



An Audit Report on
The Lower Colorado River Authority

September 2016
Report No. 17-001



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Overall Conclusion

The Lower Colorado River Authority (LCRA) generally had processes and controls over financial management and managing capital projects to ensure that it complied with LCRA policies and procedures and state requirements. However, the LCRA should strengthen certain controls over irrigation billing, accounts payable and compensation, to ensure that it complies with all applicable requirements and that all financial processes are consistently implemented. It also should document and consistently follow its policies and procedures for financial processes.

- **Billing. The LCRA's controls over energy and raw water billing were working as intended to ensure that bills were accurate and sent to customers in a timely manner; however, auditors identified significant weaknesses in the LCRA's controls over irrigation billing.** Specifically, the LCRA did not ensure that the source data for calculating irrigation bills was correct. Additionally, the LCRA did not ensure that changes to the water usage data in its water measurement system were documented. For an invoice tested in the Gulf Coast division, auditors identified deficiencies in the irrigation invoice and the irrigation contract.
- **Accounts Payable. The LCRA's accounts payable process had controls in place to ensure that invoices were properly approved and supported; however, the LCRA should strengthen controls to help ensure that invoices are approved and paid in a timely manner. The LCRA does not have controls in place to comply with timely payment requirements in Texas Government Code, Chapter 2251 (the Prompt Payment Act). Additionally, while the LCRA's accounts payable department had numerous desk procedures governing specific processes, the LCRA did not have any documented policies and expectations for prompt payment and timely approvals.**

Background Information

The Lower Colorado River Authority (LCRA) is a conservation and reclamation district that the Legislature created in 1934. The LCRA provides a variety of services, including delivering electricity, managing the water supply and environment of the lower Colorado River basin, providing public recreation areas, and supporting community development. The LCRA does not receive state appropriations or have the ability to levy taxes.

In fiscal year 2015, the LCRA had operating revenues of \$1.02 billion and operating expenses of \$784 million.

Texas Special District Local Laws Code, Section 8503.0021, states that based on the results of an audit, including a performance-related audit, the State Auditor may make recommendations to the legislature in anticipation of a review of the LCRA by the Sunset Advisory Commission scheduled to be performed before the 2019 legislative session.

Sources: The LCRA; Texas Special District Local Laws Code, Section 8503.0021; and Texas Government Code, Section 325.025.

This audit was conducted in accordance with Texas Special District Local Laws Code, Section 8503.015.

For more information regarding this report, please contact Verma Elliott, Assistant State Auditor, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

- Executive Compensation. Compensation **increases to the LCRA's executive** management were approved and appropriate based on its policies; however, the LCRA did not consistently document its justifications for the compensation increases at the time of the compensation awards. For 12 of 44 compensation increases tested, the LCRA did not document its justification for bonuses totaling \$98,596 at the time the bonuses were awarded.
- Contracting and Procurement. **The LCRA's procurement and contracting** process was operating effectively; however, the LCRA should update its desk procedures for procuring fuel and energy contracts.
- Capital Projects. The LCRA complied with its internal policies and procedures over identifying, planning, and executing capital projects.
- Information Technology. The LCRA had sufficient access and application controls over its information technology systems and applications; however, it should improve its change management process to ensure adequate segregation of duties.

Auditors communicated other, less significant issues to the LCRA in writing.

The State Auditor's Office conducted this audit in accordance with Texas Special District Local Laws Code, Section 8503.015. In addition, Texas Special District Local Laws Code, Section 8503.0021, states that based on results of an audit, including a performance-related audit, the State Auditor may make recommendations to the legislature, including whether a review of the LCRA conducted under the Texas Sunset Act should include the financial operation and management of generation or transmission of electricity under the wholesale electricity operations of the LCRA and its affiliated nonprofit corporations.

To conduct this audit, auditors tested transactions related to electricity generation and transmission; irrigation and raw water; and capital projects. This audit included a review of the **LCRA's management and the LCRA's compliance with** legislative requirements. Auditors determined that the LCRA generally had processes and controls over financial management and managing capital projects to ensure that it complied with LCRA policies and procedures and state requirements. This report also identifies areas in which the LCRA needs improvement. This audit did not identify significant issues associated with the financial operation or management of the generation or transmission of electricity under the wholesale electricity operations of the LCRA or its affiliated nonprofit corporations.

