Review of Revenue Management

Accounting Division
Project #20130203
February 2014
Project Team

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Executive Summary

Introduction
The Annual Audit Plan for fiscal year 2013 includes a review of Texas Water Development Board’s (TWDB) revenue management process.

Background
The revenue management function is shared between two teams within the Accounting Division. The Revenue, Payroll, & Accounts Payable team is responsible for ensuring that receipts are recorded accurately and collected on time. The Financial Reporting team is responsible for approving transactions and preparing managerial and financial reports.

Revenue transactions include receipts from legislative appropriations, bond sales, loan repayments, investment sales, contract revenues, and federal draws. For fiscal year 2012, the agency deposited 1,164 receipts totaling approximately $1.4 billion, with the main revenue sources being investment sales (34%), loan repayments (20%), debt issuance (16%), and federal draws (16%). The largest individual deposit was $162 million from debt issuance, while the smallest was $.02 for an employee reimbursement for a telephone charge.

Overview
Overall, the agency’s revenue management process has sufficient controls to ensure that resources are used efficiently and effectively, assets are safeguarded, and compliance with agency and contract requirements is achieved. Improvements are needed to ensure the accuracy of financial reporting and the security of personal sensitive information. In addition, the review found that the Accounting Division does not perform criminal background checks as part of its applicant screening process and that management has not provided staff with regular ethics training. Accounting management has developed and implemented written procedures to guide such processes as revenue collection, contract receivables, daily deposits, and annual financial reporting. The review found evidence of checklists and process-specific desk procedures on revenue collection, contract receivables, daily deposits, and the TWDB Annual Reporting Procedures.

The overall objective of the review was to determine the extent to which the revenue management process has controls to ensure objectives are met efficiently and effectively and in compliance with agency and contract requirements. In addition, the review sought to determine whether the revenue management process ensures financial reporting is performed in an accurate and timely manner. The detailed audit objectives and conclusions are briefly described in the objectives and conclusions section of this review.

Closing
Internal Audit would like to thank the Accounting Division for the cooperation and assistance provided to the Internal Audit staff. For questions or additional information concerning this audit report, please contact Amanda Jenami at 512-463-7978.
Objectives and Conclusions

Verify whether processes ensure revenue activities are accurately reported in the annual financial statements.

For the annual financial statements for fiscal year ended August 31, 2012, the audit reviewed supporting schedules to determine whether revenue activities were reasonably supported. The review found an error within the financial statements of one of the funds, where both accrued interest receivable and interest revenue were understated by $5 million.

Verify whether revenue management procedures ensure revenues are identified, collected, and recorded in an accurate and timely manner.

The audit verified the validity of a sample of 60 transactions by agreeing to appropriate supporting documentation. The audit found that the transactions were appropriately supported, coded, reviewed (by another individual), recorded, and posted in a timely manner.

Verify whether management has instilled a control environment sufficient for integrity and business ethics.

The audit reviewed Accounting’s requirements for applicants for employment and employee training. The review determined that while revenue management staff has access to and executes tasks dealing with such sensitive information as agency bank accounts, wire transfers, cash, checkbooks, and incoming checks, the positions have not been designated as “security sensitive.” Additionally, the division has not performed criminal background checks on applicants for employment as part of the screening process. Finally, division management has not provided staff with ethics training on a regular basis.

Verify whether financial information systems ensure the confidentiality, integrity, and availability of financial reporting.

The audit did not include a detailed information security review of revenue management’s computerized information systems, because of a recent Department of Information Resources (DIR) agency-wide information security review. However, while reviewing the data in one of the systems, the audit found a deficiency in the security of sensitive personal data. Further, password management controls within the Micro Information Product (MIP) application require improvement to align them with agency policy.

Verify the extent to which incompatible duties within the revenue management function are segregated.

