

Weaknesses in the Commission's Financial Processes Do Not Ensure that the Commission Generates Accurate and Reliable Expenditure and Revenue Information

We identified errors or missing supporting documentation in 63.7 percent of expenditures we randomly sampled. Based on our testing, we estimate that as much as $1,251,693 of the Commission's expenditures from September 2001 through May 2003 could be in error or missing adequate support.

Our testing identified the following errors:

- We identified expenditures that had errors or that were lacking adequate supporting documentation. Most of these expenditures were charged to the incorrect program cost accounts or object codes or had supporting documentation that included mathematical inaccuracies or that did not match the purchase vouchers. The Commission was also unable to locate two of the associated purchase vouchers, as well as any other documentation related to these expenditures. We also identified expenditures (53.6 percent of our sample) for which the purchase vouchers did not include documentation that the expenditures had been appropriately reviewed and approved. The errors identified in the expenditures suggest that this review and approval process was not occurring or was inadequate.

- The Commission has not corrected prior audit findings we identified in fiscal year 2000 related to travel expenditures. Our sample of expenditure transactions contained travel vouchers, and we found that 63 percent of them contained errors such as those noted in the first bullet above. According to information in USAS, the Commission's travel expenditures for fiscal year 2002 exceeded $140,000.

We noted control weaknesses related to expenditures that create an environment in which errors could occur without detection and lead to inaccurate financial information. Specifically:

- The Commission lacks a formally documented indirect cost allocation plan to allocate indirect costs across functions. The Commission currently divides administrative expenses evenly between its licensing and enforcement functions, but it has no documented basis for this allocation. This results in a distorted representation of the costs associated with individual strategies.

- The Commission did not have written policies and procedures for processing payroll. Establishing and enforcing written policies and procedures helps to ensure accountability. The Commission developed policies and procedures for payroll after we brought this issue to its attention.

Finally, the Commission did not have proper documentation to support four (5.9 percent) of the revenue deposits we tested. The Commission's deposit records indicated it deposited $305 for book sales for these four items. However, because the Commission lacked documentation supporting the number of books ordered and delivered, we could not verify that the Commission deposited the correct amount. The absence of supporting documentation creates a risk that a staff member could misappropriate payments without detection.

Chapter 5-C

The Commission Lacks Support for Fiscal Year 2002 and 2003 Journal Vouchers Totaling More than $1.6 Million

We sampled the Commission's fiscal year 2002 and 2003 journal vouchers and identified the following errors:

- The Commission could not locate any supporting documentation for 40 percent of the journal vouchers in our sample. These journal vouchers resulted in accounting entries totaling more than $1.6 million.
- The Commission lacked approval documentation for 83 percent of the journal vouchers for which it had partial supporting documentation.

We reviewed USAS information and determined that all journal vouchers we sampled appeared to be made for Commission business purposes.

Journal vouchers are accounting journal entries made for the purpose of correcting or adjusting previous revenue or expenditure entries in USAS. For control reasons, all journal vouchers should contain explanations and references to the documentary evidence supporting the entry or entries. In addition, all journal vouchers should be approved by the appropriate, designated authority. An inappropriate journal voucher could result in (1) underbilling or overbilling a strategy, program, or fund and/or (2) the reporting of inaccurate financial information. Journal vouchers can also be used to cover inappropriate transactions or misuses of funds.

The Commission did not have written policies and procedures for processing journal vouchers. In addition, at the time of our audit, the Commission did not have staff with the expertise to correctly process journal vouchers. Following written policies and procedures and ensuring that staff possess the required expertise reduce the risk that errors could occur without detection. The Commission developed procedures for preparing journal vouchers after we brought this issue to its attention.

Chapter 5-D

The Commission Reported Inaccurate Financial Information in Its Fiscal Year 2002 Annual Financial Report and Could Not Provide Support for All Information in that Report

The Commission's fiscal year 2002 Annual Financial Report contained significant errors, and the Commission lacked documentation to support certain items in that report. These errors resulted in understatements totaling $111,203. In addition, as discussed in Chapter 2-A, because the Commission is not consistently collecting administrative penalties, the total amount of accounts receivable could have been $1,923,600 or higher.

