An Audit Report on

The Credit Union Department: A Self-directed, Semi-independent Agency

December 2016

Report No. 17-014

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Overall Conclusion

The Credit Union Department (Department) accurately calculated, properly collected, and properly reduced/waived credit union operating fees in compliance with Department requirements, policies, and procedures. It also had a reasonable budget process to ensure that revenue (consisting primarily of operating fees) adequately covered its operational costs. However, the Department should improve controls over waiving late payment penalties.

The Department also should strengthen controls over its reporting processes. It did not have a formal process or documented policies and procedures for the preparation and review of the reports audited. The Department's fiscal year 2015 *Annual Financial Report* contained significant financial errors, and one of those errors was carried to the Department's 2015 *Report of Nonfinancial Data*. The Department also incorrectly reported assets into the State Property Accounting system, which contributed to the errors in its 2015 *Annual Financial Report*. The Department should address the identified weaknesses in its accounts payable and inventory processes, which contributed to the Department's reporting errors.

> **Background Information**
>
> The 81st Legislature designated the Credit Union Department (Department) as a self-directed, semi-independent (SDSI) agency. Prior to that, the Department was funded through the General Appropriations Act.
>
> The Department is a financial regulatory agency whose mission is to safeguard the public interest, protect the financial interests of credit union members, and promote public confidence in the credit union industry. The Department is entrusted with ensuring the safety and soundness of state-chartered credit unions in Texas. As of August 31, 2015, the Department regulated 185 state-chartered credit unions.
>
> The Department is charged with adopting a fee structure that determines the operating fees that state-chartered entities pay. The fees are used to fund the Department's operations. As an SDSI agency, the Department does not receive funds through the General Appropriations Act.
>
> The Department is governed by the Credit Union Commission, which has nine members appointed by the Governor. Four members must be from the credit union industry and five members must be from the general public with no direct involvement in the management of a financial institution.
>
> Source: The Department.

In addition, while the Department's 2014 Biennial Self-directed, Semi-independent *(*SDSI*)* Report complied with Texas Finance Code requirements and was accurate, its 2015 Annual SDSI Report included incorrect financial information. The Department understated commission member travel expenditures and overstated employee travel expenditures in its 2015 Annual SDSI Report.

The Department accurately calculated all three performance measures tested; however, it should improve certain controls to ensure that it continues to accurately calculate the performance measures audited.

The Department should strengthen controls over internal and contracted information technology operations. Specifically, the Department did not (1) have

This audit was conducted in accordance with Texas Government Code, Section 472.103; Texas Finance Code, Section 16.004; and Texas Occupations Code, Section 1105.004.

For more information regarding this report, please contact Michael Clayton, Audit Manager, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

documented and approved policies and procedures, (2) communicate security requirements to its information technology contractor, and (3) adequately monitor contractor activities.

Auditors communicated other, less significant issues related to purchasing, travel, reporting, performance measures, operating fees, and user access to Department management. Auditors also identified certain weaknesses in information technology controls. To minimize risks associated with public disclosure, auditors communicated details about the information technology weaknesses to the Department's management separately in writing.

Table 1 presents a summary of the findings in this report and the related issue rating. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters and Related Issue Ratings		
Chapter	Title	Issue Rating [a]
1	The Department Complied With Requirements for Setting Fees and Penalties; However, It Should Improve Controls Over Waiving Late Payment Penalties	Low
2	The Department Should Strengthen Controls Over Its Financial Accounting and Reporting Processes to Help Ensure That It Reports Accurate Information	High
3	The Department Accurately Calculated All Three Performance Measures Tested; However, It Should Improve Certain Controls to Ensure That It Continues to Accurately Calculate the Performance Measures Audited	Low
4	The Department Should Strengthen Controls Governing Internal and Contracted Information Technology Operations	Medium

[a] A chapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter is rated Low if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

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

At the end of each chapter in this report, auditors made recommendations to address the issues identified during this audit. The Department agreed with the findings and recommendations in this report.

Audit Objective and Scope

The objective of this audit was to verify the accuracy of certain financial and performance data and the effectiveness of related controls at selected self-directed, semi-independent agencies and evaluate the agencies' process for setting fees and penalties. The agency selected for this audit was the Department.

