

**Report to Management
Audit of Financial Monitoring**

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Texas Water Development Board

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KEY POINTS OF REPORT

Overall Conclusion

Financial Monitoring (FM) has been successful in performing its mission of protecting the Board's loan portfolio. There have been no defaults in loan repayments to date, and during the past year the number of delinquencies in submitting required audits has decreased. Overall shortfalls and reserve fund shortages among the entities have also decreased.

Because of its small size, FM has been able to operate successfully and effectively with an organizational set-up that would most likely pose a problem for a larger entity. Although management is addressing the issue, the volume of work for the division could become overwhelming if staff members are not replaced when they leave the agency. The number of staff members may also need to be increased as the TWDB portfolio grows.

Several areas of operation could improve through better use of automation. The Texas Water Information System Enhancement (TxWISE) was planned in 2007, and a determination was made to convert the Financial Information System (FIS) as a part of TxWISE Phase III. As a result needed automation enhancements in FIS, and the related efficiencies, were delayed. Therefore, the conversion of the FIS to TxWISE is now essential to continued successful operation of FM.

FM staff members are qualified and trained to effectively perform their assigned duties. Most division processes and activities were documented in the *FM Standard Operating Procedures* manual effective March 2010.

All performance appraisals have been completed, but individual staff members could benefit from additional clarification of their responsibility and expected contribution.

Key Facts and Observations

Three performance appraisals were completed after the required due date.

The workload distribution process should be assessed to maximize overall team performance.

Automation enhancements could increase the efficiency of performing entity tracking, stability reviews, and single audit reviews.

Additional consideration of the audit portion of TxWISE is needed and maintenance of FIS cannot be performed.

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A. Management Summary

1. Purpose

The purpose of this report is to present the conclusion, observations, recommended action plans, and management responses from the audit of the Financial Monitoring (FM) Division in Finance. This audit was conducted in accordance with the *Standards for the Professional Practice of Internal Auditing* and generally accepted government auditing standards.

The government standards require that the audit is planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for observations and conclusions based on the selected audit objectives. The evidence obtained provides a reasonable basis for the observations and conclusions based on these objectives.

2. Background

FM is one of five divisions in Finance. All staff members in the division report through a team lead to the Chief Financial Officer (CFO). There are six financial examiners including the team lead, and an administrative technician. The staff reported to a division director until the end of April 2009, when the current team lead was hired.

FM's mission is to protect the financial health of the Board's loan portfolio and the statutory, regulatory, and contractual integrity of its financial assistance programs by assisting and monitoring assistance recipients in matters of finance-related legal and contractual compliance.

The team lead reports quarterly to the Board about loan recipient compliance with rules, regulations, and bond covenants. Activities in the division include: (1) reviewing loan recipients' single audits, (2) performing stability reviews on loan recipients, (3) working with troubled entities, (4) making site visits to loan recipients, and (5) performing the final accounting for completed projects.

Staff members enter and review data in the audit portion of the Financial Information System (FIS), which is the current system of record. However, upon completion of the Texas Water Information System Enhancement (TxWISE) Phase III, FM will shift to the new platform.

All seven FM staff members were interviewed during the audit including the team lead and a staff member who recently left the agency. The CFO, a consultant from Northbridge Environmental Management Consultants (Northbridge), and nine staff members in Operations and Administration (O&A), Construction Assistance, and Finance also provided input.

3. Scope and Objectives

The scope of this audit encompassed the examination and evaluation of the adequacy and effectiveness of the internal controls and quality of performance in carrying out assigned responsibilities. Responsibilities for the final accounting process were not reviewed because it is a part of the entire funding process and

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should be reviewed in a subsequent audit. The scope of this audit included specific program steps designed to assess:

- Accomplishment of goals and objectives,
- Effectiveness and efficiency of operations,
- Compliance with laws, rules, and regulations, and
- Reliability and integrity of data.

The objectives included procedures designed to determine if:

- Performance appraisals are up-to-date and performance plans are appropriate,
- Workload is equitably divided and staff is clear on priorities,
- Stability reviews are performed efficiently and are up-to-date,
- Process for tracking entities' audited financial statements is effective and efficient,
- Single audit process is accomplished in an effective and timely manner, and
- Audit portion of FIS has been adequately considered in the design of TxWISE and plans have been made to adequately maintain FIS until TxWISE Phase III is complete.

4. Conclusion

FM has been successful in performing its mission of protecting the Board's loan portfolio. There have been no defaults in loan repayments to date, and during the past year the number of delinquencies in submitting required audits has decreased. Overall shortfalls and reserve fund shortages among the entities have also decreased.

