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State Auditor

State of Texas Financial Portion of the

Statewide Single Audit Report for the Year Ended August 31, 2005

March 2006
Report No. 06-555

Statewide Single Audit Report for the Year Ended August 31, 2005

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Overall Conclusion

The Comprehensive Annual Financial Report (CAFR) for the State of Texas accurately presents the financial position and activities of the State for the year ended August 31, 2005.

The ability to prepare materially correct financial statements represents a significant accomplishment for the State. With the third-largest budget among all 50 states, nearly \$77.7 billion¹ in annual expenditures, and more than 200 state agencies and institutions of higher education, the State must contend with significant complexities in preparing its basic financial statements. The financial statements provide a comprehensive picture of how the State used its resources during the year, as well as the State's remaining assets and obligations at the end of the year.

Background Information

The State's basic financial statements include both government-wide and fund financial statements.

- Government-wide financial statements are designed to present an overall picture of the financial position of the State. These statements do not include retirement system assets, trust funds, or agency funds.
- Fund financial statements present financial information, focus on the most significant funds, and are presented in a form that is more familiar to experienced users of governmental financial statements.

We audited material accounts of major funds at 13 of the State's largest agencies and institutions of higher education.

Auditing financial statements is not limited to reviewing the accuracy of the numbers in those statements. Conducting this audit also requires the State Auditor's Office to audit the underlying systems and processes that agencies and institutions of higher education use to record their financial activities. Through that effort, we identified specific weaknesses that certain agencies should correct to ensure the accuracy of their financial information.

The State Auditor's Office conducts this audit so that the State can comply with legislation and federal grant requirements that require it to obtain an opinion regarding the material accuracy of its basic financial statements and a report on

¹ The \$77.7 billion in annual expenditures exceeded the \$61.7 billion appropriated for fiscal year 2005 primarily because:

- Certain expenditures (such as higher education institutions' expenditures of funds held outside the State Treasury and expenditures for the Food Stamp program) are included in the Comprehensive Annual Financial Report but are not included in the General Appropriations Act.
- The Comprehensive Annual Financial Report presents actual expenditures of federal funds, while the General Appropriations Act presents estimated receipts of federal funds.
- The Comprehensive Annual Financial Report is presented on an accrual basis, while the General Appropriations Act is presented on a cash basis.

internal controls related to those statements. The results of this audit are used primarily by bond-rating agencies that rate newly issued bonds and by federal agencies that award grants.

Key Points

The financial systems and controls at the agencies audited were adequate to enable the State to prepare materially correct basic financial statements.

Audit work identified control weaknesses at only 4 of the 13 state agencies and institutions of higher education audited. (Appendix 2 of this report lists all agencies and institutions of higher education audited.) This reflects positively on the State's ability to accomplish the complicated task of preparing materially accurate basic financial statements.

Certain agencies need to address specific weaknesses to ensure the accuracy of their financial information.

Two agencies did not reconcile their internal accounting systems with the Uniform Statewide Accounting System (USAS) before they issued their annual financial reports. Reconciliations are important because they help ensure that financial information is accurate. Auditors also identified agencies that had weaknesses in access controls for their automated systems, did not ensure that employee time records were accurate, or did not have finalized policies and procedures for their accounting functions:

- The line items audited at the Department of Aging and Disability Services (Department) were materially accurate, but the Department did not complete the reconciliation of information in its internal accounting system with information in USAS. Additionally, the Department should ensure that employee time records in the human resource management system are accurate and should develop well-documented policies and procedures for the majority of its accounting functions.
- The Department of State Health Services (Department) should strengthen certain aspects of its financial and information technology operations. For example, it should complete the reconciliation of its internal accounting system with USAS before issuing its annual financial report. The Department should also regularly update user access rights for the Texas WIC Information Network. The Department should ensure that employee time records in the human resource management system are accurate, and it should finalize policies and procedures at the program level for its accounting functions.
- The Health and Human Services Commission should correct inappropriate access rights to its primary financial system and the primary financial systems of two other health and human services agencies. It should also document policies and procedures for key accounting functions.

- The Texas Workforce Commission (Commission) should correct information technology weaknesses that could allow unauthorized users to have access to the Commission's automated systems and data. It should also correct issues regarding the absence of (1) a fire suppression system and a secondary method of power supply in its data center and (2) an uninterruptible power supply system for its mainframe systems.

Summary of Managements' Responses

The agencies to which we addressed recommendations agreed with our recommendations.

Summary of Information Technology Review

Auditors reviewed the internal controls over significant accounting and information systems at the agencies and institutions of higher education audited. To do that, we identified systems that compiled and contained data used to prepare financial statements and then reviewed basic data protection controls such as user access rights, location of data, and backup processes. As discussed previously, auditors identified certain information technology control weaknesses that the Department of Aging and Disability Services, the Department of State Health Services, the Health and Human Services Commission, and the Texas Workforce Commission should correct to help ensure the reliability of their financial information.

Auditors also reviewed internal controls within USAS and did not identify any significant control weaknesses in that system.

Summary of Objective, Scope, and Methodology

The audit objective was to determine whether the State's basic financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2005.

The Statewide Single Audit is an annual audit for the State of Texas. It is conducted so that the State complies with the Single Audit Act Amendments of 1996 and the Office of Management and Budget (OMB) Circular A-133. The State Auditor's Office performed the financial portion of the Statewide Single Audit and audited the fiscal year 2005 Schedule of Expenditures of Federal Awards. The State Auditor's Office contracted with KPMG LLP to perform the federal portion of the Statewide Single Audit. The federal portion included a review of compliance and controls over the State's federal awards.