The scope of this audit covered the Department's financial and performance data for fiscal years 2015 and 2016, including the Department's:

- 2015 *Annual Financial Report*, 2015 Annual SDSI Report, 2014 Biennial SDSI Report, and 2015 *Report of Nonfinancial Data*. Auditors also conducted limited work on fixed assets inventory.
- Travel and purchase expenditures from fiscal year 2015 through May 2016.
- Selected fiscal year 2015 performance measures:
  - Percentage of Credit Unions Receiving Regular Examination Annually.
  - Percentage of Reports to Credit Unions Within 20 Days.
  - Percentage of Complaints Investigated and Responded to Within 30 Days of Receipt.
- Fiscal year 2015 and fiscal year 2016 operating fees and budget process.
- Selected year-end annual accounting transactions from fiscal year 2014.

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Detailed Results

Chapter 1

The Department Complied With Requirements for Setting Fees and Penalties; However, It Should Improve Controls Over Waiving Late Payment Penalties

Chapter 1 Rating: Low [1]

The Credit Union Department (Department) had an adequate process for setting fees that was based on its budgetary needs. Specifically, for fiscal years 2015 and 2016, the Department:

- Considered several factors to help it formulate its proposed budgets, including historical revenue and expenditure trends; salaries and turnover; credit union assets, mergers, and conversions; and the Department's planned capital improvements and strategic initiatives.

- Used the proposed budgets and projected fees to determine whether any adjustments to the fee structure were needed. The Department determined that no adjustments to the fee structure were needed for fiscal years 2015 and 2016.

- Ensured that the Credit Union Commission formally approved the budgets.

The Department also had processes for adjusting operating fees for all credit unions to ensure that its revenue, which consists primarily of those fees, adequately covered its operational costs. Specifically:

- Title 7, Texas Administrative Code, Section 97.113 (7 TAC 97.113), states that credit union operating fees shall be paid annually in two installments. The final installment can be lowered after a review of the actual revenues to date and projected revenues for the remainder of the fiscal year. The Department compared the actual revenues to date and projected revenues for the remainder of the fiscal year against the projected expenditures for fiscal years 2015 and 2016 to determine the amount that the final installments should be reduced. In compliance with 7 TAC 97.113, the Department reduced fees for the final installment for fiscal year 2015 by a total of approximately $326,000, or 17 percent.

[1] Chapter 1 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

In addition, the Department reduced the fees for the final installment for fiscal year 2016 by a total of approximately $682,000, or 34 percent.

- In compliance with its policy, the Department calculated that it had an excess fund balance of $439,596 at the end of fiscal year 2015, which it used to reduce fees for all credit unions for fiscal year 2016. Department policy requires its fund balance to be limited to $845,000 and that any excess funds be used to reduce the operating fees for credit unions during the next fiscal year.

In calculating and billing operating fees for each credit union, the Department complied with 7 TAC 97.113. The Department also complied with its policies and procedures for the collection of operating fees for fiscal years 2015 and 2016. Specifically, the Department:

- Accurately calculated the operating fees for each credit union for fiscal year 2015. Total fees collected were $3.426 million.

- Accurately calculated the operating fees for each credit union for fiscal year 2016. Total fees collected were $3.246 million.

- Properly billed, collected, and deposited the sample of 80 credit union operating fees tested into the Texas Treasury Safekeeping Trust Company in compliance with Department policies and procedures.

The Department also properly waived the fiscal year 2015 operating fees for one credit union and the fiscal year 2016 operating fees for two credit unions. Specifically, the Department's commissioner documented the cause for the waivers—which were awarded because those credit unions were in the process of liquidation—and reported those waivers to the Credit Union Commission as required by 7 TAC 97.113. The Department also documented its reasons for reducing by 50 percent the fiscal year 2015 operating fees for one credit union that had been put into conservatorship because it was insolvent.

However, the Department should improve its controls over waiving late payment fees. Specifically, 7 TAC 97.113 states that members will be charged a 10 percent fee for late payments of operating fees, unless the Commissioner waives the late fee for "good cause." However, the Department did not maintain documentation supporting the "good cause" for 6 (55 percent) of 11 late fee waivers for fiscal year 2015 and for 3 (75 percent) of 4 late fee waivers for fiscal year 2016. The Department also lacked documented policies and procedures for its process for waiving late fees. Not properly waiving late fees increases the risk that the Department would not receive all its fee revenue.

Recommendation

The Department should develop, document, and implement policies and procedures for the waiver of fees for late payment of operating fees.

