



John Keel, CPA
State Auditor

A Report on

**State of Texas Compliance with
Federal Requirements for the
National Guard Military
Operations and Maintenance
Projects Program for the Fiscal
Year Ended August 31, 2011**

February 2012

Report No. 12-021



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State of Texas Compliance with Federal Requirements for the National Guard Military Operations and Maintenance Projects Program for the Fiscal Year Ended August 31, 2011

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Overall Conclusion

The State of Texas complied in all material respects with the federal requirements for the National Guard Military Operations and Maintenance (O&M) Projects Program in fiscal year 2011.

As a condition of receiving federal funding, U.S. Office of Management and Budget (OMB) Circular A-133 requires non-federal entities that expend at least \$500,000 in federal awards in a fiscal year to obtain Single Audits. Those audits test compliance with federal requirements in 14 areas, such as allowable costs, cash management, and reporting. The requirements for 1 of those 14 areas vary by federal program and outline special tests that auditors are required to perform, such as requirements related to expenditures of American Reinvestment and Recovery Act (Recovery Act) funds. The Single Audit for the State of Texas included (1) all high-risk federal programs for which the State expended more than \$86,555,601 in federal funds during fiscal year 2011 and (2) other selected federal programs.

National Guard Military Operations and Maintenance (O&M) Projects Program

The National Guard Military Operations and Maintenance (O&M) Projects Program provides funding for states through cooperative agreements to support the operations and maintenance of Army National Guard and Air National Guard facilities and provides authorized service support activities to National Guard units and personnel through assistance awards.

From September 1, 2010, through August 31, 2011, the State of Texas expended \$57.5 billion in federal funds for federal programs and clusters of programs. The State Auditor's Office audited compliance with requirements for the National Guard Military Operations and Maintenance (O&M) Projects Program at the Adjutant General's Department (Department), which spent \$61,920,634 in federal funds during fiscal year 2011.

This audit was conducted in accordance with Single Audit Act Amendments of 1996 and Office of Management and Budget Circular A-133.

For more information regarding this report, please contact James Timberlake, Audit Manager, or John Keel, State Auditor, at (512) 936-9500.

Key Points

The Department complied in all material respects with the requirements tested for the National Guard Military Operations and Maintenance (O&M) Projects Program. However, auditors identified certain significant deficiencies and non-compliance (see text box for definitions of finding classifications).

The Department did not spend program income prior to requesting advance federal funding or submitting reimbursement requests. While the Department has established a process to separately account for and collect program income, its program managers determine when to spend program income. As a result, program income is often not spent until a purchase can be made entirely with available program income.

The Department did not always require its contractors to submit certified weekly payrolls for one project funded by the Recovery Act. While the Department required its two contractors to maintain those payrolls for the Department's review, it did not collect certified weekly payrolls from the contractors as required by the Davis-Bacon Act.

The Department did not always report complete and correct information in the financial reports it is required to submit to the federal government. Specifically, the Department did not report program income it had earned or the amount of state matching funds it had provided on its Request For Advance Or Reimbursement report (referred to as an "SF 270" report). Additionally, the Department reported amounts on its SF 270 reports that were not supported by information from its accounting systems, the Uniform Statewide Accounting System, and its subledger system (the Integrated Engineering Management System or IEMS).

Auditors followed up on three findings from prior fiscal years for the National Guard Military Operations and Maintenance (O&M) Projects Program.

The Department fully implemented recommendations for one finding from a prior fiscal year.

The Department partially implemented recommendations for one finding from a prior fiscal year.

Finding Classifications

Control weaknesses are classified as either significant deficiencies or material weaknesses:

- A **significant deficiency** indicates control weaknesses, but those weaknesses would not likely result in material non-compliance.
- A **material weakness** indicates significant control weaknesses that could potentially result in material non-compliance with the compliance area.

Similarly, compliance findings are classified as either non-compliance or material non-compliance, where material non-compliance indicates a more serious reportable issue.

The State Auditor's Office reissued one finding from a prior fiscal year as a fiscal year 2011 finding in this report.

Summary of Management's Response

Management generally concurred with the audit findings. Specific management responses and corrective action plans are presented immediately following each finding in this report.

Summary of Information Technology Review

The audit work included a review of general and application controls for key information technology systems related to the National Guard Military Operations and Maintenance (O&M) Projects Program at the Department. Auditors did not identify significant control weaknesses related to the information technology systems reviewed.

Summary of Objectives, Scope, and Methodology

With respect to the National Guard Military Operations and Maintenance (O&M) Projects Program, the objectives of this audit were to (1) obtain an understanding of internal controls, assess control risk, and perform tests of controls unless the controls were deemed to be ineffective and (2) provide an opinion on whether the State complied with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on the National Guard Military Operations and Maintenance (O&M) Projects Program.

The audit scope covered federal funds that the State spent for the National Guard Military Operations and Maintenance (O&M) Projects Program from September 1, 2010, through August 31, 2011. The audit work included control and compliance work at the Department.

The audit methodology included developing an understanding of controls over each compliance area that was material to the National Guard Military Operations and Maintenance (O&M) Projects Program. Auditors conducted tests of compliance and of the controls identified for each compliance area and performed analytical procedures when appropriate. Auditors assessed the reliability of data the Department provided and determined that the data provided was reliable for the purposes of expressing an opinion on compliance with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on the National Guard Military Operations and Maintenance (O&M) Projects Program.