Given the results of this audit, the State Auditor's Office recommends that the Sunset Advisory Commission staff conduct its review of the LCRA as currently directed by Texas Government Code, Section 325.025. That section specifies that the scope of a river authority sunset review includes governance, management, operating structure, and compliance with legislative requirements. This review can be conducted without a technical review of the financial operation or management of the generation or transmission of electricity under the wholesale electricity

operations of the LCRA or its affiliated nonprofit corporations, although issues relating to those matters may arise in the course of the review.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters/Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating ^a
1-A	The LCRA Has Sufficient Controls Over Energy and Raw Water Billing	Low
1-B	The LCRA Sent Irrigation Invoices in a Timely Manner; However, It Lacked Adequate Controls to Ensure That the Invoices Were Accurate and Complied with Requirements	High
2	The LCRA Ensured That Invoices from Vendors Were Properly Approved and Supported; However, It Should Implement Controls to Comply With the Prompt Payment Act	Medium
3	Compensation Increases for Executive Management Were Properly Approved and Complied with LCRA Policies; However, the LCRA Did Not Consistently Document Its Justifications for the Increases	Medium
4	The LCRA's Procurement and Contracting Process Was Operating Effectively; However, the LCRA Should Update Its Desk Procedures for Procuring Fuel and Energy Contracts	Low
5	The LCRA Complied with Its Internal Policies and Procedures for Identifying, Planning, and Executing Capital Projects	Low
6	The LCRA Had Sufficient Access and Application Controls Over Its Information Technology; However, It Should Improve Its Change Management Process	Low
<p>^a A chapter or subchapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.</p> <p>A chapter or subchapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.</p> <p>A chapter or subchapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.</p> <p>A chapter or subchapter is rated Low if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.</p>		

Summary of Management's Response

At the end of certain chapters in this report, auditors made recommendations to address the issues identified during this audit. The LCRA agreed with the recommendations in this report.

Audit Objective and Scope

The objective of this audit was to determine whether selected financial management processes and related controls of the LCRA help ensure compliance with state requirements and LCRA policies and procedures and prevent or detect fraud, waste, and abuse.

The scope of this audit covered the **LCRA's** financial management activities related to billing, accounts payable, compensation, procurement, and contracting and the related information systems from July 1, 2014, through February 29, 2016. The scope also included **a review of the LCRA's management of capital projects** from July 1, 2013, through February 29, 2016.

Contents

Detailed Results

Chapter 1

The LCRA Has Sufficient Controls Over Energy and Raw Water Billing; However, Controls Over Irrigation Billing Do Not Ensure That Invoices Are Accurate or Comply With Requirements..... 1

Chapter 2

The LCRA Ensured That Invoices from Vendors Were Properly Approved and Supported; However, It Should Implement Controls to Comply With the Prompt Payment Act..... 8

Chapter 3

Compensation Increases for Executive Management Were Properly Approved and Complied with LCRA Policies; However, the LCRA Did Not Consistently Document Its Justifications for the Increases 11

Chapter 4

The LCRA's Procurement and Contracting Process Was Operating Effectively; However, the LCRA Should Update Its Desk Procedures for Procuring Fuel and Energy Contracts 13

Chapter 5

The LCRA Complied with Its Internal Policies and Procedures for Identifying, Planning, and Executing Capital Projects..... 15

Chapter 6

The LCRA Had Sufficient Access and Application Controls Over Its Information Technology; However, It Should Improve Its Change Management Process..... 16

Appendices

Appendix 1

Objective, Scope, and Methodology..... 18

Appendix 2	
Issue Rating Classifications and Descriptions.....	23
Appendix 3	
Background on the LCRA	24
Appendix 4	
Operating Revenues and Expenses for the LCRA and the LCRA's Transmission Services Corporation	25
Appendix 5	
LCRA Irrigation Divisions.....	27
Appendix 6	
LCRA Service Areas.....	28
Appendix 7	
Statutes Relevant to an Audit of the LCRA	29

Detailed Results

Chapter 1

The LCRA Has Sufficient Controls Over Energy and Raw Water Billing; However, Controls Over Irrigation Billing Do Not Ensure That Invoices Are Accurate or Comply With Requirements

The Lower Colorado River Authority (LCRA) has sufficient controls in place to ensure that energy invoices to generation and transmission customers are accurate and processed in a timely manner and in accordance to applicable requirements. Additionally, the LCRA accurately invoiced customers for energy and raw water based on approved rates and according to contract terms. However, LCRA's controls over irrigation billing do not ensure that invoices are accurate or comply with requirements.