The scope of the financial portion of the Statewide Single Audit included an audit of the State's basic financial statements and a review of significant controls over financial reporting and compliance with applicable requirements. As required by the Single Audit Act, this report also includes our *Report on Internal Control over*

Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.

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

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Schedule of Findings and Responses

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2005*

Financial Statement Findings

This chapter identifies the reportable conditions related to the financial statements that are required to be reported in accordance with *Government Auditing Standards*.

Chapter 1-A

The Department of Aging and Disability Services Should Strengthen Certain Aspects of Its Financial Operations

Issue 1

The Department of Aging and Disability Services Did Not Resolve All Reconciling Items It Identified in Fiscal Year 2005

Reference No. 06-555-01
(Prior Audit Issue 05-555-01)

During fiscal year 2005, the Department of Aging and Disability Services (Department) began reconciling monthly balances in its internal accounting

The Department's Summary Adjustment

The majority of the \$17 million adjustment the Department made affected two expenditure accounts:

- Public assistance payments (accounted for approximately \$5 million or 29 percent of the \$17 million adjustment)
- Materials and supplies (accounted for approximately \$4 million or 24 percent of the \$17 million adjustment)

The remaining \$8 million of the \$17 million adjustment included multiple revenue and expenditure line items.

system (the Health and Human Services Administration System, or HHSAS) with the State's accounting system (the Uniform Statewide Accounting System, or USAS). However, it did not complete the reconciliation process and resolve all reconciling items by the time it compiled its annual financial report for fiscal year 2005.

In order for its annual financial report to agree with USAS, the Department made a summary adjustment of approximately \$17 million to HHSAS (see text box for additional details). In fiscal year 2006, the Department intends to reverse the adjustment it made to HHSAS and to continue resolving the reconciling items.

Recommendation

The Department should resolve all reconciling items before it compiles its annual financial report.

Management's Response

The Department agrees with the recommendation and will work to resolve all reconciling items before it compiles future annual financial reports.

Responsible for corrective action: Tammy Callaway, Accounting Director

Implementation target: 11/1/2006

Issue 2

The Department of Aging and Disability Services Did Not Ensure that Employee Time Records in the Human Resource Management System Were Accurate

Reference No. 06-555-02

In fiscal year 2005, the Department did not ensure that employee time records in its Human Resources Management System (HRMS) were accurate. In a sample of 54 time sheets, auditors identified 12 instances in which data in HRMS did not reflect the data on employee time sheets. This resulted in an \$850 overstatement of the Department's liabilities. The Department corrected these errors in HRMS after auditors brought them to its attention.

The Department's timekeeping system was manual in fiscal year 2005, and the Department states that an automated timekeeping system was implemented in fiscal year 2006.

Recommendation

The Department should ensure that employee time records in HRMS are accurate.

Management's Response

In some cases, the balances on the paper monthly time reports were not the same as reflected in the Human Resource Management System. The timesheets pulled in the audit sample were used as source documents for data entry of leave taken or additional hours worked by employees into the PeopleSoft system. The employee monthly time reports on file were produced the month after data entry was made. On occasion, employees and/or supervisors make corrections to timesheets that were previously submitted and data entered. Therefore, in some instances, paper monthly time reports maintained by the timekeeping unit (pulled as part of this audit sample), will not match the record in the Human Resource Management System; however, this is not necessarily an indicator that the amount of time an employee actually worked was incorrect in the automated system. As noted above, an automated system has been implemented in fiscal year 2006.

Contact: Amy Tippie, Program Specialist, Administrative Management Services

Implementation Target: N/A

Issue 3

The Department of Aging and Disability Services Did Not Have Well-Documented Policies and Procedures for the Majority of Its Accounting Functions

Reference No. 06-555-03
(Prior Audit Issue 05-555-01)

The Department did not have well-documented policies and procedures for the majority of its accounting functions during most of fiscal year 2005.

It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel. Accurately carrying out accounting duties is critical to accurate financial reporting.

Recommendation

The Department should thoroughly document policies and procedures for all of its accounting functions.

Management's Response

The Department agrees with the recommendation and will continue current efforts to thoroughly document policies and procedures for all its accounting functions.

Responsible for corrective action: Tammy Callaway, Accounting Director

Implementation target: 8/31/2006

The Department of State Health Services Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

Issue 1

The Department of State Health Services Did Not Complete the Reconciliation of Its Internal Accounting System with the State's Accounting System

Reference No. 06-555-04

(Prior Audit Issues 05-555-02, 04-555-02, 03-555-01, 02-555-01, and 01-021)

In fiscal year 2005, the Department of State Health Services (Department) attempted to complete the reconciliation of its internal accounting system (the

Reconciling Items as of the End of Fiscal Year 2005

The Department's reconciling items consisted at least of the following:

- Appropriation Year 2005: 202 items totaling \$63 million
- Appropriation Year 2004: 110 items totaling \$14 million
- Appropriation Year 2003: 20 items totaling \$5 million

Health and Human Services Administrative System, or HHSAS) with the State's accounting system (the Uniform Statewide Accounting System, or USAS). However, as of the fiscal year end, there were at least 332 outstanding reconciling items. The absolute value of those items was approximately \$83 million, which averages approximately \$250,000 per reconciling item (see text box for additional details).

The Department did not generate a trial balance to prepare its fiscal year 2005 annual financial report; therefore, it used USAS to prepare its annual financial report. Because the Department did not generate a trial balance, auditors could not test the trial balance to determine whether a coding error that was identified by the State Auditor's Office in fiscal year 2004 at the Department of Health (the Department's predecessor agency) was corrected.²

Although the Department's annual financial report was materially accurate, the Department should complete the reconciliation to ensure that information in HHSAS and USAS is accurate.