The Commission's fiscal year 2002 financial statements contained significant errors.

On its fiscal year 2002 financial statements, the Commission:

- Did not report $46,797 in "Legislative Transfers In" as part of its Statement of Activities. As a result, the ending fund balance it reported was understated by that amount.

- Understated depreciation expenses by $40,123.

- Incorrectly reported its capital outlay expense as a negative $24,283. This number should have been reported as $0.

- Did not report as accounts receivable penalties that it assessed but did not collect in fiscal year 2002. Because the Commission does not use a separate code for penalties when it processes revenue transactions in USAS and does not track accounts receivable separately, we could not accurately estimate the Commission's accounts receivable for fiscal year 2002. However, because the Commission is not consistently collecting administrative penalties, it had $1,923,600 or more in administrative penalties that were assessed but not collected as of the end of fiscal year 2002. The Comptroller of Public Accounts' *Reporting Requirements and Technical Guidance for Annual Financial Reports for State Agencies and State Colleges and Universities* specifies that "Accounts Receivable may be identified as revenues relating to the prior fiscal year and received within the first 60 days after the end of the related fiscal year."

The Commission lacks support for certain items in its fiscal year 2002 Annual Financial Report.

The Commission lacks key supporting information to validate the accuracy of its fiscal year 2002 Annual Financial Report. Specifically:

- The Commission could not provide support for the $90,535 it reported as accounts payable in its fiscal year 2002 financial statements.

- The Commission's communications and utilities expenditures reported in its Annual Financial Reports increased from $53,774 in fiscal year 2001 to $86,428 in fiscal year 2002 (an increase of almost 61 percent). We first communicated this issue to the Commission in July 2003, but it was not able to provide explanations until several months later. The Commission's explanations identified additional problems, including a double billing that was not identified until after it was paid, miscoding of expenditures, and a possible error in the fiscal year 2001 Annual Financial Report.

Chapter 5-E

Inadequate Oversight and Management of the Commission's Enforcement Function Has Resulted in the Assessment of Incorrect Penalty Amounts

The Commission does not consistently assess administrative penalties in compliance with its own regulations. We identified 484 instances in which the Commission assessed a penalty that was either higher or lower than the penalty specified by the Texas Administrative Code (TAC), Title 22, Part 4, Section 89.1. The result of these errors is that the Commission overcharged licensees $25,725 for some offenses and undercharged licensees $56,600 for other offenses.

These errors occurred because the Commission has not adequately managed the enforcement function to ensure compliance with laws and regulations. Specifically, when it revised its schedule of penalties in the TAC in 2000, the Commission neglected to update a table in its database that determines the amount of penalties it assesses. Therefore, individuals the Commission cited for certain violations (violations for which the Commission had changed the penalty amount) were assessed the wrong penalty amount. For example, the prior rules adopted in 1998 called for a warning with no penalty for the first offense involving a salon that does not have proper equipment or square footage. The Commission's current rules (in effect since April 2000) require it to impose a penalty of $300. From April 2000 through June 2003, however, the Commission assessed warnings without penalties for first offenses of this kind. The Commission was not aware of these errors until we brought them to its attention.

Chapter 5-F

The Commission Has Not Implemented Key Information Technology Controls to Help Ensure the Integrity of Financial and Operational Data

Weaknesses in the Commission's information technology controls have resulted in lost financial information and could allow the entry of duplicate inspection and violation reports. In addition, as discussed in Chapter 5-E, the Commission assessed incorrect penalty amounts for some violations, which indicates that the Commission does not have an adequate change control process to ensure that it appropriately updates all information systems when changes are necessary as a result of revisions to statutes, regulations, or business needs.

Weaknesses in the Commission's server backup testing resulted in the loss of financial information.

The Commission reported that it lost certain financial information, including its log of purchase vouchers and accounting policies and procedures, when its server crashed in 2003. This occurred because, when the Commission converted its server from Windows NT to Windows 2000 in fiscal year 2003, it did not test to determine that its server backups were working properly.

Weaknesses in data entry controls allow the entry of duplicate inspection and violation reports.

The Commission has not implemented controls to prevent the entry of duplicate inspection and violation reports into its licensing and enforcement system. This can lead to inaccurate information for managing Commission operations.