Because of its small size, FM has been able to operate successfully and effectively with an organizational set-up that would most likely pose a problem for a larger entity. Although management is addressing the issue, the volume of work for the division could become overwhelming if staff members are not replaced when they leave the agency. The number of staff members may also need to be increased as the TWDB portfolio grows.

Several areas of operation could improve through better use of automation. TxWISE was planned in 2007, and a determination was made to convert FIS as a part of TxWISE Phase III. As a result needed automation enhancements in FIS, and the related efficiencies, were delayed. Therefore, the conversion of FIS to TxWISE is now essential to continued successful operation of FM.

FM staff members are qualified and trained to effectively perform their assigned duties. Most division processes and activities were documented in the *FM Standard Operating Procedures* manual effective March 2010.

All performance appraisals have been completed, but individual staff members could benefit from additional clarification of their responsibility and expected contribution.

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5. Action Plans

The following steps are recommended:

- **Because of its small size and limited resources, FM management may determine that creating “ownership” of an entity (that is, the same person performs the stability review, single audit, and site visits) may not be feasible. Nevertheless, FM management should consider some form of structure that provides better continuity, more equitable work distribution and contribution, and continued service to TWDB and its monitored entities. In this respect, the team lead should continue with the cross-training plan.**
- **FM management should work with executive management and Information Technology (IT) to increase the efficiency of entity tracking, stability reviews, and single audit reviews.**
- **FM management should work with executive management and IT to ensure that the conversion of FIS to TxWISE or the rewrite of FIS remains one of TWDB’s highest priorities. FM management and staff should consider what preliminary steps in analyzing their business process and documenting their system requirements would be useful for future FIS/TxWISE development.**

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B. Detailed Observations

1. Three Performance Appraisals were Completed After the Required Due Date

Performance appraisals for the team lead and two of the financial examiners were completed after the due date. TWDB policy requires that all TWDB employees receive an annual evaluation of their performance that is due “no later than the first of the month after an employee has completed his/her first year of employment with the TWDB and every 12 months thereafter.”

Two of these evaluations were due no later than May 1, 2010 and one was due no later than June 1, 2010. The first two were completed at the end of June and the last one was completed early in July.

2. Workload Distribution Should be Assessed to Maximize Overall Team Performance

Currently, workload distribution within FM is based upon priority and specialization. “Priority” is simply the understanding that problem entities are worked first. Non-problem entities remain in a queue until they are eventually processed.

“Specialization” is the assignment of specific functions to specific personnel, generally based upon knowledge and experience. Although every financial examiner performs some stability reviews, under specialization, the majority of them are performed by two of the five financial examiners. Similarly, nearly all single audits are monitored by one individual. All single audits are reviewed by the team lead. The most problematic entities are assigned to the special examiner. The majority of the final accounting assignments are performed by senior staff.

Continuity could suffer from this organizational set-up. For example, for any given entity the stability review could be performed by Employee A, the single audit by Employee B, and a site visit by Employee C. However, the current set-up has the advantage of providing a safety net since more than one person cognizant of the inherent risks or issues works with each entity. In addition, by segregating the duties, this set-up effectively precludes possible conflicts of interest.

Perception of work equity or work contribution could also suffer. Most staff members indicated that they thought the workload is not fairly divided among the financial examiners. In addition, although all staff agreed that the main priority was responding to entity needs and helping to resolve problems, not all staff members were clear on what task they should perform next.

Finally, there are some control issues over stability reviews that are in-progress. Stability reviews are monitored by three reports: (1) a report indicating which audits have not been received, (2) a report of audits received but not reviewed, and (3) a report listing audits that have been reviewed. However, there is no report available that tracks which stability reviews are currently being analyzed by the financial examiners. Nor is there any way to determine which stability reviews are “on-hold” because of errors or discrepancies, the nature of those problems, and which examiner is performing follow-up.

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The team lead has implemented team cross-training with the idea of eventually providing all staff members with the capability to perform all functions at a high level.

Recommended Action Plan 2: Because of its small size and limited resources, FM management may determine that creating “ownership” of an entity (that is, the same person performs the stability review, single audit, and site visits) may not be feasible. Nevertheless, FM management should consider some form of structure that provides better continuity, more equitable work distribution and contribution, and continued service to TWDB and its monitored entities. In this respect, the team lead should continue with the cross-training plan.

Management Response 2: Management will implement appropriate actions. Over the last year significant operational improvements have been implemented that have allowed Financial Monitoring to address the changing economic conditions facing our customers. While the operational changes have been positive, management of the work effort can and will be improved.

*Responsible parties: CFO and FM Team Lead
Estimated completion date: November 1, 2010*

3. Automation Enhancements Could Increase the Efficiency of Performing Entity Tracking, Stability Reviews, and Single Audit Reviews

The following processes could derive significant efficiencies if they are incorporated into Phase III of the TxWISE project.