Recommendation

The Department should reconcile its internal accounting system with the State's accounting system.

² During the audit of fiscal year 2005, auditors followed up on issues identified at the Department of Health in fiscal years 2001 through 2004. At the beginning of fiscal year 2005 (September 1, 2004), the Department of Health ceased to exist, and its operations were assumed by the newly formed Department of State Health Services.

Management's Response

The Department of State Health Services (DSHS) concurs with the auditors' determination that the department's Annual Financial Report was materially correct.

DSHS agrees that it needs to continue to strengthen the reconciliation processes to ensure all corrections are processed prior to generation of the financial data for the AFR.

However, DSHS believes that we did not adequately communicate with the State Auditor staff the appropriate status of our reconciliation of the internal accounting system (HHSAS) to USAS. Because of the communication issues, the auditors derived this finding based on the available cash balances in HSAS and USAS to produce an absolute value as of the last day of fiscal year 2005.

In basing the reconciliation on a snap shot of the cash balances at the end of the fiscal year, DSHS verified that certain timing issues did impact the cash balance between the two systems. We tracked all reconciling items to include the timing issues that are prevalent at the end of each fiscal year and should have provided better communication to the auditors so that they could be considered in the auditor's calculations. Timing issues, such as payroll which reduces cash balances in USAS prior to payday on September 1, deposits that come in at the end of the year and cannot be posted to the internal system until year end close is completed, and the year end closeout transactions required by the Comptroller's Office all impact the cash balances in the two system.

DSHS provided the auditors with a breakdown of the timing variances after field work was completed; however, because of the Comprehensive Annual Financial Report deadlines, there was not sufficient time for the documentation to be audited.

DSHS did not generate a trial balance from the internal accounting system for completion of the department's Annual Financial Report (AFR). However, with the transformation to the Department of State Health Services in fiscal year 2005, much of the non-cash detail for the legacy agencies (payables, receivables and inventory) required for the AFR was only in USAS. Therefore, we used USAS, the state's accounting systems of record, to provide the most accurate AFR.

Date for completion: August 2006

Person Responsible: Larry Boriack, General Ledger Manager

Issue 2

The Department of State Health Services Did Not Regularly Update User Access Rights for the Texas WIC Information Network

Reference No. 06-555-05
(Prior Audit Issue 05-555-03)

In fiscal year 2005, the Department did not regularly update user access rights to the Texas WIC Information Network (Texas WIN), which is the system that maintains program and expenditure information for the Women, Infants, and Children nutrition program. Specifically, 10 individuals whose employment had been terminated or who transferred to another health and human services agency still had access to Texas WIN. After auditors brought this matter to the Department's attention, it deleted access rights for these 10 users. Auditors did not identify any financial discrepancies that resulted from these weaknesses.

Recommendation

The Department should regularly update user access rights for Texas WIN.

Management's Response

DSHS agrees that regular updates to user access rights for Texas WIN should be performed. We will implement a review of all access rights and implement procedures for the timely reviews throughout the year for all staff to include those outside of DSHS and perform updates as appropriate.

Date for Completion: April 2006

Persons Responsible: Mike Montgomery, WIC Program

Issue 3

The Department of State Health Services Did Not Ensure that Employee Time Records in the Human Resource Management System Were Accurate

Reference No. 06-555-06

In fiscal year 2005, the Department did not ensure that employee time records in its Human Resources Management System (HRMS) were accurate. In a sample of 63 time sheets, auditors identified 21 instances in which data in HRMS did not reflect the data on employee time sheets. Thirteen of the data entry errors resulted in the Department's overstating its obligations by a net amount of approximately \$1,500 (or 85 hours). In fiscal year 2006, the Department corrected these errors after auditors brought them to its attention.

The Department's timekeeping system was manual in fiscal year 2005, and the Department states that an automated timekeeping system was implemented in fiscal year 2006.

Recommendation

The Department should ensure that employee time records in HRMS are accurate.

Management's Response

DSHS agrees that we should have accurate timekeeping records for employees and will work with HHSC timekeeping staff and Convergys to continue to develop proper controls in the new automated timekeeping system.

We have verified with HHSC staff that of the 63 monthly timesheets tested by the auditors, that only one employee was overpaid and the department had recouped the funds. In addition, HHSC reports that no employees were underpaid but instead were due some additional accruals for compensatory time earned. HHSC also reported that this additional time has been posted.

Date for Completion: April 1, 2006

Person Responsible: Mickey Gregory, HHSC; Wilson Day, DSHS

Issue 4

The Department Did Not Have Finalized Policies and Procedures at the Program Level for Its Accounting Functions for Fiscal Year 2005

Reference No. 06-555-07

In fiscal year 2005, the Department did not have finalized policies and procedures for accounting functions for the following programs:

- Substance Abuse Program
- Women, Infants, and Children (WIC) Program (lacked finalized policies and procedures for reconciliation of payments between systems)
- NorthSTAR Program (which provides mental health and chemical dependency services)
- Mental Health Services for Adults and Children Program

Additionally, the Department did not have finalized policies and procedures for generating its monthly payroll.

It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel. The duties of staff performing accounting functions are critical to accurate financial reporting.

Recommendation

The Department should thoroughly document policies and procedures for the accounting functions of all programs.

Management's Response

As part of our transformation to Department of State Health Services on September 1, 2004, a significant effort was made to continue to provide uninterrupted services to our customers and clients. During this time, we were also establishing the DSHS policies and procedures. Even though some of the DSHS policies were not finalized, we continued to have procedures for the accounting functions listed to verify the accuracy of the information and provide adequate controls.