Management's Response

The Department agrees that it should implement written policies to improve and strengthen the procedures for the waiver of a penalty against a credit union for the untimely payment of its operating fee. A new written policy is being implemented to provide, among other things, that a credit union may obtain relief from late payment penalties only if it can demonstrate, to the satisfaction of the Commissioner that the late payment was due to: (1) reasonable cause and (2) circumstances beyond the credit union's control. Further, the credit union must show that the failure to timely pay occurred notwithstanding the exercise of ordinary care and in the absence of any credit union neglect.

The Department will comply with the SAO recommendation to develop, document, and implement policies and procedures for the waiver of fees for late payment of operating fees.

***Responsible Management**: Commissioner*

***Due**: December 1, 2016*

Chapter 2

The Department Should Strengthen Controls Over Its Accounting and Reporting Processes to Help Ensure That It Reports Accurate Information

Chapter 2 Rating:

High [2]

The Department did not have an adequate process or documented policies and procedures for preparing and reviewing its reports. As a result, the Department's fiscal year 2015 *Annual Financial Report*; 2015 Annual Self-directed, Semi-independent (SDSI) Report; and 2015 *Report of Nonfinancial Data* contained errors. However, the Department's required 2014 Biennial SDSI Report complied with Texas Finance Code requirements and was accurate.

Additionally, the Department incorrectly reported assets in the State Property Accounting (SPA) system, and it had weaknesses in its year-end accounts payable and inventory processes. Those issues contributed to the reporting errors discussed above.

Annual Financial Report

The Department did not have documented policies and procedures for preparing its *Annual Financial Report*, and it did not formally document its review of its *Annual Financial Report*. As a result, the Department's fiscal year 2015 *Annual Financial Report* contained significant errors. Based on a review of the report, auditors determined:

- The Department incorrectly transferred liabilities and fund balance amounts from the Uniform Statewide Accounting System to its *Annual Financial Report* as negative amounts rather than positive amounts. As a result, the Department:
  - Underreported current liabilities by $311,144 (or 67 percent).
  - Underreported total liabilities by $567,957 (or 96 percent).
  - Overreported total net assets by $270,722 (23 percent).

  The transfer errors also resulted in an $18,000 overstatement of the general fund balance (the Department's operating fund) and a $24,378 understatement of the governmental fund balance (the balance of all Department funds).

[2] The risk related to the issues discussed in Chapter 2 is rated as High because they present risks or results that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.

- In the capital assets note disclosure in its *Annual Financial Report*, the Department overstated furniture and equipment by $22,273 (23 percent) (see text box for definition of capitalized assets). Specifically, the Department (1) incorrectly included 2 assets it no longer owned totaling $38,281 and (2) incorrectly excluded 3 assets totaling $16,008. In addition, because the Department understated current liabilities and total liabilities, it reported incorrect accumulated depreciation.

> **Capitalized Assets**
>
> Capitalized Asset - A capitalized asset is an asset that has a value equal to or greater than the capitalization threshold established for that asset type. The threshold for the asset type determines materiality. Capitalized assets are reported in an agency's annual financial report.
>
> Source: The Office of the Comptroller of Public Accounts' *State Property Accounting (SPA) Core Training*.

Because of weaknesses in its year-end accounts payable process, the Department improperly recorded $74,623 in expenditures for fiscal year 2014 and $23,847 in expenditures for fiscal year 2015 in its accounting system. Specifically, the Department included in its estimates for fiscal years 2014 and 2015 expenditures for goods and services that it had not ordered or received in those fiscal years. The Office of the Comptroller of Public Accounts' reporting guidelines defines payables as amounts obligated for goods or services actually rendered or provided to an agency by the end of the reporting period but for which the agency has not yet made payment should be recorded as accounts payable. As a result of those errors:

- The Department understated professional fees and services by $45,463 in its fiscal year 2015 *Annual Financial Report*. That error also appeared in the Department's reporting of professional fees in its fiscal year 2015 *Report of Nonfinancial Data*.

- The Department overstated travel expenditures by $4,875 in its fiscal year 2015 *Annual Financial Report*. Specifically:

  - The weaknesses in the Department's accounts payable process caused $3,591 of that overstatement.