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Independent Auditor's Report

*State of Texas Compliance with
Federal Requirements for National
Guard Military Operations and
Maintenance (O&M) Projects Program
for the Fiscal Year Ended
August 31, 2011*

Report on Compliance with Requirements that Could Have a Direct and Material Effect on
The National Guard Military Operations and Maintenance (O&M) Projects Program and on
Internal Control Over Compliance in Accordance with
U.S. Office of Management and Budget Circular A-133
Independent Auditor's Report

Compliance

We have audited the State of Texas's (State) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on the National Guard Military Operations and Maintenance (O&M) Projects Program for the year ended August 31, 2011. Compliance with the requirements of laws, regulations, contracts, and grants applicable to the National Guard Military Operations and Maintenance (O&M) Projects Program is the responsibility of the State's management. Our responsibility is to express an opinion on the State's compliance based on our audit.

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 the National Guard Military Operations and Maintenance (O&M) Projects 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.

This audit was conducted as part of the State of Texas Statewide Single Audit for the year ended August 31, 2011. As such, the National Guard Military Operations and Maintenance (O&M) Projects Program was selected as a major program based on the State of Texas as a whole for the year ended August 31, 2011. The State does not meet the OMB Circular A-133 requirements for a program-specific audit and the presentation of the Schedule of Program Expenditures does not conform to the OMB Circular A-133 Schedule of Expenditures of Federal Awards. However, this audit was designed to be relied on for the State of Texas opinion on federal compliance, and in our judgment, the audit and this report satisfy the intent of those requirements. In addition, we have chosen not to comply with a reporting standard that specifies the wording that should be used in discussing restrictions on the use of this report. We believe that this wording is not in alignment with our role as a legislative audit function.

In our opinion, the State complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on the National Guard Military Operations and Maintenance (O&M) Projects Program for the year ended August 31, 2011. However, the results of our auditing procedures disclosed 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:

Agency	Program	Compliance Requirement	Finding Number
Adjutant General's Department	National Guard Military Operations and Maintenance (O&M) Projects Program	Cash Management	12-101
	National Guard Military Operations and Maintenance (O&M) Projects Program-ARRA	Davis - Bacon Act	12-102
	National Guard Military Operations and Maintenance (O&M) Projects Program	Reporting	12-103
	National Guard Military Operations and Maintenance (O&M) Projects Program-ARRA		

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 the National Guard Military Operations and Maintenance (O&M) Projects Program. 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 the National Guard Military Operations and Maintenance (O&M) Projects Program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the State’s internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in internal control over compliance which are described in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies:

Agency	Program	Compliance Requirement	Finding Number
Adjutant General’s Department	National Guard Military Operations and Maintenance (O&M) Projects Program	Cash Management	12-101
	National Guard Military Operations and Maintenance (O&M) Projects Program-ARRA	Davis - Bacon Act	12-102
	National Guard Military Operations and Maintenance (O&M) Projects Program	Reporting	12-103
	National Guard Military Operations and Maintenance (O&M) Projects Program-ARRA		

Schedule of Program Expenditures

The accompanying Schedule of Program Expenditures for the National Guard Military Operations and Maintenance (O&M) Projects Program (Schedule) of the State for the year ended August 31, 2011, is presented for purposes of additional analysis. This information is the responsibility of the State’s management and has been subjected only to limited auditing procedures and, accordingly, we express no opinion on it. However, we have audited the Statewide Schedule of Expenditures of Federal Awards in a separate audit, and the opinion on the Statewide Schedule of Expenditures of Federal Awards is included in the *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2011*.

The State’s responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State’s responses and, accordingly, we express no opinion on the responses.

This report is intended for the information and use of the Governor, the Members of the Texas Legislature, the Legislative Audit Committee, the management of the State, KPMG LLP, federal awarding agencies, and pass-through entities. However, this report is a matter of public record, and its distribution is not limited.

John Keel, CPA
State Auditor

February 21, 2012

**Schedule of Program Expenditures for
 The National Guard Military Operations and Maintenance (O&M) Projects Program
 For the State of Texas
 For the Year Ended August 31, 2011**

Schedule of Program Expenditures			
Agency	Pass-through to Non-state Entity	Direct Expenditures	Totals
Adjutant General's Department			
Other than American Recovery and Reinvestment Act	\$0	\$59,125,722	\$59,125,722
American Recovery and Reinvestment Act	0	2,794,912	2,794,912
Total for the National Military Operations and Maintenance (O&M) Projects Program	\$0	\$61,920,634	\$61,920,634
Note: Federal expenditures for the National Guard Military Operations and Maintenance (O&M) Projects Program at state entities not included in the scope of this audit totaled \$323,866 for the year ended August 31, 2011.			

Schedule of Findings and Questioned Costs

*State of Texas Compliance with
Federal Requirements for National
Guard Military Operations and
Maintenance (O&M) Projects Program
for the Fiscal Year Ended
August 31, 2011*

Summary of Auditor's Results

Financial Statements

Issued under separate cover. See State Auditor's Office report entitled *State of Texas Financial Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2011*.