DSHS agrees that finalizing these policies and procedures for all accounting functions is important to our continued effort to strengthen our financial operation.

Date for Completion: June 1, 2006

Persons Responsible: Wilson Day and Kathleen Barnett

Chapter 1-C

The Health and Human Services Commission Should Strengthen Certain Aspects of Its Information Technology and Financial Operations

Issue 1

The Health and Human Services Commission Should Monitor System Access and Restrict User Access to Match Users' Job Functions

Reference No. 06-555-08
(Prior Audit Issues 05-555-03 and 05-555-07)

As a result of House Bill 2292 (78th Legislature, Regular Session), in fiscal year 2005 the Health and Human Services Commission (Commission) consolidated several administrative functions. The Commission became responsible for maintaining access rights to the Health and Human Services Administrative System (HHSAS, the internal accounting system) and the Human Resources Management System (HRMS) for all health and human services agencies.

The following issues regarding access rights increase the risk that individuals could make unauthorized additions, changes, or deletions to financial data without detection (however, auditors noted no such instances):

- At the Commission, 19 users had access to both enter and approve financial transactions in HHSAS. The Commission's policy states that users should not approve the transactions they enter; however, 3 of the 19 users entered and approved a total of 162 of their own financial transactions. The Commission deleted nine of these users' transaction approval rights when auditors inquired about this issue. In addition, auditors identified 23 users who had access to HHSAS when they should not have had this access. The Commission deleted this access for 22 of these users when auditors inquired about this issue.
- At the Department of Aging and Disability Services, 17 users who had access to HHSAS were not employed by the agency. After auditors inquired about this issue, the Commission deleted these 17 user accounts.
- At the Department of State Health Services, four users who had access to HHSAS or HRMS were not employed by the agency. After auditors inquired about this issue, the Commission deleted these four user accounts.

Recommendation

The Commission should monitor system access and restrict user access to match users' job functions.

Management's Response

Action Planned: The HHSAS Enterprise Security Manager's Security and Workflow Administration Team (ESM-SWAT) currently reviews the Human Resources Termination Report on a weekly basis. The current procedure requires that the end user's supervisor submit an HHSAS Security Form deleting access for terminating employees. ESM-SWAT has implemented a procedure where the HHSAS Security Administrator is notified when access is setup or deleted for non-agency staff.

To improve monitoring of system access, the ESM-SWAT and the HHSAS Financials Enterprise Support Center have established an automated monthly report of user accounts. This report is used by ESM-SWAT to identify and delete inactive accounts.

HHSC agrees that user access should match the user's job functions. As a compensating control for authorized exceptions to this practice, the HHSAS Enterprise Support Center is conducting an analysis of audit tables and fields and new on-line audit triggers established September 25, 2005. The HHSAS Enterprise Support Center, in coordination with the HHS agency Accounting Departments, will implement monitoring procedures for key HHSAS activities

and will investigate and report unusual or unauthorized events to agency management.

The new monitoring activities will begin after the first quarter of 2006, when implementation of the audit tables and reporting features are targeted to begin.

Title of Responsible Person: HHSAS Financials ESC Manager

Estimated Completion Date: March 31, 2006

Issue 2

The Health and Human Services Commission Should Document Policies and Procedures for Key Accounting Functions

Reference No. 06-555-09

The Commission does not have documented policies and procedures for the majority of key accounting functions related to the recording of public assistance payments and federal revenue. In addition, the Commission does not have documented policies and procedures for reconciling information in HHSAS with information in the State's accounting system (the Uniform Statewide Accounting System, or USAS).

Having documented policies and procedures is a key control over the Commission's financial reporting. It is important for management to communicate and monitor, through policies and procedures, staff members' responsibilities and expectations related to their job functions. In addition, policies and procedures are beneficial for new employees and backup personnel. The accounting staff's duties are critical to accurate financial reporting.

Recommendation

The Commission should document policies and procedures for all key accounting functions and controls.

Management's Response

Action Planned: HHSC will document policies and procedures for all key accounting functions and controls.

Title of Responsible Person: Director of Fiscal Management

Estimated Completion Date: April 1, 2006

The Texas Workforce Commission Should Strengthen Certain Aspects of Its Information System Security and Its Fire Protection and Backup Power Capabilities

Issue 1

The Texas Workforce Commission Should Strengthen Security and Password Settings

Reference No. 06-555-10
(Prior Audit Issue 05-555-04)

Security Settings

Security settings are critical to the security of automated systems and data because they control functions such as:

- Granting and restricting access to business systems, data, and other resources.
- Enforcing password and user account rules.
- Auditing access to resources.

The Texas Workforce Commission (Commission) has improved computer security since the State Auditor's Office's 2004 audit by deactivating certain default security settings and reducing the number of accounts with powerful security settings (see text box for additional information about security settings). However, the Commission still needs to correct weaknesses in password and security settings to decrease the risk that unauthorized users could access its automated systems and data.

The Commission should improve mainframe password settings. The mainframe password settings that the Commission uses are not sufficient to ensure adequate security. However, this is partially mitigated by the fact that the Commission limits the number of invalid access attempts that are allowed. It also requires users to change their passwords with sufficient frequency. Requirements for password settings are outlined in Title 1, Texas Administrative Code, Chapter 202. The Department of Information Resources' *Practices for Protecting Information Resources Assets* also provides recommendations in this area.

The Commission should review baseline mainframe security settings. The Commission has created an annual security audit checklist to guide the review of security settings. However, the Commission has not implemented this checklist by using it to review the adequacy of baseline mainframe security settings. Although these settings are reviewed informally during system upgrades, these reviews may not be sufficiently thorough.