Chapter 1-A

The LCRA Has Sufficient Controls Over Energy and Raw Water Billing

Chapter 1-A
Rating:
Low ¹

From July 1, 2014, through February 29, 2016, the LCRA issued energy invoices totaling \$1.4 billion. LCRA's energy invoices include transactions related to transmission and wholesale electric generation. Auditors tested 25 energy invoices totaling \$97.8 million and determined that the LCRA:

- Issued the invoices in a timely manner.
- Retained supporting documentation of generation and transmission billing transactions.
- Calculated the invoices correctly.

Raw Water

Raw water is water in its natural state, prior to any treatment.

Source: The U.S. Environmental Protection Agency.

From July 1, 2014, through February 29, 2016, the LCRA issued invoices totaling \$49.0 million for raw water to its customers (the average invoice was \$5,781.62, see text box for a description of raw water). Auditors tested a random sample of 10 raw water invoices that were higher than the average invoice; the 10 invoices tested totaled \$2.2 million. For all 10 invoices tested, the LCRA:

¹ The risks related to the issues discussed in Chapter 1-A are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

- Invoiced customers according to contracted raw water rates and LCRA board-approved rates.
- Issued the invoices in a timely manner.
- Retained supporting documentation and meter data.
- Correctly calculated the invoices.

Management’s Response

Finding: The LCRA Has Sufficient Controls Over Energy and Raw Water Billing

Management Response: *LCRA strives to maintain the highest level of accuracy and integrity in billing its energy and raw water customers. LCRA takes pride in the State Auditor’s findings that our billings for energy and raw water are well-documented, calculated correctly, and timely.*

Chapter 1-B

The LCRA Sent Irrigation Invoices in a Timely Manner; However, It Lacked Adequate Controls to Ensure That the Invoices Were Accurate and Complied with Requirements

Chapter 1-B
Rating:
High ²

Customers contract with the LCRA for irrigation services for rice and turf crops or supplemental agricultural use. Auditors identified significant weaknesses in LCRA’s controls over three areas related to irrigation billing:

- The LCRA did not ensure that water usage data used to produce the invoices was accurately entered into its billing system.
- The LCRA allowed changes to water usage data in its billing system without requiring the reason for the change to be documented or the changes to be reviewed.
- The LCRA did not ensure that the supplemental agricultural use contracts and invoices that auditors tested clearly communicated how irrigation charges are assessed.

² The risks related to the issues discussed in Chapter 1-B are rated as High because they present risks or results that if not addressed could substantially affect the audited entity’s ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

Because an invoice may contain hundreds of flow meter readings, inaccurate water usage data can have a significant effect on a customer's invoice. Without adequate controls, the LCRA cannot ensure that it is correctly billing irrigation customers.

The LCRA's Irrigation Divisions

The LCRA operates three irrigation divisions: (1) Garwood; (2) Gulf Coast, also known as Bay City; and (3) Lakeside, also known as Eagle Lake. A business office in each division is responsible for contracting with customers, monitoring water usage, and maintaining records for billing.

Source: The LCRA.

Auditors tested an invoice from each of the LCRA's three irrigation divisions: Lakeside, Gulf Coast, and Garwood (see text box for more information about the irrigation divisions). The invoices tested totaled \$161,390; the Garwood invoice was the largest invoice, and auditors tested 355 flow meter readings for that invoice.

For each of the invoices tested, the LCRA generated invoices based on the water usage data in its Water Application Management System (WAMS) and invoiced customers in a timely manner. However, the LCRA lacked adequate controls to ensure that the invoices were accurate and complied with requirements. The weaknesses in LCRA's controls are discussed in more detail below.