Federal Awards

Internal Control over major programs:

Material weakness(es) identified? No

Significant deficiency(ies) identified? Yes

Major programs with Significant Deficiencies:

CFDA Number	Name of Federal Program or Cluster
12.401	National Guard Military Operations and Maintenance (O&M) Projects

Type of auditor's report issued on compliance for major programs:
Unqualified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? Yes

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
12.401	National Guard Military Operations and Maintenance (O&M) Projects

Dollar threshold used to distinguish between type A and type B programs: \$86,555,601

Auditee qualified as low-risk auditee? No

Section 2:

Financial Statement Findings

Issued under separate cover. See State Auditor's Office report entitled *State of Texas Financial Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2011*.

Section 3:

Federal Award Findings and Questioned Costs

This section identifies significant deficiencies, material weaknesses, and instances of non-compliance, including questioned costs, as required to be reported by Office of Management and Budget Circular A-133, Section 510(a).

Adjutant General's Department

Reference No. 12-101

Cash Management

(Prior Audit Issue 10-01)

CFDA 12.401 - National Guard Military Operations and Maintenance Projects

Award year – October 1, 2010 to September 30, 2015

Award numbers – W912L1-11-2-1001 and W912L1-11-2-1007

Type of finding – Significant Deficiency and Non-Compliance

To the extent available, recipients shall disburse funds available from repayments to and interest earned on a revolving fund, program income, rebates, refunds, contract settlements, audit recoveries and interest earned on such funds before requesting additional cash payments (Title 2, Code of Federal Regulations, Section 215.22).

Questioned Cost: \$ 0
U.S. Department of Defense

In addition, National Guard Regulation (NGR) 5-1, Chapter 11, Section 11-6, states that the amount the grantee requests for reimbursement will be reduced by the amount of program income received.

The Adjutant General's Department (Department) did not disburse program income prior to requesting advance funding or submitting reimbursement requests. The Department has established a process to separately account for and collect program income. However, program managers determine when to disburse program income; as a result, program income is often not disbursed until a purchase can be made entirely with available program income. This leads to the Department processing advance and reimbursement requests while program income is still available. Based on data the Department provided, the Department earned a total of \$28,950 in program income in fiscal year 2011. Department management also asserted that the Department had \$13,809 in available program income as of August 31, 2011.

Not disbursing program income prior to requesting federal funds results in the Department requesting more federal funds than it needs.

Recommendation:

The Department should disburse program income prior to requesting advance funding or submitting reimbursement requests.

Management Response and Corrective Action Plan:

Management agrees with the recommendation and, to the extent possible, the department will disburse program income prior to requesting advance funding or submitting reimbursement requests. The department is developing written policies and procedure to address the reporting and disbursement of program income.

Implementation Date: August 2012

ADJUTANT GENERAL'S DEPARTMENT

Responsible Person: Pamela Darden

Reference No. 12-102

Davis-Bacon Act

CFDA 12.401 - National Guard Military Operations and Maintenance Projects - ARRA

Award year – July 24, 2009 to September 30, 2010

Award number – W912L1-09-2-9036 (ARRA)

Type of finding – Significant Deficiency and Non-Compliance

When required by the Davis-Bacon Act, the U.S. Department of Labor's (DOL) government-wide implementation of the Davis-Bacon Act, or by federal program legislation, all laborers and mechanics employed by contractors or subcontractors to work on construction contracts in excess of \$2,000 financed by federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (Title 40, United States Code (USC), Sections 3141-3144, 3146, and 3147). All projects funded in whole or in part by the American Recovery and Reinvestment Act of 2009 (Recovery Act) are required to comply with Davis-Bacon Act requirements (Title 2, Code of Federal Regulations (CFR), Section 176, Subpart C).

Questioned Cost: \$ 0

U.S. Department of Defense

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL's regulations (Title 29, CFR, Sections 5.5-5.6). In addition, contractors or subcontractors are required to submit to the non-federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (Title 29, CFR, Sections 3.3-3.4). This reporting is often done using optional form WH-347, which includes the required statement of compliance (Office of Management and Budget No. 1215-0149).

For one construction project funded by the Recovery Act in fiscal year 2011, the Adjutant General's Department (Department) did not require either of its two contractors to submit certified weekly payrolls.

This construction project was the Department's only Recovery Act-funded construction project during fiscal year 2011, and it was completed in June 2011. The standard contract language the Department uses requires the contractor to make the records available for Department review, but the contract does not specifically require contractors and subcontractors to submit weekly certified payrolls to the Department. Additionally, the Department did not request to review any certified payrolls from the two contractors during fiscal year 2011. Department payments in this program for contracts subject to the Davis-Bacon Act totaled \$2,794,912 for fiscal year 2011. In the absence of certified weekly payrolls, the Department was unable to ensure that its contractors paid laborers and mechanics wages established by the DOL.

Recommendation:

The Department should develop and implement a process to collect certified payrolls from its contractors when required.

Management Response and Corrective Action Plan:

Management agrees with the recommendation to develop and implement a process to collect certified payrolls from its contractors when required. The department will conduct an internal review of boiler plate contract language to ensure that all terms included in the contracts are required and are being enforced.

