



**Independent Auditors' Report
on Compliance With Requirements Applicable to
Each Major Program and on Internal Control Over Compliance
in Accordance With OMB Circular A-133**

The Honorable Rick Perry, Governor,
and Members of the Texas State Legislature
State of Texas:

Compliance

We have audited the compliance of the State of Texas (the State) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major Federal programs for the year ended August 31, 2003, except those requirements discussed in the seventh following paragraph. We also did not audit the State's compliance with compliance requirements applicable to CFDA 93.283, Centers for Disease Control and Prevention – Investigations and Technical Assistance (CDC program), which is approximately .13% of total federal assistance received by the State. The State's major Federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. The CDC program is identified in the accompanying Schedule of Findings and Questioned Costs as a major Federal program and was audited by another auditor whose report has been furnished to us. Our opinion, insofar as it relates to the CDC program, is based solely on the report of the other auditor. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major Federal programs is the responsibility of the State's management. Our responsibility is to express an opinion on the State's compliance based on our audit.

The Schedule of Expenditures of Federal Awards and our audit described below does not include expenditures of Federal awards for the four component units of the State of Texas for financial statement purposes. Each of those agencies has their own independent audit in compliance with OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

Except as discussed in the following paragraph, we conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about the State's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State's compliance with those requirements.

We were unable to obtain sufficient documentation supporting the compliance of the State for the program compliance requirements listed below nor were we able to satisfy ourselves as to the State's compliance with those requirements by other auditing procedures. These program's compliance requirements were:

<u>Agency/University</u>	<u>Program</u>	<u>Compliance Requirement</u>	<u>Finding Number</u>
Department of Health	CFDA 93.917 - HIV Care Formula Grants	Earmarking	04-10
Department of Housing and Community Affairs	CFDA 14.871 - Section 8 Housing Choice Vouchers	Special Tests and Provisions	04-24

As identified below and described in the accompanying Schedule of Findings and Questioned Costs, the State did not comply with certain compliance requirements that are applicable to certain of its major Federal programs. Based on our audit and the report of other auditors, compliance with such requirements is necessary, in our opinion, for the State to comply with requirements applicable to the identified major Federal programs. The results of the auditing procedures are described in the accompanying schedule of findings and questioned costs as items:

<u>Agency/University</u>	<u>Program</u>	<u>Compliance Requirement</u>	<u>Finding Number</u>
Department of Health	CFDA 10.557 - Special Supplemental Nutrition Program for Women, Infants, and Children CFDA 93.217 - Family Planning Services CFDA 93.268 - Immunization Grants CFDA 93.917 - HIV Care Formula Grants CFDA 93.940 - HIV Prevention Activities-Health Department Based CFDA 93.994 - Maternal and Child Health Services Block Grant to the States	Subrecipient Monitoring	04-07
Department of Health	CFDA 10.557 - Special Supplemental Nutrition Program for Women, Infants, and Children CFDA 93.217 - Family Planning Services CFDA 93.268 - Immunization Grants CFDA 93.917 - HIV Care Formula Grants CFDA 93.940 - HIV Prevention Activities-Health Department Based CFDA 93.994 - Maternal and Child Health Services Block Grant to the States Medicaid Cluster	Cash Management Allowable Costs/Cost Principles	04-11 04-08