Recommendations

The Commission should:

- Require password settings to meet current industry standards to the extent practical as required by Title 1, Texas Administrative Code, Chapter 202, and as recommended in the Department of Information Resources' *Practices for Protecting Information Resources Assets*.
- Periodically (for example, annually) perform a complete review of mainframe security settings

Management's Response

Management concurs with this recommendation.

Action Plan:

- *TWC will implement password settings that meet industry standards to meet Title 1, Texas Administrative Code, Chapter 202 requirements on or before 3/15/2006. This implementation also includes strengthening password for LAN and Client Server Systems (except PeopleSoft).*
- *PeopleSoft will comply after upgrade to release 8.8 PeopleSoft HR will be upgraded September 2006. PeopleSoft Financial will be upgraded in September 2007.*
- *TWC has purchased a RACF software product, Vanguard Advisor, to generate reports that will facilitate evaluation and review of baseline mainframe security settings. Vanguard Advisor will be installed by February 28, 2006.*
- *TWC will establish an annual review and create a checklist and procedures for reviewing and reporting security findings. TWC anticipates finalizing these procedures and review processes by 8/31/2006.*

Responsible party: Joe Vermillion

Issue 2

The Texas Workforce Commission Should Strengthen Information System Security Monitoring

Reference No. 06-555-11
(Prior Audit Issue 05-555-05)

Security Management Products

Mainframe security management products are used to restrict access to a computer system to only users who have been authorized to access the system.

These security products identify and authenticate users, determine the information assets to which each user is authorized, and log and report unauthorized users' attempts to access protected assets.

The Commission should revise its security reporting to make this task more manageable and ensure that it is performed consistently. The Commission does not adequately review security reports that provide information on security events identified by its mainframe computer's security management product (see text box). This prevents it from promptly investigating potential instances of unauthorized access.

Reviewing security reports is important because this can enable the Commission to detect security events such as unauthorized attempts to access its mainframe and, therefore, its automated systems and data. Although the security reports are comprehensive, they are lengthy and can be difficult to manage and review. While the Commission distributes the full reports to its central computer security function and

portions of the reports to departmental security managers, improvements are needed to ensure an effective review process.

The Commission has taken preliminary steps to correct this issue by:

- Purchasing software that monitors security and generates monitoring reports. However, the Commission has not yet begun using this software.
- Generating daily monitoring reports that list any (1) changes made to operating system libraries or (2) use of a specific, powerful administrative account.
- Generating daily reports of departmental incidents that have occurred on the Commission's internal network.

Recommendations

The Commission should:

- Ensure that it reviews security reports and investigates significant security events. The Commission should also ensure that its staff report the outcomes of these investigations to management.
- Provide training and/or additional instruction to departmental security managers regarding how to use the security reports and tools.
- Produce a streamlined version of the current security report for the central information technology security staff or implement alternative security monitoring tools to make the monitoring task more manageable. The central information technology security staff should monitor system-level security events, and the departmental security managers should review security events related to the information technology resources of their respective departments.

Management's Response

Management concurs with this recommendation.

Action Plan:

- *TWC is creating a security group. The security group will design reports and develop procedures for use by RACF security administrators.*
- *The security group will provide necessary training to departmental security managers regarding the use of security reports and tools.*
- *TWC has purchased Vanguard Advisor and will have it installed by 2/28/2006.*

- *The TWC security group will design a streamlined security report for the central information technology security staff.*
- *The security group will implement security-monitoring procedures for the department security managers to monitor and review their respective departments' security events.*
- *The security group will be created by June 20, 2006. Procedures and training will be complete by 8/31/06.*

Responsible party: Robert Von Quintus

Issue 3

The Texas Workforce Commission Should Strengthen Its Fire Protection and Backup Power Capabilities

Reference No. 06-555-12
(Prior Audit Issue 05-555-06)

The Commission's data center does not have a fire suppression system (other than handheld extinguishers), a secondary method of power supply (such as a generator), or an uninterruptible power supply system for its mainframe systems. However, certain information technology resources at the Commission, including the mainframe equipment in the Commission's data center, are subject to transfer to the Department of Information Resources in accordance with the requirements of House Bill 1516 (79th Legislature, Regular Session). As a result, the Commission has not dedicated funds to correct the issues in its data center and is waiting until a decision is made regarding which information technology resources will be transferred to the Department of Information Resources.

Although the Commission has a processing agreement for an alternative site for system backup and recovery, the lack of a fire suppression system in the data center increases the reliance on this backup site and could result in significant costs to the Commission if it needed to rely on the backup center for an extended period of time.

Having an uninterruptible power supply system or generator could help the Commission avoid having to (1) revert to its off-site backup and recovery processing facility to continue operations, (2) delay processing until power could be restored to the data center, or (3) lose and re-enter data.

Recommendations

The Commission should:

- Work with the Department of Information Resources to determine which information technology resources will be transferred to the Department of Information Resources.
- After the information technology resources that will be transferred to the Department of Information Resources have been identified, perform a formal cost-benefit analysis and decide whether any of the following is cost-beneficial:
 - Installing a central fire suppression system in its data center.
 - Installing both an uninterruptible power supply system and a backup generator for its data center.
 - Installing a backup generator without an uninterruptible power supply system in its data center.

Management's Response

Management concurs with this recommendation.

Action Plan:

TWC will not be able to conduct any additional analysis on this issue until DIR has established a contract with a service provider for data center operations. The expectation TWC has is that all data center operations will be relocated to a Tier-3 data center that has a fire suppression system and a UPS system with a backup power generator in place. If TWC were to be selected as one of the consolidated data centers, it would have to be brought up to a Tier-3 data center standards. The plan and cost for that would have to be negotiated between DIR, the service provider and the agencies using the data center.