Chapter 6

The Commission's Gross Fiscal Mismanagement Requires Immediate Corrective Action and the Implementation of a Long-Term Financial Remediation Plan

The Commission's fiscal mismanagement was severe and pervasive. The Commission had two executive directors during the period that we audited. Throughout our audit, the Commission had difficulty locating records and providing explanations for issues we identified. The current executive director was hired in July 2002 and has begun to take steps to address our findings. For example, the Commission is beginning to draft financial policies and procedures, and it is beginning to address the issue of uncollected penalties by resuming administrative hearings. Fully correcting gross fiscal mismanagement at the Commission will require:

- Immediate action to correct certain deficiencies.
- The implementation of a long-term financial remediation plan to repair the Commission's financial health and to ensure that it can provide reliable and useful information.

Without corrective action, the Commission's deficiencies in fiscal management will continue to hinder its ability to provide services and manage its operations.

Certain deficiencies must be corrected immediately.

Immediate corrective action is necessary for the following issues:

- Complete enforcement authority should be used to collect penalties, including continuing the hearings process at SOAH and consistently blocking the renewal of licenses for individuals who have not paid administrative penalties.
- Controls over the receipt of funds should be implemented.
- A process to ensure compliance with capital budget restrictions in the General Appropriations Act should be enforced, and documentation to support compliance should be retained.
- TexasOnline subscription fees should be paid on time and in the proper amount.
- A process to ensure that revenue is deposited within three business days of receipt should be implemented.
- A monthly process to perform cash reconciliations to the State Treasury account balance should be implemented.
- Written procedures to ensure that all transactions are accurate, properly authorized, and properly documented should be implemented. These procedures should address:
    - Adequate segregation of duties between the payroll function and release of payroll into USAS.

    - Supervisory review of payroll information and processing.
    - Adequate staff training in the preparation of financial transactions.
    - Periodic review and revision of USAS user access capabilities, including whether user access is appropriate for current job responsibilities.

- A process should be implemented to ensure that the Commission's reports and records present a complete and accurate picture of its financial activities and position. This includes the implementation of:
    - A quality control process for preparing financial statements. A process should be developed for examining financial data before it is submitted to the contractor that prepares the Commission's annual financial statements.
    - A quality control examination on the completed financial statements to detect and prevent errors.
    - Processes to ensure that supporting documentation for financial activities is maintained in accordance with the state records retention policies.
- Certain collection accounts and processes should be established. These include an allowance for doubtful accounts, a bad debt expense account, criteria defining uncollectible accounts, and procedures to age accounts receivable to determine which accounts receivable are not likely to be collected.
- A process should be implemented to ensure that the correct penalty amounts are assessed for all violations.
- A process should be established to ensure that adequate server backups are tested and performed regularly.
- Controls should be implemented over the licensing and enforcement system to ensure accurate information and compliance with regulations.

A long-term financial remediation plan is also necessary.

To fully address financial management and internal control weaknesses, the development and implementation of a long-term financial remediation plan also is necessary. This plan should ensure that the Commission's financial management system supports:

- The fiduciary role of management and the Commissioners.
- Compliance with legal and regulatory requirements.
- Ongoing fiscal and budgetary monitoring.
- The capturing of financial information required to measure performance.
- The Commission's strategic plan.
- The safeguarding of resources against waste, loss, and misuse.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

Our objective was to determine whether the Cosmetology Commission's (Commission) processes and operations ensure that it is meeting statutory responsibilities, safeguarding resources, and complying with applicable laws and regulations. To accomplish that objective, we:

- Determined whether the Commission's operational processes are effective and efficient.
- Determined whether the Commission is complying with applicable laws and regulations.
- Determined whether the Commission's financial processes ensure accurate, complete, and reliable financial information.

Scope

Our audit covered licensing, enforcement, and financial processes from fiscal years 2000 to 2003. Testing of transactions focused on fiscal years 2002 and 2003 and included licenses, revenues, expenditures, and journal vouchers. We also tested compliance with laws and regulations.

Methodology

The audit methodology consisted of collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with the Commission's management and staff.