The LCRA does not have an effective process to ensure that meter readings for irrigation billing are accurately recorded in its billing system.

For the invoices tested, LCRA employees did not consistently enter water use data accurately into WAMS, from which the LCRA issues invoices to irrigation customers. Specifically, auditors identified data entry errors for 1 of 29 data sheet entries tested in the Gulf Coast Division and 9 of 355 data sheet entries in the Garwood Division. The LCRA does not have a formal process or controls in place to review the water usage data entered into WAMS for accuracy. Those errors were a result of human errors that were not detected. Auditors did not identify any errors in testing in the Lakeside Division.

LCRA irrigation coordinators within each irrigation division monitor daily irrigation flows using flow meters and manually record all meter measurements for a single day on hard-copy data sheets. The irrigation coordinators submit those data sheets to the business office, which enters the readings into WAMS. The errors that auditors identified included instances in which data entered into WAMS for the time on, time off, and/or flow amounts did not match the information on the data sheet.

The LCRA lacks documented policies and procedures that establish criteria for when and how water usage data in WAMS may be changed.

In addition, the LCRA did not document or track changes made to the water usage data. For the invoice tested in the Garwood Division, auditors identified 13 instances in which LCRA Irrigations Operations management approved changes to water usage recorded in WAMS. However, the LCRA did

not have support for the revised data entered into WAMs or documentation of the reasons for the management overrides. LCRA Irrigation Operations management stated that the water usage amounts were adjusted after the customer disputed the reported amount of water used.

The LCRA should improve its billing processes and contracts for irrigation services to ensure that invoices contain sufficient and accurate information.

Supplemental Agricultural
Use Contracts

The LCRA offers supplemental water use contracts for agricultural purposes other than for rice or turf irrigation, such as row crops, aquaculture, and wildlife management.

Source: The LCRA.

The supplemental agricultural use contract related to the invoice audited in the Gulf Coast Division did not specify that the customer's contracted acreage may be subdivided or when a charge based on a minimum acreage amount may be applied (see text box for more information about that type of contract). The customer contracted with the LCRA for irrigation services for 255 acres. The customer pre-paid \$3,103.35 (\$12.17 per acre for the 255 acres stated in the contract). However, the LCRA subdivided those acres into three sections. One of those sections was 15 acres, which was less than the minimum acreage of 25 acres. As a result, the customer was charged for 265 acres, rather than the 255 acres specified in the contract. While the contract specified that a minimum amount could be applied to the contracted acreage, it did not specify any subdivision of the contracted acreage.

For the invoice tested in the Gulf Coast Division, auditors identified several deficiencies. Specifically:

- The invoice included charges for 265 acres, not the 255 acres for which the customer contracted. The invoice for the irrigation services did not provide sufficient detail to clearly show that the customer was charged for 10 acres more than the total included in the contract, resulting in an over billing of \$121.70. The lack of clarity in the billing for irrigation makes it difficult for customers to understand and verify the accuracy of their invoices.
- The invoice did not reflect a \$3,103.35 payment that the LCRA received from the customer at the start of the irrigation season. The LCRA's Billing division enters the invoice amounts into its accounting system. However, the division offices are responsible for creating the field detail reports, which are included in the invoice sent to the customer. For the invoice tested, the information in the field detail report included credit for the pre-payment, and the total due did not match the amount due on the invoice. The LCRA's processes do not ensure that the information in its accounting system, from which the invoices are produced, matches the information in the field detail reports. The customer paid the invoice in full, including the \$3,103.35 already paid. The LCRA later issued a refund.

Recommendations

The LCRA should:

- Develop a documented process that helps ensure that water use data is entered into WAMS accurately. That process could include (1) ensuring proper training for data entry staff and (2) requiring supervisory reviews.
- Develop written policies and procedures for when and how changes to water usage data may be made.
- Require that any changes to water usage data in WAMS be reviewed and approved and that those changes be documented, including reasons for a change and the name of the person approving it.
- Ensure that its contracts and invoices contain language that clearly explains when and how a subdivision will occur and when a minimum acre charge will be applied to an irrigation customer's invoice.
- Ensure that LCRA's policies and procedures include steps to verify that any payments paid on a customer's account are clearly identified and reflected in invoices.