  - The Department incorrectly classified a $1,284 travel reimbursement overpayment as revenue without canceling the expenditure (instead of correctly classifying it as the refund of an expenditure). That resulted in the Department overstating travel expenditures, as well as overstating revenue in its fiscal year 2015 *Annual Financial Report* by $1,284.

2015 Annual SDSI Report

The Department did not have documented policies and procedures for the preparation of SDSI reports, and it did not formally document its reviews of its SDSI reports.

In its 2015 Annual SDSI Report, the Department reported incorrect financial information. Specifically, the Department:

- Understated travel expenditures for the Credit Union Commission members by $4,832. The Texas Finance Code requires reporting of total amount of per diem expenses and travel expenses paid to each member of an agency's policy making body.
- Overstated travel expenditures by $9,742 because it incorrectly included all travel expenditures (for both Credit Union Commission members and employees), instead of including only travel expenditures for employees. The Texas Finance Code requires reporting of the total amount of per diem expenses and travel expenses paid for all agency employees.

The Department was required to submit its 2015 Annual SDSI Report to the Office of the Governor, the House Appropriations Committee, the Senate Finance Committee, and the Legislative Budget Board. Not having documented policies and procedures for and not documenting its review of its Annual SDSI Report increases the risk that the Department will report inaccurate information in the future.

SPA Reporting

In addition to the capital asset reporting errors discussed above, the Department incorrectly reported both controlled and inventoried assets in the SPA system (see text box for definitions of those asset classes). While those errors had no effect on the Department's Annual Financial Report for fiscal year 2015, the Department uses the SPA system as its inventory-tracking system and should ensure that each property item listed in the SPA system is still within its possession. Specifically:

> **Controlled and Inventoried Assets**
>
> Controlled Asset - A controlled asset is an asset that has a value that is less than the capitalization threshold established for that asset type. However, due to its high-risk nature, it is required to be reported in the SPA system. Controlled assets are not reported in an agency's annual financial report, but they are included in its annual physical inventory.
>
> Inventoried Asset - An inventoried asset is an asset that is neither capitalized nor controlled but is tracked in the SPA system for inventory purposes. Inventoried assets are not reported on an agency's annual financial report or included in its annual physical inventory.
>
> Source: The Office of the Comptroller of Public Accounts' *State Property Accounting (SPA) Core Training*.

- For controlled assets, the Department (1) incorrectly included in the SPA system one asset that it no longer owned and (2) incorrectly excluded from the SPA system two assets. That resulted in the asset balance being reported at an amount lower than it should have been reported in the SPA system by one asset and $3,205.

- For inventoried assets, the Department (1) incorrectly included in the SPA system 13 assets that it no longer owned; (2) recorded 2 assets in the SPA system in error; (3) included 3 assets in the SPA system that it should have classified as controlled or capital assets; and (4) incorrectly excluded 3 assets from the SPA system. That resulted in the asset balance being reported at an amount higher than it should have been reported in the SPA system by 15 assets and $8,816.

Recommendations

The Department should:

- Develop, document, and implement policies and procedures for preparing its *Annual Financial Reports*, SDSI Reports, and *Reports of Nonfinancial Data*.

- Develop, document, and implement a formal review process that (1) verifies the accuracy of the calculations for its *Annual Financial Reports*, SDSI Reports, and *Reports of Nonfinancial Data* and (2) ensures that management documents its reviews of those reports. That should include:

  - Establishing a documented process to help ensure that the Department has proper support for year-end adjusting accounting entries and accurately processes adjusting accounting entries in its accounting system.

  - Establishing a documented process to help ensure that the Department properly captures and records information on assets it both purchases and discards in the SPA system.

Management's Response

The Department agrees that it should implement written policies to improve and strengthen the procedures for preparing required reports. All but one of the accounting errors were corrected during the audit process. The remaining error, which involves a refund of expenditure ($1,284) in FY 2015, is in the process of being corrected and will be reflected in the Department's FY 2017 annual financial report. Furthermore, new procedures have been developed, effective September 1, 2016, for the preparation of the required reports.

The Department has complied with the SAO recommendation to develop, document, and implement policies and procedures for preparing its annual financial reports, SDSI reports, and reports of nonfinancial data.