Agency/University	Program	Compliance Requirement	Finding Number
Department of Health	CFDA 10.557 - Special Supplemental Nutrition Program for Women, Infants, and Children	Special Tests and Provisions	04-12
	CFDA 93.283 - Center for Disease Control and Prevention - Investigations and Technical Assistance	Subrecipient Monitoring	04-27
Department of Housing and Community Affairs	CFDA 14.239 - HOME Investment Partnerships Program	Reporting	04-16
	CFDA 14.871 - Section 8 Housing Choice Vouchers	Reporting Special Tests and Provisions	04-18 04-23
	CFDA 14.239 - HOME Investment Partnership Program	Allowable Costs/Cost Principles	04-25 04-26
	CFDA 14.871 - Section 8 Housing Choice Vouchers CFDA 93.568 - Low-Income Home Energy Assistance		
Department of Human Services	CFDA 93.558 - Temporary Assistance for Needy Families Food Stamps Cluster	Procurement, Suspension, and Debarment	04-28
Department of Mental Health and Mental Retardation	CFDA 93.958 - Block Grants for Community Mental Health Services Medicaid Cluster	Allowable Costs/Cost Principles	04-30
	CFDA 93.958 - Block Grants for Community Mental Health Services	Special Tests and Provisions	04-31
Department of Protective and Regulatory Services	CFDA 93.658 - Foster Care - Title IV - E	Eligibility	04-38
	CFDA 93.556 - Promoting Safe and Stable Families CFDA 93.558 - Temporary Assistance for Needy Families CFDA - 93.658 - Foster Care - Title IV - E	Allowable Costs/Cost Principles	04-39
	CFDA 93.658 - Foster Care - Title IV - E Medicaid Cluster	Allowable Costs/ Cost Principles	04-32

<u>Agency/University</u>	<u>Program</u>	<u>Compliance Requirement</u>	<u>Finding Number</u>
Texas A&M University - College Station	Student Financial Assistance Cluster	Special Tests and Provisions	04-40
Texas A&M University - Corpus Christi			04-42
Texas Southern University			04-44
			04-45
Texas Tech University			04-46
University of North Texas			04-51
University of Texas at Austin			04-57
University of Texas at El Paso			04-59
West Texas A&M University			04-60
University of Houston			Student Financial Assistance Cluster
University of Texas at Austin	Research and Development Cluster	Subrecipient Monitoring	04-54

In our opinion, based on our audit and the report of other auditors, because of the effects of the noncompliance described in the preceding paragraph, the State did not comply in all material respects, with the requirements referred to above that are applicable to:

- CFDA 10.557 - Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
- CFDA 93.217 - Family Planning Services
- CFDA 93.268 - Immunization Grants
- CFDA 93.917 - HIV Care Formula Grants
- CFDA 93.940 - HIV Prevention Activities-Health Department Based
- CFDA 93.994 - Maternal and Child Health Services Block Grant to the States

In our opinion, based on our audit and the report of other auditors, except for the noncompliance described in the preceding two paragraphs and except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding compliance with the requirements described in the third preceding paragraph, the State complied, in all material respects, with the requirements referred to above that are applicable to each of its major Federal programs for the year ended August 31, 2003, other than those requirements discussed in the following paragraph. The results of our auditing procedures and the report of other auditors also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items:

<u>Agency/University</u>	<u>Program</u>	<u>Compliance Requirement</u>	<u>Finding Number</u>
Higher Education Coordinating Board	Student Financial Assistance Cluster-Loan Servicing of FFEL	Special Tests and Provisions	04-02
	CFDA 84.048 - Vocational Education-Basic Grants to States	Reporting	04-03
Texas Education Agency	CFDA 84.002 - Adult Education	Reporting	04-04

Agency/University	Program	Compliance Requirement	Finding Number
Health and Human Services Commission	Medicaid Cluster	Special Tests and Provisions	04-05
Department of Health	CFDA 93.917 - HIV Care Formula Grants	Allowable Costs/Cost Principles	04-09
	CFDA 93.940 - HIV Prevention Activities-Health Department Based	Allowable Costs/Cost Principles	04-14
	CFDA 93.268 - Immunization Grants	Special Tests and Provisions	04-15
Department of Housing and Community Affairs	CFDA 14.239 - HOME Investment Partnerships Program	Allowable Costs/Cost Principles	04-17
	CFDA 14.871 - Section 8 Housing Choice Vouchers	Reporting	04-19
		Eligibility	04-20
		Special Tests and Provisions	04-21 04-22
Department of Human Services	CFDA 93.566 - Refugee and Entrant Assistance - State Administered Programs	Allowable Costs/Cost Principles	04-29
Department of Mental Health and Mental Retardation	Medicaid Cluster	Cash Management	04-34
Department of Protective and Regulatory Services	CFDA 93.659 - Adoption Assistance	Eligibility	04-37
		Allowable Costs/Cost Principles	04-36
Texas A&M University - College Station	Student Financial Assistance Cluster	Reporting	04-41
Texas A&M University - Corpus Christi			04-43
Texas Tech University			04-47
University of Texas at Austin			04-55
University of Houston			04-49
University of Texas at Austin	Student Financial Assistance Cluster	Special Tests and Provisions	04-50
			04-56
			04-58
University of Texas at Austin	Research and Development Cluster	Cash Management	04-52