<u>Information collected</u> included the following:

- Interviews with Commission staff
- Commission financial and operational files
- Automated data from the Commission's licensing and enforcement databases

<u>Procedures and tests conducted</u> included the following:

- Tests of expenditures, revenues, and journal voucher transactions to ensure accuracy. Our tests of expenditures and revenues were based on statistical samples from fiscal years 2002 and 2003 in order to allow projection to the population. Our sample sizes were 69 and 68, respectively. We selected a judgmental sample of 20 journal vouchers.
- Financial analysis of the Commission's fiscal year 2002 Annual Financial Report

- Testing of licensing and enforcement files for compliance with laws and regulations
- Review of controls over automated systems and tests of accuracy of the data

Criteria used included the following:

- Texas Occupations Code, Section 1602
- Texas Administrative Code, Title 22, Part 4
- General Appropriations Act (77th Legislature)
- Commission policies and procedures
- Comptroller of Public Accounts' *Reporting Requirements and Technical Guidance for Annual Financial Reports for State Agencies and State Colleges and Universities*, June 2002

Other Information

We conducted fieldwork from June 2003 through September 2003. This audit was conducted in accordance with generally accepted government auditing standards; there were no significant instances of noncompliance with these standards.

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

- Michael Dean, CGAP, PMP (Project Manager)
- Beverly Bavousett, CPA (Assistant Project Manager)
- Lori Field
- Melissa Larson, CIA, CISA
- Rebecca Tatarski
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Sandra Vice, CIA, CGAP (Audit Manager)
- Frank Vito, CPA (Audit Director)

Management's Responses

TEXAS COSMETOLOGY COMMISSION
FRANK JOSEPH COSMETOLOGY BUILDING
5717 BALCONES DRIVE, AUSTIN, TEXAS 78731-4203
P. O. Box 26700, Austin, Texas 78755-0700

ANTOINETTE FONTENOT HUMPHREY
Executive Director

January 26, 2004

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

Re: Texas Cosmetology Commission's Management Response to State Auditor's Internal Controls and Financial Processes Audit

Dear Mr. Alwin,

I appreciate the State Auditor's work in evaluating the internal controls and systems of the Texas Cosmetology Commission for the audit period covering fiscal years 2000 to 2003. The findings and recommendations stated in your report will further assist the agency with establishing sound fiscal practices that will achieve improved accountability, reliability and minimize operational risks. As indicated in your report, I was hired as the executive director in July 2002. I immediately begin an internal evaluation of risks and control within the agency and to analyze and identify deficiencies in financial management. Prior and during the audit I worked with staff to correct many of the control weaknesses identified.

One of my first initiatives as executive director was to re-instate the administrative hearings process. The Office of Attorney General suspended their hearings previously held on behalf of the Commission in Fiscal Year 2001. Consequently, I contacted their office in August 2002 to implement a plan for the Commission to take over the hearings process.

The Commission took steps to strengthen its financial controls including hiring a Certified Public Accountant in Fiscal Year 2003 to develop and implement new accounting policies and procedures. Our new financial controls are value based and increase the agency's overall effectiveness. I look forward to receiving feedback from your office once you have had an opportunity to test the policies and procedures we have submitted for your review.

A year ago, as part of my efforts to improve operations, I requested technical assistance from the State Auditor's Office. Your staff provided informal recommendations that were implemented and served to improve our efficiencies with fee and other revenue processing. The Commission has either implemented or partially implemented all of recommendations identified for immediate corrective action. We will continue to work with your office to develop an effective long-term financial remediation plan.

Please find attached the agency's response to your financial audit report. Should you have any questions, or if I may be of assistance, feel free to contact me directly at 380-7636.