Responsible Management: *Deputy Commissioner*

Due*: Completed*

The Department agrees that it should implement a formal review process to verify the accuracy of its required reports and document management's review of those reports. A formal review process was recently utilized to verify the accuracy of the calculations of the Department's annual financial reports, for both the FY 2016 annual financial report and the SDSI annual report. The biennial SDSI report and the annual report of nonfinancial data are still being compiled as of the date of this response; however, a formal review process will be utilized to confirm the accuracy of data being submitted for those reports as well. Furthermore, the Department has proper support for its year-end adjusting entries and is in the process of organizing this data in a concise and organized format for future reference, both for internal and audit purposes.

A documented process is also being implemented to ensure the Department properly captures and records asset information for items purchased and discarded. As part of this process, a Statewide Property Accounting report will be run and reviewed semi-annually by a designated Department employee and his/her supervisor for accuracy. The review of the report will be acknowledged (signed and dated) by both employees. The Department will also continue with its normal process of completing an annual physical inventory of all assets. Finally, additional review/training is being provided to applicable employees to ensure all inventory, capital assets, and capitalized assets contain the proper Comptroller object code, if applicable, upon payment and are properly recorded in the Statewide Property Accounting system and on the annual financial report capital asset note 2.

The Department will comply with the SAO recommendation to develop, document, and implement a formal review process that verifies the accuracy of the calculations for its annual financial reports, SDSI reports, and reports of nonfinancial data and ensures that management documents its reviews of those reports.

Responsible Management: *Deputy Commissioner*

Due*: January 1, 2017*

Chapter 3

The Department Accurately Calculated All Three Performance Measures Tested; However, It Should Improve Certain Controls to Ensure That It Continues to Accurately Calculate the Performance Measures Audited

Chapter 3 Rating:
Low [3]

The Department accurately calculated all three performance measures that auditors selected for testing: (1) Percentage of Credit Unions Receiving Regular Examination Annually, (2) Percentage of Reports to Credit Unions Within 20 Days, and (3) Percentage of Complaints Investigated and Responded to Within 30 Days of Receipt. Based on the work performed on the measures, auditors determined that the Department:

- Had adequate controls to ensure that it entered reliable data into ACT! (the database the Department used to generate management reports) and accurately followed the methodology detailed in its strategic plan for calculating the performance measures Percentage of Credit Unions Receiving Regular Examination Annually and Percentage of Reports to Credit Unions Within 20 Days.
- Had adequate automated controls to ensure that ACT! correctly calculated the applicable time lines for meeting the performance measure definitions for Percentage of Reports to Credit Unions Within 20 Days and Percentage of Complaints Investigated and Responded to Within 30 Days of Receipt performance measures.
- Documented its methodology for calculating all three performance measures selected for testing.

However, auditors identified areas in which the Department should improve certain controls to ensure continued accuracy. Specifically:

- The ACT! report the Department used to calculate the Percentage of Reports to Credit Unions Within 20 Days performance measure did not include all credit unions with reports in fiscal year 2015. The Department's *Strategic Plan for Fiscal Years 2015-2019* defined that performance measure to include the total number of examination reports mailed during the reporting period. However, the Department excluded one credit union with two examination reports in fiscal year 2015 period because the query language used to generate the report

[3] Chapter 3 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

excluded "canceled" credit unions, which are credit unions that are no longer in business.

- The Department did not review the complaint data manually entered into ACT!. That resulted in the documentation for 2 (8 percent) of the 25 complaint cases tested not supporting the closing date entered into ACT! for the Percentage of Complaints Investigated and Responded to Within 30 Days of Receipt performance measure. Department policies and procedures state that the closing date, which is the date on which the closing letter is mailed to the complainant, should be entered into ACT!.

- The Department did not follow the methodology in its strategic plan for the calculation of the Percentage of Complaints Investigated and Responded to Within 30 Days of Receipt performance measure. The Department's *Strategic Plan for Fiscal Years 2015-2019* defined the performance measure methodology as dividing the number of written consumer complaints received and responded to within 30 days by the number of complaints responded to during the applicable period. However, the Department included in its calculation 2 complaints that were not received and responded to within 30 days. In addition, the Department did not formally review and approve the performance measure calculation.

While the Department correctly reported the performance measures audited for fiscal year 2015, if it does not correct the weaknesses discussed above, the Department is at increased risk that it will calculate and report inaccurate performance measure results in the future.

Recommendations

The Department should:

- Update programming in ACT! for performance measure reports to ensure that all applicable credit unions are included.