Implementation Date: August 2012

Responsible Person: Pamela Darden

ADJUTANT GENERAL'S DEPARTMENT

Reference No. 12-103

Reporting

CFDA 12.401 - National Guard Military Operations and Maintenance Projects
CFDA 12.401 - National Guard Military Operations and Maintenance Projects - ARRA
Award years - see below
Award numbers - see below
Type of finding - Significant Deficiency and Non-Compliance

The Adjutant General's Department (Department) is required to submit Standard Form 270 (SF 270) "Request for Advance or Reimbursement" each time it requests payments or advances of federal funds from the National Guard Bureau (NGR 5-1, Chapter 11, Section 11-4). Program income is reported upon reimbursement or liquidation of advance payment vouchers as soon as such income is considered "received" pursuant to state accounting procedures (NGR 5-1, Chapter 11, Section 11-6).

Questioned Cost: \$ 0
U.S. Department of Defense

The Department did not report program income on its SF 270 reports during fiscal year 2011. The Department's process for completing SF 270 reports does not include reporting program income. Only two appendices in the Department's master cooperative agreement describe earning program income: appendix 1 and appendix 7. The Department earned a total of \$28,950 in program income in fiscal year 2011. As a result of not reporting program income on its SF 270 reports, Department expenditures were not reviewed for allowability by the U.S. property and fiscal officer.

The Department also did not report the amount of state matching funds on its SF 270 reports during fiscal year 2011. The Department's process for completing SF 270 reports does not include reporting state matching funds. However, state matching funds are clearly identified in the reports that accompany the SF 270 reports. As a result of the Department's not reporting state matching amounts on the SF 270 reports, those reports were not complete.

Additionally, the Department reported amounts on its SF 270 reports that were not supported by information from its accounting system, the Uniform Statewide Accounting System (USAS), and its subledger system (the Integrated Engineering Management System or IEMS). While the Department used expenditure data from IEMS to determine the "federal share now requested" and attached that support to the SF 270 reports it submitted, it did not use accounting data to complete other lines on its SF 270 reports. Instead, the Department entered other information on the reports based on prior reports or calculations. Specifically, the Department determined its "federal payments previously requested" by recording the total program outlays from the prior month's SF-270 report, and it determined its "total program outlays to date" by adding its current expenditures to the "federal payments previously requested" line of the SF 270 report.

Reporting amounts that are not supported by financial records increases the risk that those amounts could be incorrect.

The issues discussed above affected the following awards:

Table with 2 columns: Award Numbers and Award Years. Lists awards W912L1-11-2-1000 through W912L1-11-2-1005 with their respective dates from October 1, 2010 to September 30, 2015.

ADJUTANT GENERAL'S DEPARTMENT

W912L1-11-2-1007 (Appendix 7)	October 1, 2010 to September 30, 2015
W912L1-11-2-1010 (Appendix 10)	October 1, 2010 to September 30, 2015
W912L1-11-2-1014 (Appendix 14)	October 1, 2010 to September 30, 2015
W912L1-11-2-1021 (Appendix 21)	October 1, 2010 to September 30, 2015
W912L1-11-2-1022 (Appendix 22)	October 1, 2010 to September 30, 2015
W912L1-11-2-1023 (Appendix 23)	October 1, 2010 to September 30, 2015
W912L1-11-2-1024 (Appendix 24)	October 1, 2010 to September 30, 2015
W912L1-11-2-1040 (Appendix 40)	October 1, 2010 to September 30, 2015
W912L1-10-2-3053 (RSMS)	October 1, 2009 to September 30, 2015
W912L1-07-2-3061 (ALERRT)	September 25, 2007 to September 30, 2011
W912L1-09-2-9036 (ARRA)	July 24, 2009 to September 30, 2010

Recommendations:

The Department should:

- Report program income on advance funding or reimbursement requests.
- Report state matching funds on advance funding or reimbursement requests.
- Ensure amounts it reports on the SF 270 reports agree to accounting records that support its financial statements and Schedule of Expenditures of Federal Awards, and include this supporting documentation for each part of the SF 270 report in the packet it submits to the U. S. property and fiscal officer to enhance the review and approval process.

Management Response and Corrective Action Plan:

Management agrees with the recommendations and will start reporting available information on the SF270 related to program income and state match. The department is currently in the process of developing written policies and procedures related to the utilization of program income received, the information that will be included on the SF270, and the support and reconciliation documentation needed to fully support all entries on each SF270 submitted for advances and/or reimbursements.

The department will coordinate a process with the U.S. Property and Fiscal Office to enhance the review and approval process of requests.

Implementation Date: August 2012

Responsible Person: Pamela Darden

Summary Schedule of Prior Year Audit Findings

Federal regulations (OMB Circular A-133) state, "the auditee is responsible for follow-up and corrective action on all audit findings." As part of this responsibility, the auditee reports the corrective action it has taken for the following:

- Each finding in the 2010 Schedule of Findings and Questioned Costs.
- Each finding in the 2010 Summary Schedule of Prior Audit Findings that was not identified as implemented or reissued as a current year finding.

The Summary Schedule of Prior Audit Findings (year ended August 31, 2011) has been prepared to address these responsibilities.

Adjutant General's Department

Reference No. 10-01

Cash Management Program Income

CFDA 12.401 - National Guard Military Operations and Maintenance Projects

Award years - see below

Award numbers - see below

Type of finding - Significant Deficiency and Non-Compliance

Cash Management:

To the extent available, program income, rebates, refunds, and other income and receipts must be disbursed before requesting additional federal cash draws (Title 2, Code of Federal Regulations, Part 215.22).