We did not audit compliance with requirements governing billing and collection of Perkins loans for certain portions of the State. Those requirements govern functions that are performed by Affiliated Computer Services, Inc. (ACS) and AMS Servicing Group. Since we did not apply auditing procedures to satisfy ourselves as to compliance with those requirements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance with those requirements.

The service organizations' compliance with the requirements governing the functions that they perform was examined by other accountants whose reports have been furnished to us. The reports of the other accountants indicate that compliance with those requirements was examined in accordance with the Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*. Based on our review of the service organization accountants' reports, we have determined that all of the compliance requirements included in the *Compliance Supplement* that are applicable to the Student Financial Aid Cluster major program are addressed in either our report or the report of the respective service organization's accountants. Further, based on our review of the service organization accountants' reports, we have determined that they do not contain any findings of noncompliance that would have a direct and material effect on the Student Financial Aid Cluster major program.

Internal Control Over Compliance

The management of the State is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to Federal programs. In planning and performing our audit, we considered the State's internal control over compliance with requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Requirements governing billing and collection of Perkins loans are performed by the service organizations noted above. Internal control over compliance relating to such functions was reported on by other accountants in accordance with the Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*. Copies of the service organizations accountants' reports have been furnished to us. However, the scope of our work did not extend to internal control maintained at the respective service organizations as noted above.

We and the other auditors noted certain matters involving the internal control over compliance and its operation that we and the other auditors consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State's ability to administer a major Federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants.

Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs, and are listed below excluding those reportable conditions we also consider to be material weaknesses:

Agency/University	Program	Compliance Requirement	Finding Number
Higher Education Coordinating Board	Student Financial Assistance Cluster - Loan Servicing of FFEL	Special Tests and Provisions	04-01 04-02
Health and Human Services Commission	Medicaid Cluster	Special Tests and Provisions	04-05
Department of Health	CFDA 10.557 - Special Supplemental Nutrition Program for Women, Infants, and Children	Special Tests and Provisions	04-12

Agency/University	Program	Compliance Requirement	Finding Number		
Department of Health	CFDA 93.940 - HIV Prevention Activities-Health Department Based	Allowable Costs/Cost Principles	04-14		
	CFDA 93.283 - Center for Disease Control and Prevention-Investigations and Technical Assistance	Reporting	04-61		
Department of Housing and Community Affairs	CFDA 14.871 - Section 8 Housing Choice Vouchers	Special Tests and Provisions	04-23		
		Reporting	04-18		
Department of Human Services	CFDA 93.566- Refugee and Entrant Assistance - State Administered Programs	Allowable Costs/Cost Principles	04-29		
Department of Mental Health and Mental Retardation	Medicaid Cluster	Cash Management	04-34		
Department of Protective and Regulatory Services	CFDA 93.556 - Promoting Safe and Stable Families	Cash Management	04-35		
	CFDA 93.558 - Temporary Assistance for Needy Families				
	CFDA 93.658 - Foster Care - Title IV - E				
	CFDA 93.659 - Adoption Assistance				
	CFDA 93.667 - Social Services Block Grant				
	CFDA 93.659 - Adoption Assistance			Eligibility	04-37
	CFDA 93.658 - Foster Care - Title IV - E			Eligibility	04-38
	CFDA 93.556 - Promoting Safe and Stable Families CFDA 93.558 - Temporary Assistance for Needy Families CFDA - 93.658 - Foster Care - Title IV - E			Allowable Costs/Cost Principles	04-39
Texas A&M University - College Station	Student Financial Assistance Cluster	Special Tests and Provisions	04-40		
Texas Southern University			04-44		
			04-45		
Texas Tech University			04-46		