- Develop, document, and implement a formal review process to verify that it uses the correct data in performance measure calculations and that it uses the approved methodology when performing the calculations.

Management's Response

The Department agrees that it must ensure that all applicable credit unions are captured in performance measure reports. The Remedial Exams Report Received and Regular Exams Report Received reports within the 8/31/15 Management Report show the remedial and regular exam conducted during 2015; however, the Report Processing Time Report for the fiscal year end (within same Management Report) did not include those reports. The reason those reports were excluded is that the SQL query for the Report Processing Time Report failed to include cancelled credit unions. The Department has corrected this issue by reprogramming the database. The report now reflects all exams conducted during the report period.

The Department has complied with the SAO recommendation to update programming in ACT! for performance measure reports to ensure that all applicable credit unions are included.

Responsible Management: *Deputy Commissioner*

Due: *Completed*

The Department agrees that correct data and proper methodology is critical to performance measure calculations. The inaccuracy noted in the complaint closing dates (2 of 264) were simply data entry errors. These errors reflect the Department took longer to resolve the complaint than it actually did; and the Department was still within its 30-day deadline to resolve complaints. These data entry errors had no financial effect on the Department. However, the Department has begun instituting new controls to confirm the accuracy of performance measure calculations.

The Department will fully comply with the SAO recommendation to develop, document, and implement a formal review process to verify that the correct data was used in the performance measure calculations and that the approved methodology was used when performing the calculations.

Responsible Management: *Deputy Commissioner*

Due: *February 1, 2017*

Chapter 4

The Department Should Strengthen Controls Governing Internal and Contracted Information Technology Operations

Chapter 4 Rating:
Medium [4]

The Department implemented high-level security policies stating that access to state information resources shall be appropriately managed. Those policies referenced the requirements in Title 1, Texas Administrative Code, Chapter 202, and Texas Government Code, Section 2054.134. However, auditors identified the following areas in which the Department should strengthen its information technology controls:

- The Department did not have detailed documented and approved policies and procedures governing its information technology operations in the areas of (1) assigning administrative access, (2) patching servers, (3) configuring hardware and software, and (4) using firewall hardware and software.
- The Department did not limit access to update data in ACT! based on each user's job duties. Two users without a business need to update data in ACT! had update access to that application. As noted above, the Department did not have documented policies and procedures governing administrative access. Not assigning appropriate administrative access to ACT! increases the risk that the Department's data could contain errors.
- The Department did not provide security requirements to its information technology vendor before it contracted with that vendor to manage the Department's information technology resources. Not defining vendor security requirements increases the risk that (1) the vendor may not provide appropriate service, (2) the Department may not fully accomplish its information technology objectives, and (3) the Department's information technology security could be compromised.
- The Department did not monitor the activities of its information technology vendor, which operates portions of the Department's technology environment. *The State of Texas Contract Management Guide* states that monitoring the performance of a contractor is a key function of proper contract administration and that state agencies are required to conduct enhanced monitoring for high-risk contracts.

Auditors also identified certain weaknesses in information technology controls. To minimize risks associated with public disclosure, auditors

[4] The risk related to the issues discussed in Chapter 4 is rated as Medium because they present risks or results that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.

communicated details about the information technology control weaknesses to the Department's management separately in writing.

Recommendations

The Department should:

- Develop, document, and implement information technology policies and procedures governing its information technology operations in the areas of (1) assigning administrative access, (2) patching servers, (3) configuring hardware and software, and (4) using firewall hardware and software.
- Limit user access to ACT! based on each user's job duties.
- Provide adequate security requirements to its information technology vendor.
- Develop, document, and implement security requirements for monitoring vendor performance and compliance that comply with Title 1, Texas Administrative Code, Chapter 202.

Management's Response

The Department agrees that it should implement written policies to improve and strengthen its information technology policies and procedures. The Department is working with the Department of Information Resources to develop the appropriate policies and procedures to cover these issues.

The Department will comply with the SAO recommendation to develop, document, and implement information technology policies and procedures governing its information technology operations in the areas of (1) assigning administrative access, (2) patching servers, (3) configuring hardware and software, and (4) using firewall hardware and software.

Responsible Management: *Commissioner*

Due: *June 1, 2017*

The Department agrees that access to the database should be limited based on an individual's job duties. The Department has taken the necessary actions to limit database access and has already limited access to update data in ACT! to the appropriate Department personnel.