The audit conducted a walk-through of several processes, including the billing and collection for Treasury bill interest, bond sales, loan repayments (principal and interest), and federal receipts.
The review found that segregation of duties over loan principal and interest collection could be improved if the custodial account activity was recorded in its own discrete general ledger account and if the related accounts were independently reconciled.

**Verify whether the revenue management process ensures compliance with agency and contract requirements.**

Audit testing on the previously mentioned sample of 60 transactions found that revenue management transactions were being processed in compliance with agency procedures.

**Detailed Issues with Management Responses**

**Issue 1 - Financial Reporting**

**1.1 Accounting for Deferred Interest**

Accrued interest receivable and interest revenue for the fiscal year ended 2012 were each understated by $5 million because a year-end accrual adjustment was not made. This was a misstatement of the Texas Water Development Fund II’s financial statements. (For the fiscal year ended August 31, 2012, the Texas Water Development Fund II reported interest receivable balance and interest revenue totals of $1 million and $16 million, respectively.)

In 2010, the borrower requested, and the Board approved, to defer interest payments on its loan agreements. Later, in September 2012, the borrower paid the entire principal and interest due, including that which had been deferred. Because the interest payment took place after the close of the August 31, 2012, fiscal year, staff incorrectly recorded the receipt as revenue for the subsequent 2013 fiscal year.

Following the applicable accounting policy for this governmental fund transaction, the $5 million interest revenue collected in fiscal year 2013 should have been recognized as revenue in the fiscal year in which it became both “measurable and available.” The State of Texas considers receivables collected within 60 days after year end to be available.

The error may have been due to the non-standard nature of the transaction (i.e., staff did not intuitively recognize the need for an accrual). This suggests that staff may benefit from training targeted at the financial accounting reporting intricacies of today’s dynamic banking environment. That the current transaction review process failed to pick up an error of this magnitude suggests it needs to be enhanced for improved effectiveness.

**Recommendations**

Accounting should

1. Provide all financial reporting and key finance personnel with training, including governmental accounting, investment accounting, financial reporting, recent updates, and accrual accounting, to ensure they learn the reporting intricacies of today’s dynamic
banking environment. The training should also cover all the different types of transactions that could trigger an accrual at year end.

2. Anticipate and record principal and interest payments to either the clearing account or a receivable account when due, not when paid. If correctly anticipated, the activity posted by the division will offset the amounts deposited by the custodian. Activities not matched should be investigated and addressed until resolved.

3. Enhance the process of preparing and approving the reconciliation for receivables from interest and dividends to ensure that all components or interest are adequately considered and included.

4. Enhance the supervisory review and approval of loan transactions.

Management Action Planned:

1. Management agrees with the need for training. The annual training plan for accounting staff will include continuing education covering topics on governmental accounting, investment accounting, financial reporting, ethics, and recent updates.

   **Responsible Parties:**
   
   Accounting Director; Chief Finance Officer

   **Estimated Completion Date:**
   
   December 31, 2014

2. Management agrees. Principal and interest payments will be recorded as a receivable when due and then cleared once paid.

   **Responsible Parties:**
   
   Accounting Director; Chief Finance Officer

   **Estimated Completion Date:**
   
   September 1, 2015

3. Management agrees with the need to improve the interest receivable reconciliation process. The procedure for preparing the year-end interest receivable reconciliation will be improved to ensure that all sources of interest revenue are accrued and reconciled in the proper accounting period.

   **Responsible Parties:**
   
   Accounting Director; Chief Finance Officer

   **Estimated Completion Date:**
   
   August 31, 2014
4. Management agrees with the need to enhance the supervisory review. Additional care will be taken in the review of loan transactions to ensure that income is recorded in the correct accounting period.