Updates:

- *TWC has conducted a cost analysis on 4-11-2005 for a Fire Suppression system and Emergency System.*
- *The estimated cost for the Fire Suppression system was \$232,810.*
- *The maintenance cost for the Fire Suppression system was estimated to be \$2,500 for the first 3 years and \$4,000 per month thereafter.*

- *The estimated cost for a 750 KVA generator, 2 Ton AC units and a 350 KVA UPS system is \$810,000.*
- *The estimated cost for a 750 KVA generator and 2 Ton AC units is \$530,000.*

Responsible party: Dee Meador

Federal Award Findings and Questioned Costs

For fiscal year 2005, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Year Ended August 31, 2005*, by KPMG LLP, dated February 21, 2006.

Summary Schedule of Prior Audit Findings

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2005*

Summary Schedule of Prior Audit Findings

Federal regulations (Office of Management and Budget Circular A-133) state that “the auditee is responsible for follow-up and corrective action on all audit findings.” As part of this responsibility, the auditees report the corrective actions they have taken for the findings reported in:

- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2001* (SAO Report No. 02-555, May 2002)
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2002* (SAO Report No. 03-555, April 2003)
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2003* (SAO Report No. 04-555, March 2004)
- *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2004* (SAO Report No. 05-555, March 2005)

The Summary Schedule of Prior Audit Findings (for the year ended August 31, 2005) has been prepared to address these responsibilities.

Chapter 3-A

The Department of Aging and Disability Services Should Correct Weaknesses in Financial Reporting that Could Decrease the Reliability of Its Financial Information

Reference No. 05-555-01

At the beginning of fiscal year 2005 (September 1, 2004), the Department of Human Services ceased to exist, and its operations were assumed by the newly formed Department of Aging and Disability Services. Although the prior audit issues referenced below were identified in the Department of Human Services’ fiscal year 2004 operations, recommendations were addressed to the Department of Aging and Disability Services. Therefore, we followed up on prior audit issues at the Department of Aging and Disability Services.

During fiscal year 2004, the Department of Human Services did not:

- Perform monthly reconciliations of its financial information in a timely manner.
- Have well-documented policies and procedures for accounting functions.

During fiscal year 2005, the Department of Aging and Disability Services:

- Began reconciling monthly balances; however, it did not complete the reconciliation process and resolve all reconciling items by the time it

compiled its annual financial report. Therefore, the prior finding regarding reconciliation was reissued as current year finding 06-555-01.

- Did not have well-documented policies and procedures for accounting functions. Therefore, the prior finding regarding policies and procedures was reissued as current year finding 06-555-03.

Corrective Action and Management's Response

See current year findings 06-555-01 and 06-555-03.

Chapter 3-B

The Department of State Health Services Should Strengthen Certain Aspects of Its Financial and Information Technology Operations

Reference No. 05-555-02, 05-555-03
(Prior Audit Issues 04-555-02, 03-555-01, 02-555-01, and 01-021)

During the audit of fiscal year 2005, auditors followed up on issues identified at the Department of Health in fiscal years 2001 through 2004, and the results of that work are discussed below. At the beginning of fiscal year 2005 (September 1, 2004), the Department of Health ceased to exist, and its operations were assumed by the newly formed Department of State Health Services.

During fiscal year 2004, the Department of Health:

- Did not completely reconcile financial information and prepared its annual financial reports using information from the Uniform Statewide Accounting System (USAS) rather than from the Health and Human Services Administrative System (HHSAS, the internal accounting system).
- Did not always terminate access to information technology systems for individuals whose employment had been terminated.

During fiscal year 2005, the Department of State Health Services:

- Did not completely reconcile the information in HHSAS with the information in USAS and did not generate a trial balance (as a result, auditors could not determine whether the trial balance from HHSAS was accurate). Therefore, the prior finding regarding reconciliation and the generation of the trial balance was reissued as current year finding 06-555-04.
- Did not ensure that access to its Texas WIC Information Network (Texas WIN) was limited to individuals currently employed with the Department.

Therefore, the prior finding regarding termination of system access was reissued as current year finding 06-555-05.

In addition, the function of security access controls for HHSAS and the Human Resource Management System was delegated to the Health and Human Services Commission during fiscal year 2005. Current year finding 06-555-08 was issued to the Health and Human Services Commission regarding access rights to the Department of State Health Services' internal accounting system.

Corrective Action and Management's Response

See current year findings 06-555-04, 06-555-05, and 06-555-08.

Chapter 3-C

The Texas Workforce Commission Should Strengthen Certain Aspects of Its Information System Security and Its Fire Protection and Backup Power Capabilities

Reference No. 05-555-04, 05-555-05, 05-555-06

Of the three findings identified at the Texas Workforce Commission (Commission) in fiscal year 2004, the Commission partially corrected two and did not correct one:

- The Commission partially corrected a fiscal year 2004 finding regarding its security and password settings. However, it has not reviewed its baseline mainframe security settings, nor has it improved its password setting; therefore, this finding was reissued as current year finding 06-555-10.
- The Commission partially corrected a fiscal year 2004 finding regarding its security monitoring. However, it did not adequately review security reports that provide information on security events identified by its mainframe computer's security management product; therefore, this finding was reissued as current year finding 06-555-11.
- The Commission did not correct a fiscal year 2004 finding regarding its fire protection and backup power capabilities; therefore, this finding was reissued as current year finding 06-555-12.

Corrective Action and Management's Response

See current year findings 06-555-10, 06-555-11, and 06-555-12.