In addition, National Guard Regulation (NGR), Chapter 10, Section 10-7, mandates the following:

- Program income is reported on reimbursement or liquidation of advance payment vouchers as soon as such income is considered "received" pursuant to state accounting procedures. Unliquidated amounts of program income will be carried forward on the next voucher.
- The amount the State requests for reimbursement will be reduced by the amount of program income received. However, the maximum estimated cost reflected in the appropriate budget will increase by the amount of program income; but the maximum federal funding limitation reflected in the agreement will not increase.

Initial Year Written: 2009
Status: Partially Implemented

U.S. Department of Defense

The Adjutant General's Department (Department) did not disburse program income, rebates, refunds, or other income and receipts prior to requesting advance funding or submitting reimbursement requests. Department program managers are responsible for spending the program income earned as a result of activities within their programs, and the Department's State Property and Fiscal Office prepares an annual summary detailing the program income earned and expended from fiscal year 1998 to the present. However, program managers and staff do not have a clear understanding of the use of program income.

None of the 52 reimbursement requests tested included accounting for program income, rebates, refunds, or other income. These 52 requests also did not include receipts to adjust the amounts being requested. The 52 requests

ADJUTANT GENERAL'S DEPARTMENT

totaled \$12,275,491.45. As of November 16, 2009, Department accounting records show \$177,043.72 in program income retained in program accounts for fiscal year 2009.

Program Income:

Program income earned during the project period shall be retained by the recipient and used in accordance with federal awarding agency regulations or the terms and conditions of the award (Title 2, Code of Federal Regulation, Section 215.24).

National Guard Regulation (NGR) 5-1 states that, for purposes of National Guard Bureau (NGB) Cooperative Agreements, program income shall mean the gross income received by the state military department that is directly generated by a cooperative agreement supported activity. NGR 5-1 requires that program income be reported on reimbursement or liquidation of advance payment vouchers as soon as such income is considered "received" pursuant to state accounting procedures.

The Adjutant General's Department (Department) did not correctly determine, record, and use program income earned in accordance with the program requirements and NGR 5-1, as applicable. However, the Department's program income expenditures for fiscal year 2009 complied with requirements for the National Guard Military Operations and Maintenance Projects program. In addition, the Department does not consistently calculate program income using program receipts in accordance with its rental agreements.

Auditors tested 37 Department transactions to record program income earned and the 5 Department expenditures of program income. The program income earned totaled \$66,041.19 and the program income expended totaled \$17,634.93. Auditors identified the following:

- The Department (1) did not calculate program income in accordance with the contract agreement provisions or (2) collected program income from sources not allowed by the contract agreement for 3 (8 percent) of the 37 program income transactions tested. For these three errors, program income earned, and therefore reapplied to the program, was \$380 less than the established amount. Specifically:
 - For 2 of these errors, the program income amount in the Department's accounting system did not match the supporting price sheet.
 - For 1 of these errors, the program income was earned from a source that was not allowed by the contract agreement.
- The Department did not record program income in the proper account for 2 (5 percent) of the 42 program income transactions tested.
- The Department added three of the five program income expenditures to the associated Appendix budget for the Master Cooperative Agreement as required by the contract grant agreement, but it did not amend the Appendices for the other two expenditures.

Department program managers are responsible for spending the program income earned as a result of activities within their program. The Department's State Property and Fiscal Office prepares an annual summary detailing the program income earned and expended from fiscal year 1998 to the present. However, Department program managers and program staff do not have a clear understanding regarding the use of program income, and the Department did not consistently include the program income for the fiscal year in the budget information for its Master Cooperative Agreement Appendices.

The issues discussed above affected the following awards:

Award Numbers

Award Years

DAHA41-04-2-1000 (MCA)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1001 (Appendix 1)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1002 (Appendix 2)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1003 (Appendix 3)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1004 (Appendix 4)	October 1, 2003 - September 30, 2009

ADJUTANT GENERAL'S DEPARTMENT

DAHA41-04-2-1005 (Appendix 5)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1007 (Appendix 7)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1014 (Appendix 14)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1021 (Appendix 21)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1022 (Appendix 22)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1023 (Appendix 23)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1024 (Appendix 24)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1028 (Appendix 28)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1040 (Appendix 40)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1010 (Appendix 10)	October 1, 2005 - September 30, 2009
W912L1-04-2-3034 (RSMS)	February 25, 2005 - September 30, 2009
W912L1-05-2-3055 (Geospatial)	September 15, 2005 - September 30, 2009
W912L1-06-2-3059 (Peace Prairie)	March 9, 2007 - June 30, 2009
W912L1-07-2-3061 (ALERT)	September 25, 2007 - March 31, 2010
W912L1-08-2-3070 (JBOT)	October 1, 2008 - March 31, 2010

Corrective Action:

This finding was reissued as current year reference number: 12-101

Reference No. 10-02

Equipment and Real Property Management

CFDA 12.401 - National Guard Military Operations and Maintenance Projects

Award years - see below

Award numbers - see below

Type of finding - Material Weakness and Material Non-Compliance

Governmental units will manage equipment in accordance with state laws and procedures (Title 2, Code of Federal Regulation, Part 225, Appendix B). In addition, the Office of Management and Budget Circular A-133 Compliance Supplement, Part 3, Section F, mandates that states receiving federal awards shall use, manage, and dispose of equipment acquired under a federal grant in accordance with state laws and procedures. Texas Government Code, Section 403.273, also specifies that a state agency shall conduct an annual physical inventory of all property in its possession, and at all times the property records of a state agency must accurately reflect the property possessed by the agency. In addition, the Office of the Texas Comptroller of Public Accounts' (Comptroller's Office) *SPA Process User's Guide* states that each item of property, capitalized or controlled, must be assigned a unique property inventory number. Each agency is responsible for ensuring that property is tracked and secured in a manner that is most likely to prevent loss, theft, damage, or misuse. Agencies must know at all times where all property under their control is located. Agencies must also complete Form 73-283 after conducting an annual physical inventory, and the agency head must submit this form to the Comptroller's office no later than 20 days after the last day of the fiscal year.

Initial Year Written: 2009
Status: Implemented

U.S. Department of Defense

The Adjutant General's Department (Department) does not have sufficient internal controls over its equipment. Auditors identified several deficiencies that are discussed below.

State Property Accounting System Information and Purchase Documentation:

Auditors identified discrepancies in the State Property Accounting (SPA) system and purchase documentation for 16 (19 percent) of 84 property records tested. Specifically:

- 3 equipment purchases should have been recorded as capitalized assets but were not.
- 4 equipment items had serial numbers in the purchase documentation that were not in SPA.

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- 5 equipment items had serial numbers in SPA that did not match the serial numbers on the purchase documentation.
- 4 equipment items had duplicate serial numbers in SPA.

These discrepancies occurred because of data entry errors into SPA (for which there was no Department review process) and because the Department assigned incorrect coding to equipment transactions in its accounting system.

Location and Property Tag Information:

Thirty-four (40 percent) of the 84 equipment items that auditors attempted to physically locate had discrepancies in the location and property tag information listed in SPA. Specifically:

- 3 equipment purchases were not capitalized but should have been, which resulted in the assigned tag number not being recorded in SPA.
- 10 equipment items were in locations that differed from the location listed in SPA.
- 4 equipment items could not be located. Specifically:
 - 3 of the 4 items were recorded in SPA, but Department could not locate these items.
 - 1 of the 4 items was selected from Department expenditure data, but the Department could not locate the purchasing documentation necessary to reference the item in SPA and locate the item.
- 16 equipment items did not have the assigned property tags affixed to them.
- 1 equipment item lacked supporting purchase documentation.

These discrepancies occurred because the Department does not perform a secondary review of data entry into SPA, the Department assigned incorrect coding to equipment transactions in its accounting system, there is a lack of controls over issuing equipment and property tags, the Department's method of receiving equipment is decentralized, there is a lack of documentation retention, and a failure to confirm the annual inventory certifications that employees perform. In addition, if property is received at an installation other than Camp Mabry, the Department's property manager is frequently not informed. The four equipment items that could not be located cost \$34,421.

Annual Inventories:

The Department certified its annual inventory to the Comptroller's Office without receiving and confirming all inventory certifications from equipment custodians. The Department also submitted its certification to the Comptroller's Office 15 days after the due date. The Department also did not ensure that all equipment custodians verified the inventory and did not resolve all discrepancies in inventory results. In addition, the Department did not consistently update the inventory in SPA with information for equipment purchases.

The Department performed its annual inventory by asking 20 employees who are assigned equipment in SPA to complete inventory verification reports. However:

- Twelve (60 percent) of the 20 employees did not complete an inventory verification report.
- Seven (35 percent) of the 20 employees submitted inventory verification reports that included discrepancies that the Department did not correct.

Updates to the State Property Accounting System:

Six equipment items in SPA (five of which were controlled assets) were not assigned to a responsible person. No locations were listed for these items in SPA. The Department also had surplus equipment that was still assigned to 29 individuals in SPA, and it had not yet made the adjustments in SPA to correctly record the responsible person and location. In addition, the Department did not update SPA to add equipment purchased for 5 (50 percent) of 10 control forms that were included in the annual inventory documentation.

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Reconciliations

The Department's process to reconcile SPA with the Uniform Statewide Accounting System (USAS) is adequate if the correct information is in both systems. Auditors reviewed the reconciliation documentation and determined that the reconciliation process identified purchases of capital assets that were correctly entered into SPA but were not entered into USAS as capitalized assets. However, auditors determined that two computer equipment items were incorrectly coded in USAS as expenditures instead of being capitalized and were not entered into SPA through the purchasing process. As a result, these purchase transactions should have been included in the reconciliation. The Department asserted that it would adjust the fiscal year 2010 beginning balance.

The weaknesses in controls discussed above increase the risk for misuse or theft of equipment and use of federal and state funds for inappropriate or unallowable purposes. The Department's equipment acquisitions for fiscal year 2009 totaled \$1,257,065. Property records in SPA show that the Department had a total of \$5,422,088.36 in equipment at the end of fiscal year 2009.