**Responsible Parties:**

*Accounting Director; Chief Finance Officer*

**Estimated Completion Date:**

*January 31, 2014*

### 1.2 Misclassification of Interest Receivable

Accrued interest was incorrectly classified as accounts receivable on the August 31, 2012, financial statements for both special revenue funds and enterprise funds. (The accounts receivable balance for the special revenue funds was stated as $39,083 and should have been $11,156, while the accounts receivable balance for the enterprise funds was stated as $37,887 and should have been $0.) This was a coding error that the end-of-year reconciliation and management review did not pick up. This suggests the reconciliation and management review processes need to be enhanced for improved effectiveness.

**Recommendation**

Accounting staff should ensure that all reconciliations, including the custodial accounts, are independently prepared and reviewed.

**Management Action Planned:**

*Management agrees. Reconciliations for the balance sheet accounts (loan activity) will be independently prepared and approved on at least a monthly basis.*

**Responsible Parties:**

*Accounting Director; Chief Finance Officer*

**Estimated Completion Date:**

*September 1, 2014*

### 1.3 Custodial Clearing Account Records

The custodial bank account is not reflected in the agency’s general ledger (MIP). Failure to fully record all transactions of this account "on the books" could unnecessarily lead to undetected financial reporting errors. When a loan or principal payment is made, funds physically move through at least two accounts at two different institutions. First, the loan principal or interest proceeds are deposited to the cash clearing account held by the custodian (not presently reflected in the agency’s books). Next, staff will wire funds from the custodian to an account held at the Texas Comptroller of Public Accounts (either account 0040, “Cash in Bank,” or account 0045,
“Cash in State Treasury”). The wire transfer gets recorded as the initial deposit to either 0040 or 0045.

Accounting does not use a general ledger account for the custodial bank account to record both the receipts and disbursements along with a running balance. Rather, Accounting only records the disbursement paid as a deposit when it gets transferred to one of the Comptroller accounts. Theoretically, the clearing account does not maintain an overnight balance, because funds are wired to the other accounts on the same day. According to management, this justifies the “off the record” treatment. For the sample of 25 transactions tested, the size of this transaction type averaged $7 million, with the largest being $36 million.

**Recommendation**

Accounting should establish the custodial bank account on the general ledger and record its clearing account activity.

**Management Action Planned:**

*Management agrees. A general ledger account will be added and the underlying transactional activity will be recorded in the general ledger.*

**Responsible Parties:**

*Accounting Director; Chief Finance Officer*

**Estimated Completion Date:**

*September 1, 2015*

**Issue 2 - Criminal Background Checks**

Accounting has not performed criminal background checks on applicants for employment as part of the applicant screening process. This undermines many of the agency’s efforts to safeguard agency assets and data. The majority of Accounting staff has access to and executes tasks dealing with such sensitive agency information as agency employees’ Social Security numbers, agency bank accounts, wire transfers, cash, checkbooks, and incoming checks. However, none of the agency’s Accounting positions are designated as “security sensitive.” Background checks require the agency to establish an account with the Texas Department of Public Safety and to pay a nominal fee for each criminal background check.

**Recommendations**

Agency management should

1. Designate Accounting positions as security sensitive.

2. Develop and implement a policy requiring criminal background checks for employees and applicants in “security sensitive” positions so agency assets and data are better safeguarded.
Management Action Planned:

1. Management agrees with the need to designate Accounting positions as “security sensitive” and will work to implement this process as soon as possible.

   Responsible Parties:
   Human Resources Director; Chief Finance Officer

   Estimated Completion Date:
   April 1, 2014

2. Management agrees. An agency policy will be developed and implemented on performing criminal background checks.

   Responsible Parties:
   General Counsel; Human Resources Director; Chief Deputy Executive Administrator

   Estimated Completion Date:
   May 1, 2014

**Issue 3 - Ethics Training**

Although Accounting staff has access to and executes tasks dealing with such sensitive agency information as agency employees’ Social Security numbers, agency bank accounts, wire transfers, cash, checkbooks, and incoming checks, management does not provide staff with regular business ethics training. Some of the staff has not had ethics training in more than 10 years. Providing regular ethics training tailored for accounting and finance staff is crucial in instilling the right values, rules, and regulations; setting the right tone and ethical culture from the top; setting management expectations; and providing staff with guidance.