Sincerely,

Antoinette Fontenot Humphrey

Antoinette Fontenot Humphrey

Executive Director
Texas Cosmetology Commission

Attachments

★ (512) 380-7600 ★ (800) 943-8922 ★ FAX (512) 454-0339 ★ Web: www.txcc.state.tx.us

Chapter 1 – There was Gross Fiscal Mismanagement at the Commission During Fiscal Years 2002 and 2003

The Commission acknowledges that historical weaknesses in its financial management systems have contributed to existing deficiencies. The current administration is aggressively modifying processes aimed at increasing reliability and accuracy of its financial data. For example, the agency re-engineered its collection processes and reallocated resources in Fiscal Years 2002 and 2003 to increase the collection of administrative penalties. As a result, in Fiscal Year 2003, the agency exceeded previous year's collections by over $300,000. The Commission also changed its procedures so that revenues could be effectively deposited to the state treasury within statutory timeframes, hired an accounting firm to analyze our financial reporting and to produce legislative required financial reports, settled its accounts with Texas Online and corrected accounting tables so that the accurate fine amounts would be assessed. Commission employees take their roles as public servants and stewards of state resources seriously. Under the current administration, the agency is striving to operate at the highest level of integrity, professionalism and dedication. We acknowledge the critical weaknesses identified by the auditor's and are committed to resolving them expeditiously.

Chapter 2-A The Commission Has Not Collected $2.8 Million in Penalties and Has Not Followed Statutory and Regulatory Requirements for Collecting Penalties

The Commission acknowledges that historically, the rate of fines collected has been inadequate. The Office of Attorney General (OAG) discontinued the functions necessary to conduct hearings with State Office Administrative Hearings (SOAH) on behalf of the Commission in Fiscal Year 2001. Therefore, the Commission, under my administration, took steps to absorb this function and the associated additional costs internally. Because of these additional costs, the Commission's implementation of the hearings process was phased in by performing the following steps: 1) contacting the OAG and SOAH in August 2002 to gain an understanding of how to take over the hearings process; 2) hiring additional staff and allocating computer programming resources at a cost of over $60,000 in Fiscal Year 2003; 3) requiring staff to take leave without pay in Fiscal Year 2003; 4) requesting financial aid from the Governor's Office after we exhausted all of our resources pursuing compliance with statutory and regulatory requirements for the collection of administrative penalties and other mandated procedures in Fiscal Year 2003; and 5) presenting cases before SOAH in Fiscal Year 2004. To compensate for the additional time and costs required to absorb the hearings process internally, the agency implemented intermediate measures to promote the collection of fines. For example we declined renewal applications for licensees until they paid their fines or presented evidence that they requested a SOAH hearing and we sent thousands of letters to licensees requesting payment of outstanding accounts.

Other steps taken to correct weaknesses in the agency's fine collection procedures in Fiscal Years 2002 and 2003 included; 1) replacing the Interim Enforcement Director with a state bar certified criminal attorney; (2) reviewing backlogged case files (estimated to be 4,000 cases); and, 3) evaluating cases from the previous three years to ensure that the Commission's evidence would be sufficient and admissible when attempting to prove allegations giving rise to a proposed penalty. The steps initiated by the current administration in Fiscal Years 2002 and 2003 resulted in the agency increasing the collections rates retroactively going back to Fiscal Year 2000. This success has carried forward into Fiscal Year 2004.

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During the First and Second Quarter of Fiscal Year 2004, 841 cases were set on the SOAH docket for hearings. This is an increase from the 785 cases set in Fiscal Year 2000 and 542 cases set in Fiscal Year 2001 by the OAG.

With regard to the Auditor's assessment that the overlap in timing of fiscal years when penalties were assessed and when they were collected could result in inconclusive data, the agency agrees. Therefore, when analyzing the Commission's handling of collections we researched the percentage of violations issued that were paid. Based on our analysis we have concluded that only 3 percent of our licensees received a violation on two or more separate occasions within a three-year period. Therefore, we found that the auditor's assessment that the agency's failure to collect all administrative penalties served as a disincentive for licensees to comply with the Commission's laws and rules to be inconclusive. The following information shows the percentage of violations assessed that were paid.

FY 2000	71% of violations issued were paid
FY 2001	57% of violations issued were paid
FY 2002	92% of violations issued were paid
FY 2003	84% of violations issued were paid
FY 2004	71% of the violations issued were paid (Fiscal Year 2004 reflects first quarter and the first two weeks of the second quarter. The agency collected $316,773 of the $344,575 fines assessed this fiscal year. There is less than a $28,000 difference between the two fine amounts. The collection rate for Fiscal Year 2004 shows that the agency continues to have success in collecting fines assessed from previous years.