Chapter 3-D

The Health and Human Services Commission Should Monitor Financial System Access and Security and Take Prompt Action to Maintain Compliance with System Security Policies

Reference No. 05-555-07

The Health and Human Services Commission did not correct a fiscal year 2004 finding regarding monitoring of the security access to its financial system; therefore, this finding was reissued as current year finding 06-555-08.

Corrective Action and Management's Response

See current year finding 06-555-08.

Chapter 3-E

The Texas Education Agency Should Correct Certain Issues in Information Technology to Ensure that It Continues to Properly Administer the Foundation School Program

Reference No. 04-555-06, 03-555-07, and 03-033

The Texas Education Agency (Agency) did not correct a prior finding regarding system documentation. In 2004, the State Auditor's Office reported that the Agency had not properly documented all applications and data used in its Foundation School Program allocation and payment processes.

Corrective Action

Since 2004, the risk associated with the lack of documentation has decreased because the Agency partially implemented a new online Foundation School Program system in January 2005.

The Agency is running the new system parallel with its old system. Although the new system was scheduled to be fully implemented in June 2005, this did not occur. The Agency now expects the new system to be fully implemented in August 2007. The Agency should ensure that the new system is properly documented.

Independent Auditor's Report

*State of Texas Financial Portion of the
Statewide Single Audit Report for the
Year Ended August 31, 2005*

Summary of Auditor's Results

Financial Statements

- | | |
|---|-------------|
| 1. Type of auditor's report issued: | Unqualified |
| 2. Internal control over financial reporting: | |
| a. Material weakness identified? | No |
| b. Reportable conditions identified not considered to be material weaknesses? | Yes |
| c. Noncompliance material to financial statements noted? | No |

Federal Awards

For fiscal year 2005, federal award information has been issued in a separate report. See *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2005*, by KPMG LLP, dated February 21, 2006.



Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Honorable Rick Perry, Governor
The Honorable Carole Keeton Strayhorn, Comptroller of Public Accounts
The Honorable David Dewhurst, Lieutenant Governor
The Honorable Tom Craddick, Speaker of the House of Representatives
and
Members of the Texas Legislature
State of Texas

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate discretely presented component units, and remaining fund information of the State of Texas as of and for the year ended August 31, 2005, and have issued our report thereon dated February 21, 2005. Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

Internal Control over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters that come to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The accompanying schedule of findings and responses describes reportable conditions for the Department of Aging and

Disability Services, the Department of State Health Services, the Health and Human Services Commission, and the Texas Workforce Commission.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

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

Work Performed by Other Auditors

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

Entities Audited by Other Auditors	Scope of Work Performed
Texas Guaranteed Student Loan Corporation	An audit of the financial statements of each major fund of the Texas Guaranteed Student Loan Corporation, a component of the State of Texas, was conducted as of and for the years ended September 30, 2005, and September 30, 2004.
Texas Local Government Investment Pool	An audit of the statements of pool net assets of the Texas Local Government Investment Pool, an investment trust fund of the State of Texas, was conducted as of August 31, 2005, and the related statements of change in pool net assets for the year then ended.
Texas Treasury Safekeeping Trust Company	An audit of the financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company, a component unit of the State of Texas, was conducted as of and for the year ended August 31, 2005.
Texas Prepaid Higher Education Tuition Board	An audit of the financial statements of the business-type activities, the aggregate discretely presented component unit, each major fund, and the fiduciary fund information of the Texas Prepaid Higher Education Tuition Board, a Board of the State of Texas, was conducted as of and for the year ended August 31, 2005.
Employees Retirement System	An audit of the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Employees Retirement System of Texas was conducted as of and for the year ended August 31, 2005. An audit was also conducted for the combining statements of fiduciary net assets and changes in fiduciary net assets of the pension plans administered by the Employees Retirement System as of August 31, 2005.

Entities Audited by Other Auditors	Scope of Work Performed
Department of Housing and Community Affairs	An audit of the financial statements of the governmental activities, business-type activities, major funds, remaining fund information, and supporting schedules 1A through 1D of the Department of Housing and Community Affairs was conducted as of and for the year ended August 31, 2005.
Permanent University Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the Permanent University Fund was conducted as of and for the years ended August 31, 2005, and August 31, 2004.
The University of Texas System Long-Term Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the University of Texas System Long-Term Fund was conducted as of and for the years ended August 31, 2005, and August 31, 2004.
The University of Texas System Short-Intermediate Term Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the University of Texas System Short-Intermediate Term Fund was conducted as of and for the years ended August 31, 2005, and August 31, 2004.
The University of Texas System Permanent Health Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the Permanent Health Fund was conducted as of and for the years ended August 31, 2005, and August 31, 2004.
The University of Texas System General Endowment Fund	An audit of the statements of fiduciary net assets, changes in fiduciary net assets, and supplemental schedules of the University of Texas General Endowment Fund was conducted as of and for the years ended August 31, 2005, and August 31, 2004.
Department of Transportation Turnpike Authority	An audit of the statements of net assets of the Central Turnpike System of the Texas Transportation Authority was conducted as of August 31, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended.
The University of Texas System	An audit of the consolidated balance sheet of the University of Texas System was conducted as of and for the year ended August 31, 2005, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the year then ended.

This report, insofar as it relates to the entities listed in the table above, is based solely on the reports of the other auditors.