**Recommendation**

In conjunction with an enhanced agency wide ethics training for all staff, management should provide Accounting staff with specialized ethics training (for finance professionals) on a regular basis (i.e., at least annually). The training could include the process of ethical reasoning and how to apply it when specific dilemmas occur. It could also include such topics as illegal accounting, reporting practices, network security issues, and theft.

**Management Action Planned:**

Management agrees. Finance staff will take an enhanced version of ethics training tailored for financial personnel on a biennial basis.

**Responsible Party:**

Executive Administrator
**Estimated Completion Date:**

*December 31, 2014*

**Issue 4 - Security of Sensitive Information**

One of the computerized information systems includes sensitive personal information. This information is presently available in an “unencrypted” format and can be printed. For example, it can be accessed and printed directly through the software by privileged users or it exists in previously produced files on the network and in backups that can be accessed and taken by an undetermined number of users. The risk of a data breach is even greater considering the data is stored and processed by a third party whose operations have not been vetted through a Statement on Standards for Attestation Engagements (SSAE) No. 16 type review. An SSAE No. 16 review evaluates and reports on a service organization’s internal controls.

In addition, the password management controls for one of the systems do not meet the complexity requirements as described in the agency’s information security policy.

**Recommendations**

Accounting should discontinue the use of the employee's sensitive personal information as an identifier when using any software. Further, management should inventory and secure all sensitive personal information located on the network and related backups. In addition, Accounting should provide a compensating control to mitigate the effects of the password management control deficiency described previously.

**Management Action Planned:**

*Management agrees. Staff will first prepare a security assessment report to fully describe the vulnerabilities. Additionally, staff will prepare a plan of action and milestones for approval by management to correct any weaknesses noted in the assessment.*

**Responsible Parties:**

*Information Security Officer; Chief Deputy Executive Administrator*

**Estimated Completion Date:**

*April 30, 2014*

**Issue 5 - White Papers**

The audit reviewed the relevant accounting policies, as articulated in the fiscal year 2012 annual financial statements. The review found that it would be beneficial if Accounting started preparing and retaining white papers to document the background and rationale for changing or adopting new accounting methodologies. On several occasions, white papers, if retained, would have described why previous management selected certain accounting methodologies (e.g., revenue recognition treatment on advance administrative draws, restructured loans, interest in governmental funds vs. proprietary funds, or zero interest coupon bonds (GASB 62/APB 21)).
Recommendation

Accounting should adopt a practice of writing and keeping white papers on complex accounting topics that provides the background and rationale on positions taken.

Management Action Planned:

Management agrees. White papers will be used to document complex accounting decisions, methodologies, and processes.

Responsible Parties:

Chief Finance Officer; Chief Deputy Executive Administrator

Estimated Completion Date:

September 1, 2014
Appendix:
Scope and Methodology

The audit tested the August 31, 2012, year-end financial reporting of revenue activities and a sample of 60 receipt transactions between September 1, 2010, and May 31, 2013. Not included were receipts from legislative appropriations. Fieldwork was conducted from June through September 2013.

The audit was based upon standards as set forth in the Institute of Internal Auditors’ “International Standards for Professional Practice of Internal Auditing” and 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 audit

- Completed an internal control questionnaire on selected topics including organization, risks, controls, and reporting.
- Conducted a walk-through of revenue management processes.
- Selected and tested 60 revenue receipt transactions for appropriate classification, recording, posting, review, approval, and third-party validation.
- Reviewed the revenue management supporting schedules for the financial statements for year ended August 31, 2012.
- Reviewed applicable laws, rules, and established procedures.
- Relied on work performed in and knowledge gained from recent internal audits, including Review of Outlays and Escrow Releases (Project 20130601) and Review of the Drinking Water State Revolving Fund (Project 20130801).
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