The Department has complied with the SAO recommendation to limit access to update data in ACT! based on each user's job duties.

Responsible Management: *General Counsel*

***Due**: Completed*

The Department agrees that adequate security requirements should be communicated to and expected from its information technology vendor. The Department executed an agreement with information technology vendor on July 23, 2014, using DIR contract DIR-SDD-1869. That standard DIR contract template did not contain security requirements and DIR did not adopt the security requirements in 1 TAC 202.26 until March 17, 2015. The Department has amended its 2014 managed seat services contract with its information technology vendor to add the now required security, audit, and reporting requirements.

The Department has complied with the SAO recommendation to provide adequate security requirements to its information technology vendor.

***Responsible Management**: General Counsel*

***Due**: Completed*

The Department agrees that monitoring vendor performance and compliance is crucial to safeguard Department data and information. The Department is working with its information technology vendor to obtain patch reports and monthly security reports in addition to documenting and implementing security requirements for monitoring vendor performance and compliance.

The Department will comply with the SAO recommendation to develop, document, and implement security requirements for monitoring vendor performance and compliance that comply with Title 1, Texas Administrative Code, Chapter 202.

***Responsible management**: Commissioner*

***Due**: January 1, 2017*

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to verify the accuracy of certain financial and performance data and the effectiveness of related controls at selected self-directed, semi-independent agencies and evaluate the agencies' process for setting fees and penalties. The agency selected for this audit was the Credit Union Department (Department).

Scope

The scope of this audit covered the Department's financial and performance data for fiscal years 2015 and 2016, including, the Department's:

- 2015 *Annual Financial Report*, 2015 Annual SDSI Report, 2014 Biennial SDSI Report, and the 2015 *Report of Nonfinancial Data*. Auditors also conducted limited work on fixed assets inventory.
- Travel and purchase expenditures from fiscal year 2015 through May 2016.
- Selected fiscal year 2015 performance measures:
  - Percentage of Credit Unions Receiving Regular Examination Annually.
  - Percentage of Reports to Credit Unions Within 20 Days.
  - Percentage of Complaints Investigated and Responded to Within 30 Days of Receipt.
- Fiscal year 2015 and fiscal year 2016 operating fees and budget process.
- Selected year-end annual financial report entries from fiscal year 2014.

Methodology

The audit methodology included collecting information and documentation; interviewing Department staff regarding financial, reporting, performance measure, and operational processes; testing documentation related to reporting, adjusting entries, inventory, performance measures, purchasing, travel expenditures, revenue collection, and information technology; and analyzing and evaluating the results of the tests.

Sampling

Auditors selected nonstatistical, random samples of transactions and expenditures related to purchasing, travel, operating fee payments, and performance measures. Those samples were not necessarily representative of the population; therefore, it would not be appropriate to project the test results to the population.

For purchasing and travel, auditors used professional judgement to select additional sample items for testing. Those sample items were not representative of the population; therefore, it would not be appropriate to project those results to the populations.

Auditors tested the entire population for reduced/waived operating fees and penalty fees for late payment of operating fees for fiscal years 2015 and 2016.

Data Reliability and Completeness

To determine the reliability of expenditure and financial information in the Uniform Statewide Accounting System (USAS), auditors reviewed the data for validity and completeness by (1) reviewing user access, (2) reviewing data query language, and (3) performing high-level review of data fields and their contents for appropriateness; auditors also relied on previous State Auditor's Office audit work. Auditors determined that the data was sufficiently reliable for the purposes of this audit.

To determine the reliability of performance measure data from the ACT! database system, auditors reviewed the data for validity and completeness by (1) reviewing user access, (2) reviewing data query language, and (3) performing high-level review of data fields and their contents for appropriateness. Auditors determined that the data was sufficiently reliable for the purposes of this audit.

To determine the reliability of the National Credit Union Administration (NCUA) call report data, auditors compared the credit unions listed in ACT! with the credit unions listed in the NCUA call report data and determined that the data was sufficiently reliable for the purposes of this audit.

To determine the reliability of the revenue data in the Texas Treasury Safekeeping Trust Company (TTSTC) system, auditors compared the Department's record of revenues to the TTSTC's checks received and determined that the data was sufficiently reliable for the purposes of this audit.

Auditors relied on previous State Auditor's Office audit work on the State Property Accounting (SPA) system general controls and determined that the SPA system data was sufficiently reliable for the purposes of this audit.