<u>Agency/University</u>	<u>Program</u>	<u>Compliance Requirement</u>	<u>Finding Number</u>
University of Houston	Student Financial Assistance Cluster	Special Tests and Provisions	04-49
University of North Texas			04-51
University of Texas at Austin			04-58
University of Texas at El Paso			04-59
Texas A&M University - Corpus Christi	Student Financial Assistance Cluster	Reporting	04-43
Texas A&M University - College Station			04-41
University of Houston			04-48
University of Texas at Austin	Research and Development Cluster	Cash Management	04-52
		Matching and Program Income	04-53
		Subrecipient Monitoring	04-54

A material weakness is a 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 noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major Federal program 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 compliance 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, the following reportable conditions we and the other auditors also consider to be material weaknesses:

<u>Agency/University</u>	<u>Program</u>	<u>Compliance Requirement</u>	<u>Finding Number</u>
Department of Health	CFDA 10.557 - Special Supplemental Nutrition Program for Women, Infants, and Children CFDA 93.217 - Family Planning Services CFDA 93.268 - Immunization Grants CFDA 93.917 - HIV Care Formula Grants CFDA 93.940 - HIV Prevention Activities-Health Department Based CFDA 93.994 - Maternal and Child Health Services Block Grant to the States	Subrecipient Monitoring	04-07

Agency/University	Program	Compliance Requirement	Finding Number
Department of Health	CFDA 10.557 - Special Supplemental Nutrition Program for Women, Infants, and Children	Cash Management	04-11
		Allowable Costs/Cost Principles	04-08
	CFDA 93.217 - Family Planning Services		
	CFDA 93.268 - Immunization Grants		
	CFDA 93.917 - HIV Care Formula Grants		
	CFDA 93.940 - HIV Prevention Activities-Health Department Based		
	CFDA 93.994 - Maternal and Child Health Services Block Grant to the States Medicaid Cluster		
	CFDA 93.917 - HIV Care Formula Grants	Earmarking	04-10
	CFDA 93.283 - Center for Disease Control and Prevention-Investigations and Technical Assistance	Subrecipient Monitoring	04-27
		Allowable Costs/Cost Principles	04-06
Cash Management		04-13	
Department of Housing and Community Affairs	CFDA 14.871 - Section 8 Housing Choice Vouchers	Special Tests and Provisions	04-24
	CFDA 14.239 - HOME Investment Partnership Program	Allowable Costs/Cost Principles	04-25
	CFDA 14.871 - Section 8 Housing Choice Vouchers		
	CFDA 93.568 - Low-Income Home Energy Assistance		
Department of Human Services	CFDA 93.558 - Temporary Assistance for Needy Families Food Stamps Cluster	Procurement, Suspension, and Debarment	04-28
Department of Mental Health and Mental Retardation	CFDA 93.958 - Block Grants for Community Mental Health Services Medicaid Cluster	Allowable Costs/Cost Principles	04-30
	CFDA 93.958 - Block Grants for Community Mental Health Services	Special Tests and Provisions	04-31

<u>Agency/University</u>	<u>Program</u>	<u>Compliance Requirement</u>	<u>Finding Number</u>
Department of Mental Health and Mental Retardation	Medicaid Cluster	Special Tests and Provisions	04-33
Texas A&M University - Corpus Christi	Student Financial Assistance Cluster	Special Tests and Provisions	04-42
West Texas A&M University			04-60

This report is intended solely for the information and use of the Governor, the Members of the Texas State Legislature, Legislative Audit Committee, management of State agencies and universities, and all Federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 23, 2004