The issues discussed above affected the following awards:

Award Numbers

Award Years

DAHA41-04-2-1000 (MCA)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1001 (Appendix 1)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1002 (Appendix 2)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1003 (Appendix 3)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1004 (Appendix 4)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1005 (Appendix 5)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1007 (Appendix 7)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1014 (Appendix 14)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1021 (Appendix 21)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1022 (Appendix 22)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1023 (Appendix 23)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1024 (Appendix 24)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1028 (Appendix 28)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1040 (Appendix 40)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1010 (Appendix 10)	October 1, 2005 - September 30, 2009
W912L1-04-2-3034 (RSMS)	February 25, 2005 - September 30, 2009
W912L1-05-2-3055 (Geospatial)	September 15, 2005 - September 30, 2009
W912L1-06-2-3059 (Peace Prairie)	March 9, 2007 - June 30, 2009
W912L1-07-2-3061 (ALERRT)	September 25, 2007 - March 31, 2010
W912L1-08-2-3070 (JBOT)	October 1, 2008 - March 31, 2010

Corrective Action:

Corrective action was taken.

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Reference No. 10-03

**Procurement and Suspension and Debarment
Allowable Costs/Cost Principles**

CFDA 12.401 - National Guard Military Operations and Maintenance Projects

Award years - see below

Award numbers - see below

Type of finding - Significant Deficiency and Non-Compliance

General Controls

Agencies shall maintain internal control over federal programs that provides reasonable assurance that the institutions are managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements (Office of Management and Budget Circular A-133, Subpart C, Section 300 (b)).

Initial Year Written: 2009 Status: Partially Implemented

U.S. Department of Defense

The Adjutant General's Department (Department) uses the Uniform Statewide Accounting System (USAS) as its accounting system of record and the Integrated Engineering Management System (IEMS) as its cross-functional purchasing and accounting database system. Both systems are accessed through the Texas Military Forces (TXMF) network because most of the Department's elements operate on the TXMF network. Audit procedures included review of general level controls over USAS, IEMS, and the TXMF network.

The Department does not have formal policies or procedures regarding the periodic review of user access within IEMS at the application level or at the server level. The Department reviews user access in IEMS at the application level when there is turnover in a program manager position, which can occur every few years in some instances. Auditors reviewed the IEMS user list of 284 employees at the application level and determined that 29 users have access levels allowing them to request a purchase and provide both budget approval and final approval for that purchase, indicating a lack of segregation of duties. The IEMS user list also contains three users who have access levels allowing them entry capability (to include requesting a purchase), and these three users are not current employees. In addition, at least 42 individuals are assigned administrator level access to the IEMS database and to the server housing the IEMS application and database. These 42 individuals also have access to migrate IEMS code releases to the Department's production environment. Most of these 42 individuals have these access rights because they inherited the access rights of other roles as provided for in Microsoft Active Directory and because the IEMS database administrator position is currently vacant.

The Department provided no evidence regarding its periodic review of user access to the TXMF network. The Department asserts that its review of access history is done manually and by exception. Auditors reviewed user access to the TXMF network and identified the following:

- One administrative assistant has administrative access to the TXMF network.
- One user with administrative access to the TXMF network is no longer employed by the Department. This user was a previous employee of the TXMF.

In addition, the Department does not have change management policies or procedures for its automated systems. The Department asserts it is developing these policies and procedures.

Not reviewing user access could result in inappropriate access of the Department's systems. Allowing users and developers inappropriate or excessive access to areas in IEMS that are outside of their job functions increases the risk of inappropriate changes and does not allow for segregation of duties. In addition, not having policies and procedures over change management could result in unauthorized or inappropriate changes made to the Department's automated systems.

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Corrective Action:

Corrective action was taken.

Procurement and Suspension and Debarment

National Guard Regulation (NGR) 5-1, Section 3-10, states that acquisition of goods and services in performance of the cooperative agreement shall be according to state contracting procedures per Title 32, Code of Federal Regulations (CFR), Section 33.36, which states the following:

- When procuring property and services under a grant, a state will follow the same policies and procedures it uses for procurements from its non-federal funds.
- Grantees will maintain records sufficient to detail the significant history of a procurement. These records will include, but are not limited to, rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

State procurement guidelines include the following:

- Texas Government Code, Section 2155.132 (e), requires competitive bidding, whether formal or informal, for a purchase by a state agency if the purchase exceeds \$5,000 and is made under a written contract.
- The Texas Comptroller of Public Accounts' *The State of Texas Procurement Manual*, Section 2-28, states that, for procurements that are not subject to alternate procurement methods and are for estimated purchases of \$5,000 to \$25,000, agencies must obtain at least three informal bids, two of which must be from vendors certified as historically underutilized business (HUB) by the State.
- The Department's *Purchasing Guide* requires that purchases between \$5,000 and \$25,000 must obtain three informal verbal bids. Agencies must use the Centralized Master Bidders List (CMBL) to locate vendors who service the specific highway district for the specified class and item number. Two (2) bids must be solicited from certified HUB program. If it will enhance competition, the agency may add non-CMBL vendors to the final bid list, but written approval from the head of the agency is required to supplement non-CMBL vendors.