Information collected and reviewed included the following:

- The Department's fiscal year 2015 *Annual Financial Report*, including reports from USAS and year-end adjusting journal entries, and the Department's correspondence with the Office of the Comptroller of Public Accounts.
- The Department's fiscal year 2015 *Report of Nonfinancial Data*.
- The Department's 2015 Annual SDSI Report.
- The Department's 2014 Biennial SDSI Report.
- The Department's 2015 *Certified Annual Inventory Report* in the State Property Accounting (SPA) system.
- Select fiscal year 2014 accounts payable year end adjusting entries.
- Purchase orders, invoices, purchase vouchers, and supporting documentation for Department purchases.
- Travel vouchers, invoices, and supporting documentation for Department travel reimbursements.
- Expenditure data from USAS.
- Management reports, input data sheets, complaint files, and supporting documentation for Department performance measures from the Department's ACT! system.
- The Department's calculation spreadsheets, logs, revenue receipts, TTSTC monthly statements, and supporting documentation for Department operating fees.
- Credit Union Commission meeting packets, budget information, budget variances, and supporting documentation for the Department's budget process.
- The Department's information technology services contract.
- The Department's ACT! user access list and roles.
- The Department's USAS user access list and roles.

- Department policies and procedures.

Procedures and tests conducted included the following:

- Interviewed Department staff to identify the Department's financial and operational processes, including financial and administrative controls.
- Reviewed documentation the Department used to prepare its fiscal year 2015 *Annual Financial Report*, fiscal year 2015 *Report of Nonfinancial Data*, 2015 Annual SDSI Report, 2014 Biennial SDSI Report, and fiscal year 2015 *Certified Annual Inventory Report*.
- Tested documentation related to purchasing, travel, revenue processing, and financial reporting to determine compliance with the Department's policies and procedures and state laws and regulations.
- Tested the Department's process for selected performance measures to determine accuracy, completeness, and compliance with Department policies and procedures.
- Tested the Department's 2015 *Certified Annual Inventory Report* for completeness and accuracy.
- Recalculated the Department's fiscal year 2015 and fiscal year 2016 operating fees to determine accuracy and completeness.
- Reviewed the Department's information technology services contract to determine whether the Department defined information security standards that the vendor must follow and whether the Department monitored the vendor's performance.
- Reviewed supporting documentation related to the general controls and application controls over the Department's network and ACT! system.

Criteria used included the following:

- *GASB Codification of Governmental and Financial Reporting Standards*, 2015-2016 edition.
- Office of the Comptroller of Public Accounts' reporting requirements.
- Texas Finance Code, Sections 15.207, 16.005(b), and 16.005(c).
- Office of the Comptroller of Public Accounts' *State Property Accounting (SPA) Process User's Guide*.

- Office of the Comptroller of Public Accounts' travel policies and procedures.
- *State of Texas Procurement Manual*.
- *State of Texas Contract Management Guide*, version 1.15.
- Title 34, Texas Administrative Code, Chapter 20.
- Title 7, Texas Administrative Code, Chapter 97.
- Title 1, Texas Administrative Code, Chapter 202.
- Texas Government Code, Chapter 2054.
- The Department's *Strategic Plan for Fiscal Years 2015-2019*.
- Department policies and procedures.

Project Information

Audit fieldwork was conducted from May 2016 through November 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

- Jerod Heine, MBA (Project Manager)
- Michael Yokie, CISA (Assistant Project Manager)
- Jennifer Grant
- Richard E. Kukucka III
- Ann E. Karnes, CPA (Quality Control Reviewer)
- Brianna C. Pierce, CPA (Quality Control Reviewer)
- Michael Owen Clayton, CPA, CISA, CFE, CIDA (Audit Manager)

Appendix 2

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Otto, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

The Credit Union Department

Members of the Credit Union Commission

- Mr. Manuel "Manny" Cavazos, IV, Chair
- Ms. Beckie Stockstill Cobb
- Mr. Yusuf E. Farran, P.E.
- Mr. Steven Gilman
- Ms. Sherri Brannon Merket
- Ms. Allyson "Missy" Morrow
- Ms. Barbara "Kay" Stewart
- Mr. Gary D. Tuma
- Mr. Vik Vad

Mr. Harold E. Feeney, Commissioner