Other Work Performed by the State Auditor's Office

We issued opinions in the reports on the following financial statements, which are consolidated into the basic financial statements of the State of Texas:

- *A Report on the Audit of the Teacher Retirement System's Fiscal Year 2005 Financial Statements* (SAO Report No. 06-015, November 2005)
- *A Report on the Audit of the Fire Fighters' Pension Commissioner's Fiscal Year 2005 Financial Statements* (SAO Report No. 06-019, January 2006)
- *A Report on the Audit of the Permanent School Fund's Fiscal Year 2005 Financial Statements* (SAO Report No. 06-023, February 2006)
- *An Audit Report on the Texas Department of Transportation's Texas Mobility Fund Financial Statements from the Fund's Inception through August 31, 2005* (SAO Report No. 06-010, December 2005)
- *A Report on an Audit of the Texas Lottery Commission's Annual Financial Report for the Fiscal Year Ended August 31, 2005* (SAO Report No. 06-017, December 2005)

This report is intended solely for the information and use of the Governor, the Legislature, audit committees, boards and commissions, and management. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

John Keel, CPA
State Auditor

February 21, 2006

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The audit objective was to determine whether the State's basic financial statements accurately reflect the balances and activities for the State of Texas for the fiscal year ended August 31, 2005.

The Statewide Single Audit is an annual audit for the State of Texas. It is conducted so that the State complies with the Single Audit Act Amendments of 1996 and the Office of Management and Budget (OMB) Circular A-133. The State Auditor's Office performed the financial portion of the Statewide Single Audit and audited the fiscal year 2005 Schedule of Expenditures of Federal Awards. The State Auditor's Office contracted with KPMG LLP to perform the federal portion of the Statewide Single Audit. The federal portion included a review of compliance and controls over the State's federal awards and an audit of the Schedule of Expenditures of Federal Awards.

Scope

The scope of the financial portion of the Statewide Single Audit included an audit of the State's basic financial statements for fiscal year 2005 and a review of significant controls over financial reporting and compliance with applicable requirements.

Methodology

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

Information collected included the following:

- Agency and institution of higher education policies and procedures
- Agency and institution of higher education systems documentation
- Agency and institution of higher education accounting data
- Agency and institution of higher education year-end accounting adjustments
- Agency and institution of higher education fiscal year 2005 annual financial reports

Procedures and tests conducted included the following:

- Evaluating automated systems controls
- Performing analytical tests of account balances
- Performing detail tests of vouchers
- Comparing agency and institution of higher education accounting practices with Comptroller of Public Accounts reporting requirements

Information systems reviewed included the following:

- Agency and institution of higher education internal accounting systems
- Uniform Statewide Accounting System (USAS)

Criteria used included the following:

- Texas statutes
- Texas Administrative Code
- General Appropriations Act (78th Legislature)
- The Comptroller of Public Accounts' policies and procedures
- The Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities*
- Generally accepted accounting principles

Other Information

Fieldwork was conducted from May 2005 through March 2006. Except as discussed in the following paragraph, we conducted this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

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

- Angelica Martinez (Project Manager)
- William J. Morris, CPA (Assistant Project Manager)
- Shahpar Ali, CPA, JD
- Beverly Bavousett, CPA
- Robert Bollinger, CPA, CFE
- Pamela A. Bradley, CPA
- Lisa R. Collier, CPA
- Joe Curtis, CPA, CIA
- Olin Davis
- David Dowden
- Dean Duan, CISA
- Scott Ela
- Michelle A. Feller
- Joe Fralin, MBA
- Kelton M. Green, CPA, CFE
- Wesley Vaughn Hodgins, CPA
- Joyce Inman, CGFM
- Krissna Jones
- Joe Kozak, CPA, CISA
- Carmelita Lacar, Ph.D., CIA
- Gary Leach, CQA, CISA, MBA
- Brianna Lehman
- Frank Locklear, CISA
- Jennifer Logston
- Veda Mendoza, CIA
- Terry R. Nickel CIA, CFE, CBA, CFSA, CBM
- Jenay Oliphant
- Paige Paul, MBA
- Susan Pennington, MPA
- Agnes Rasmussen, CPA
- Elisabeth Roberts
- Cherisse Robison, MPAff
- Anthony W. Rose, MPA, CPA, CGFM
- Karen Smith
- Mary Ann Wise, CPA
- Michael Yokie, CISA
- Margaret Nicklas CIA, CGAP (Federal Coordinator)
- Kelly Linder, MSCRP (Federal Coordinator)
- Leslie P. Ashton, CPA (Quality Control Reviewer)
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Worth S. Ferguson, CPA (Quality Control Reviewer)
- Michael C. Apperley, CPA (Audit Manager)
- Susan A. Riley, CPA (Audit Manager)

Agencies and Institutions of Higher Education Audited

Financial accounts at the following state agencies and institutions of higher education were audited:

- Comptroller of Public Accounts
- Department of Aging and Disability Services
- Department of State Health Services
- Department of Transportation
- Health and Human Services Commission
- Texas A&M University
- Texas A&M University at Corpus Christi
- Texas A&M University System Administrative and General Offices
- Texas Education Agency
- Texas State University at San Marcos
- Texas Tech University
- Texas Workforce Commission
- Water Development Board

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 Jim Pitts, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Comptroller of Public Accounts

The Honorable Carole Keeton Strayhorn, Comptroller of Public Accounts
Mr. Billy Hamilton, Deputy Comptroller

Department of Aging and Disability Services

Ms. Addie Horn, Commissioner

Department of State Health Services

Dr. Eduardo Sanchez, Commissioner

Health and Human Services Commission

Mr. Albert Hawkins, Executive Commissioner

Texas Education Agency

Members of the State Board of Education
Dr. Shirley Neeley, Commissioner of Education

Texas Workforce Commission

Members of the Texas Workforce Commission
Mr. Larry Temple, Executive Director



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