The Department did not consistently follow requirements for competitive bidding and retain justification for purchases when there were fewer than three bidders. Auditors identified the following during testing:

- Three closely related purchases that were individually under \$5,000 should have been combined for a total purchase of \$5,930 and, therefore, should have been subject to competitive bidding. Although the purchases were submitted on the same day and for the same service, they were assigned consecutive purchase order numbers, and the Department's purchasers did not require that the purchases be combined and competitively bid.
- For one \$14,948.28 purchase, purchasers did not ensure that the requester obtained at least three bids from the CMBL and HUB vendors, and they did not include documentation to explain the procurement method.
- For one \$127,178 purchase, purchasers did not retain adequate documentation in the procurement file, including documentation for a comparison of vendors' qualifications or for use of the CMBL.

These issues occurred because of a lack of oversight by the Department's purchasing staff and lack of a structured system for monitoring procurement and contracting documents. The issues affected the following awards:

Award Numbers

Award Years

DAHA41-04-2-1000 (MCA)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1001 (Appendix 1)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1002 (Appendix 2)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1003 (Appendix 3)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1004 (Appendix 4)	October 1, 2003 - September 30, 2009

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DAHA41-04-2-1005 (Appendix 5)	October 1, 2003 -September 30, 2009
DAHA41-04-2-1007 (Appendix 7)	October 1, 2003 - September 30, 2009
DAHA41-04-2-1014 (Appendix 14)	October 1, 2003 -September 30, 2009
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W912L1-07-2-3061 (ALERRT)	September 25, 2007 - March 31, 2010
W912L1-08-2-3070 (JBOT)	October 1, 2008 - March 31, 2010

Recommendations:

The Department should:

- Verify that purchasers are aware of the potential for project splitting, and ensure that requesters are aware of the requirements for competitively bidding projects.
- Ensure that requesters use the CMBL and HUB vendors when obtaining bids, and maintain documentation of this in the procurement files.
- Ensure that purchasers maintain documentation on comparison of vendors in the procurement files.
- Develop and implement a process for monitoring procurement files to ensure that staff obtain and retain proper documentation to support purchases.

Management Response and Corrective Action Plan 2009:

Management agrees with the findings and recommendations that the Construction, Facilities, Maintenance, and Operations purchasing section's procedures should be strengthened and will ensure the implementation of the recommendations.

Management Response and Corrective Action Plan 2010:

After completing a review of the Adjutant General's Department (department) purchasing system and related processes, management consolidated all purchasing processes to State Services effective 1 September 2010. State Services has also added additional purchasing personnel to strengthen the system and the associated control processes. These actions were completed 1 September 2010.

Management Response and Corrective Action Plan 2011:

Effective 01 September 2010, management consolidated all purchasing processes to State Services. A new Purchasing Manager was hired 01 September 2011. The Adjutant General's Department Purchasing Procedures were updated in October 2011 and have been placed on the agency's intranet.

Implementation Date: September 1, 2011

Responsible Persons: Ms. Pam Darden

Appendix

Objectives, Scope, and Methodology

Objectives

With respect to the National Guard Military Operations and Maintenance (O&M) Projects Program, the objectives of this audit were to (1) obtain an understanding of internal controls, assess control risk, and perform tests of controls unless the controls were deemed to be ineffective and (2) provide an opinion on whether the State complied with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on the National Guard Military Operations and Maintenance (O&M) Projects Program.

Scope

The audit scope covered federal funds that the State spent for the National Guard Military Operations and Maintenance (O&M) Projects Program from September 1, 2010, through August 31, 2011. The audit work included control and compliance work at the Adjutant General's Department (Department).

Methodology

The audit methodology included developing an understanding of controls over each compliance area that was material to the National Guard Military Operations and Maintenance (O&M) Projects Program. Auditors conducted tests of compliance and of the controls identified for each compliance area and performed analytical procedures when appropriate. Auditors assessed the reliability of data the Department provided and determined that the data provided was reliable for the purposes of expressing an opinion on compliance with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on the National Guard Military Operations and Maintenance (O&M) Projects Program.

Information collected and reviewed included the following:

- Department expenditure, procurement, reporting, cash revenue, required matching, program income, and subrecipient data.
- Federal notices of award and award proposals.
- Transactional support related to expenditures, procurement, and revenues.
- Department-generated reports and data used to support reports, revenues, and other compliance areas.

- Information system support for Department assertions related to general controls over information systems that support the control structure related to federal compliance.

Procedures and tests conducted included the following:

- Analytical procedures performed on expenditure data to identify instances of non-compliance.
- Compliance testing for samples of transactions for each direct and material compliance area.
- Tests of design and effectiveness of key controls and tests of design of controls to assess the sufficiency of the Department's control structure.
- Tests of design and effectiveness of general controls over information systems that support the control structure related to federal compliance.

Criteria used included the following:

- The Code of Federal Regulations.
- Office of Management and Budget Circulars A-87, A-102, and A-133.
- The American Recovery and Reinvestment Act.
- Federal notices of award and award proposals.
- Department policies and procedures.

Project Information

Audit fieldwork was conducted from June 2011 through December 2011. Except as discussed above in the Independent Auditor's Report, 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 Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

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

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- Pamela A. Bradley, CPA (Assistant Project Manager)
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- Rebecca Franklin, CFE, CGAP, CISA (Prior Year Finding Coordinator)
- Scott Ela, CPA, CIA (Team Lead)
- Cyndie Holmes, CISA
- Karen Mullen, CGAP
- Michael Apperley, CPA (Quality Control Reviewer)
- James Timberlake, CIA (Audit Manager)

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