The success we experienced in Fiscal Year 2003, has further strengthened our resolve to aggressively set cases before SOAH and pursue contacts with licensees owing fines until accounts have be settled.

Chapter 2-B The Commission's Procedures for Handling Revenues Create a High Risk of Loss and Impropriety

The Commission agrees with the auditor's assessment that the agency's handling of revenues have been inadequate. The steps we have taken to correct the problem are as follows:

- The Commission hired a CPA in June of 2003 who developed new policies directing payroll, revenue and expenditure processing
- The Commission's travel policies were changed to require at least two staff to review and audit travel vouchers before payments are issued
- The Commission implemented new control policies that provide the proper check and balances for the processing of cash receipts
- In June of 2003, procedures were changed so that the employee who performs data entry into the Uniform Statewide Accounting System (USAS) for cash receipts no longer had access to safes containing payments
- The use of the combination safe was discontinued
- Access to the safe containing payments is now restricted to one individual as suggested

- The CPA hired by the Commission was charged with maintaining an Excel spreadsheet to reconcile our State Treasury balance to our common cash system and internal accounting system

Chapter 2-C The Commission Can Not Demonstrate that it Complied with its Authorized Capital Budget in Fiscal Year 2002

The Commission has responded proactively to the auditor's concerns about the capital budget.

When we were informed that the auditors believed that the agency exceeded its capital budget authority in Fiscal Year 2002, the Commission submitted correspondence to the Legislative Budget Board (LBB) and the Comptroller of Public Accounts (the state's designated authority on budget rules and regulations) to obtain feedback on this issue. Response from the LBB and the Comptroller's Office did not indicate that the Commission exceeded its budget authority.

The Commission has taken the audit concerns seriously and has made good faith efforts to address those issues and comply with capital budget regulations.

Chapter 2-D Control Weaknesses over the Commission's Expenditures Create a Risk that Inappropriate Transactions Could be processed

We concur with the State Auditor that control weaknesses existed in the Commission's expenditure process. Once I was made aware of this continuing problem, payroll policies were developed, USAS access allowing multiple functions to be performed by one individual was discontinued, payroll functions were segregated among individual accounting staff so that no one person could enter, revise, and approve transactions in USAS.

Chapter 3-A The Commission has not Discharged Fiscal Obligations in a Timely Manner

The Commission concurs with this assessment. Texas Online was paid the $6,000 it was owed. New procedures have been put in place so that Texas Online is paid on time.

Chapter 3-B The Commission is not complying with Statutory Deposit Requirements

The Commission concurs with Auditor's assessment regarding the timely deposit of revenue as required by the Texas Government Code. We have developed and implemented new policies and procedures to correct the problem. The policies include mandatory deposits of all revenues received by the Commission.

Chapter 4 – The Commission Misused State Funds

We concur with Auditor's findings that the Commission's Chief Financial Officer circumvented the system when awarding a contract. The resignation of this employee was effective the day the incident was reported by accounting staff.

Chapter 5A-5E The Commission has not Maintained Adequate Fiscal Records

The Commission concurs with the State Auditor's findings regarding the inadequacy of its fiscal records. To address these concerns the Commission has taken immediate action by hiring a Certified Public Accountant (June 2003) for the development and implementation of internal controls and policies; contracting with an accounting firm to perform yearly reconciliations and to prepare statutorily required financial reports; and modified its enforcement databases to correct deficiencies identified by the State Auditor's office to ensure that penalties will be assessed consistently with its regulations.

Chapter 6 The Commissions Gross Fiscal Mismanagement Requires Immediate Corrective Action and the Implementation of a Long-Term Financial Remediation Plan

We greatly appreciate the State Auditor's Office pointing out our financial weaknesses. The steps taken by the Commission to implement all of the corrective actions recommended by your office are listed as follows:

RECOMMENDATIONS	STATUS
• Continue the SOAH process and block license renewals of individuals who have unpaid fines	Implemented
• Implement controls over receipt of funds	Implemented
• Monitor capital budget	We no longer have a capital budget appropriation.
• Pay Texas Online in a timely manner	In progress Title of person responsible: Accounts Payable Accountant Implementation date February 2004
• Implement procedures to ensure that revenues are deposited within the three business day required timeframe	Implemented
• Implement a process to document monthly reconciliations to USAS	In progress Title of person responsible: Revenue Accountant Implementation date February 2004
• Implement procedures to ensure that all transactions are accurate, properly authorized, and properly documented	Implemented
• Implement a process to ensure that reports of the Commission's financial statements are complete and accurate	In progress Title of person responsible: Chief Financial Officer Implementation date May 2004
• Establish collection accounts	In progress Title of person responsible: Chief Financial Officer Implementation date June 2004
• Implement procedures to ensure that correct penalty amounts are assessed	Implemented
• Establish procedures to ensure that adequate server backups are performed and tested regularly	Implemented
• Establish controls over licensing and enforcement systems to ensure accurate information and compliance with regulations	Implemented

Auditor's Follow-up Comment to Management's Response

The Commission contacted us in September 2002 to discuss a possible non-audit engagement to review its cash management and student permitting processes and to help redesign these functions. Following this request, we held meetings totaling four hours in duration to discuss the work that could be performed. As these meetings progressed, we found that the issues the Commission identified to us were financial in nature. No work was performed, and no report was issued. At that time, we recommended to the Commission that it request an audit.

In its response, the Commission asserts that the suspension of administrative hearings resulted from changes implemented at the Office of the Attorney General. However, as we specified in the report, the Texas Occupations Code requires the Commission to schedule hearings for violators who do not pay their administrative penalties in a timely fashion. While this function may have been performed historically by the Office of the Attorney General, it is the Commission's responsibility to ensure that hearings are scheduled in compliance with statute. Further, the Commission's assertion that it exhausted its resources pursuing compliance with statutory and regulatory collection procedures indicates a failure to plan and manage so that the Commission accomplishes its mission with available resources.

The Commission asserts that fiscal year 2003 collections were $300,000 more than in fiscal year 2002. However, penalties collected in fiscal year 2002 actually decreased from fiscal year 2001, which is out of line with the historical trend that the dollars collected each fiscal year were increasing. When this deviation from historical trends is considered, the penalties collected in fiscal year 2003 appear to be a continuation of the historical trend and are not exceptionally high. See Table 2 on page 3.

The Commission also disagrees that not collecting administrative penalties reduces the incentive to comply with laws and regulations because it asserts that its number of repeat violators is only 3 percent. The number of repeat violators is not an adequate measure of the effect of not collecting penalties. Failure to collect penalties assessed for violations of laws and regulations sends a message that enforcement is not important. Such a culture weakens the accountability for compliance with safety and health standards that those laws and regulations are intended to create. In addition, Table 2 on page 3 shows that the dollars assessed in administrative penalties each year almost doubled from fiscal year 2000 to fiscal year 2002. This would tend to show that the culture of accountability for compliance needs to be strengthened.

Although our analysis indicates that the Commission may have exceeded its capital budget for construction of buildings and facilities, the Commission asserts that the additional expenses constitute separate projects not related to the capital budget. Despite the fact that, in its response, the Commission contends that the Legislative Budget Board and Comptroller of Public Accounts "did not indicate that the Commission exceeded its budget authority," the documentation the Commission provided did not clearly demonstrate that those expenses were for separate projects. Neither the Legislative Budget Board nor the Comptroller of Public Accounts would have documentation to show whether the additional expenses are for the same or separate projects. It is the Commission's responsibility to manage its capital budget appropriately so that it ensures that it complies with relevant laws and regulations. Maintaining adequate documentation for capital projects and recording transactions accurately are important components of managing a capital budget.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas "Tommy" Williams, Member, Texas Senate
The Honorable Talmadge Heflin, House Appropriations Committee
The Honorable Ron Wilson, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Cosmetology Commission

Ms. Helen R. Quiram, Board Chair
Ms. Esther Camacho, Board Member
Mr. Leif Christiansen, Board Member
Ms. Heliana Kiessling, Board Member
Mr. Philip Lapp, Board Member
Ms. Lucinda Sandoval, Board Member
Ms. Elida Zapata, Board Member
Ms. Antoinette Fontenot Humphrey, Executive Director