Entity Tracking:

For the purposes of stability and single audit reviews, the process for ensuring that the annual financial statements of all entities are being tracked is dependent on the data in FIS, perusal of monthly Board Minutes, and data downloads from Construction Assistance. Though effective, the process is manual, somewhat time-consuming, and prone to human error.

Although FIS is currently the system of record for FM, the process might be improved by tracking the entities through TxWISE.

On June 16, 2010, projects pertaining to five entities on TxWISE were selected and matched to their Audit Review Summaries within FIS. The purpose was to determine if all projects reported on the FIS Audit Review Summaries were also reported on the TxWISE list. There were no major discrepancies.

Stability Reviews:

FM utilizes an Excel spreadsheet termed the *Stability Review Master Template* to compute data from an entity’s annual financial report that will be entered into the *Audit Review* information in FIS. The template performs calculations and provides the audit trail for those calculations, but the results must be entered manually into FIS. In essence, additional manual effort must occur as a result of FIS capability shortcomings.

The template should be built into the *Audit Review* screens that are developed when TxWISE Phase III is initiated. This approach can minimize data entry

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requirements and potential for error that occurs when the results of non-system (spreadsheet) calculations must be entered into the system.

Single Audits:

Single audits are processed in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The circular allows six months from the date of receipt for completion of the single audits. FM's stated goal is to perform all single audit reviews within 90 days of receipt.

An Excel spreadsheet entitled the *Sub Recipient Monitoring Log* is used to track the status of each single audit being performed. The *Log* is an effective, but cumbersome, tool. Although it contained some minor discrepancies, they did not appear to affect sub-recipient monitoring, since all single audit reviews were completed within the required six-month time frame. Nevertheless, a thorough analysis of the necessary data elements may be warranted.

Discrepancies noted on the *Log* could be eliminated by establishing consistency in format and by the addition of proper automated edits. The tool could also be enhanced by incorporating its function into the design and implementation of TxWISE Phase III.

Recommended Action Plan 3: FM management should work with executive management and Information Technology (IT) to increase the efficiency of entity tracking, stability reviews, and single audit reviews.

Management Response 3: Management will implement appropriate improvements in consultation with Information Technology.

Responsible parties: CFO, FM Team Lead, O&A Deputy Executive Administrator, and IT Director

Estimated completion date: Implementation will coincide with TxWISE Phase III planning and implementation.

4. Additional Consideration of the Audit Portion of TxWISE is Needed and Maintenance of FIS Cannot Be Performed

FIS, which is currently the system of record for all TWDB's loans, grants, debt, and audit stability reviews, is scheduled to be redesigned and rewritten in TxWISE Phase III. If FIS is not converted to TxWISE, it will be necessary for TWDB to redesign and rewrite FIS since it can no longer be maintained.

FIS was originally written over ten years ago and was rewritten around 2003 by a contractor using PowerBuilder software with a Microsoft SQL Server database. In 2007, nearly all of the IT staff who knew anything about maintaining the system left the agency.

The PowerBuilder code that was used to create the business rules for the system is no longer available and no one at TWDB is trained to use PowerBuilder. As a result, the automated business rules for FIS cannot be changed without redesigning and rewriting the system. However, direct changes to the database and some changes to reporting services have been accomplished by IT staff upon request.

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The current FIS system does not conform to the standards set by TWDB systems analysts and programmers for new application development. Further, staff members have no knowledge of how the system functions or where the software is located.

TWDB's plan to replace FIS during the design, programming, and implementation of TxWISE Phase III was recommended by Northbridge due to the stability of FIS, its current web-based platform, FIS's critical role for operating TWDB programs, and the relationship between FIS and the agency accounting system (MIP). A senior FM staff member is assigned to participate in the conversion process.

During the development of TxWISE Phase III, the Northbridge consultant will determine how the current system works by reviewing the database and the screens, and discussing the functionality needed with the people who use it. Only FM staff members are familiar with the audit portion of FIS.

Recommended Action Plan 4: FM management should work with executive management and IT to ensure that the conversion of FIS to TxWISE or the rewrite of FIS remains one of TWDB's highest priorities. FM management and staff should consider what preliminary steps in analyzing their business process and documenting their system requirements would be useful for future FIS/TxWISE development.

Management Response 6: Management will implement appropriate improvements in consultation with Information Technology.

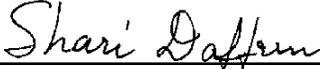
*Responsible parties: CFO and FM Team Lead
Estimated completion date: Implementation will coincide with TxWISE Phase III planning and implementation.*



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