Management's Response

Finding: The LCRA Sent Irrigation Invoices in a Timely Manner; However, It Lacked Adequate Controls to Ensure That the Invoices Were Accurate and Complied with Requirements

LCRA agrees in principle with the issues in the isolated area of irrigation billing controls identified in this report; however, it should be noted that LCRA's irrigation operations are being transitioned to a new paradigm under the LCRA Water Management Plan (WMP) that became effective in January 2016 after approval by the Texas Commission on Environmental Quality. The new WMP fundamentally changed the way LCRA sells water to its irrigation customers, and LCRA is in its first year of implementation of this change. The 2016 irrigation season was the first irrigation season that the majority of LCRA's irrigation divisions have been in operation since 2011 due to limited water supplies caused by the historic drought in this region. Commensurate with restarting large-scale irrigation operations, the standardization of billing procedures and the addition of new control measures are already being pursued to help ensure better water accounting and billing under the provisions of the new WMP.

LCRA would like to note the small financial impact of the discrepancies found within this isolated area of irrigation operations (approximately \$3,100 or 0.0003% of LCRA total revenue). Furthermore, even within irrigation operations, the amounts in question represent a small fraction of total billings (0.1% of total irrigation revenues).

SAO Recommendation: *Develop a documented process that helps ensure that water use data is entered into WAMS accurately. That process could include (1) ensuring proper training for data entry staff and (2) requiring supervisory reviews.*

Management Response: *LCRA agrees with this recommendation. LCRA will include in its procedures a formal process for ensuring accurate entry of water use data into WAMS and will require and document appropriate training for data entry staff. To further enhance quality assurance, LCRA will also strengthen, formalize and document the existing process of supervisory reviews of aggregated water use data. LCRA's vice president of Water Operations will complete these changes by Dec. 31, 2016.*

SAO Recommendation: *Develop written policies and procedures for when and how changes to water usage data may be made.*

Require any changes to water usage data in WAMS be reviewed and approved and that those changes be documented, including reasons for the change and the name of the person approving it.

Management Response: *LCRA agrees with this recommendation. LCRA will add written policies and procedures to address when and how changes to water usage data may be made; lay out a process for review and approval/disapproval of changes; and require appropriate documentation to support any approved change. LCRA's vice president of Water Operations will complete these changes by Dec. 31, 2016.*

SAO Recommendation: *Ensure that its contracts and invoices contain language that clearly explains when and how a subdivision will occur and when a minimum acre charge will be applied to an irrigation customer's invoice.*

Management Response: *Pursuant to the new WMP, LCRA has stopped selling irrigation water based on acreages; the subdivision of fields is therefore no longer a contracting and invoice issue. If and when LCRA resumes selling irrigation water on an acreage basis, the LCRA vice president of Water Operations and LCRA associate general counsel will ensure irrigation water contracts and invoices contain language that clearly explains when and how*

a field within a current account will be subdivided and when minimum acreage charges will be applied to customer billing.

SAO Recommendation: *Ensure that LCRA's policies and procedures include steps to verify that any payments paid on a customer's account are clearly identified and reflected in invoices.*

Management Response: *LCRA generally agrees with this recommendation. LCRA generates bills from the system as configured to ensure proper controls and efficiencies are in place. Payment information is readily available from the accounting system to clarify or update a customer regarding the customer's account. There are processes and procedures in place to ensure each customer's balance is kept current with payments received.*

By Dec. 31, 2016, LCRA's controller will evaluate the policies and procedures and make necessary changes to ensure they clearly outline an effective process for communicating with customers regarding account information such as payments made.

The LCRA Ensured That Invoices from Vendors Were Properly Approved and Supported; However, It Should Implement Controls to Comply With the Prompt Payment Act

Chapter 2
Rating:
Medium ³

Prompt Payment Act

The Prompt Payment Act (Texas Government Code, Chapter 2251) requires a governmental entity to pay for an applicable good or service after the later date of receiving a good, a service is performed, or an invoice is received for an applicable good or service. A payment begins to accrue interest on the date the payment becomes overdue.

An applicable payment is overdue on the 31st day for a state agency and on the 46th day for a political subdivision.

The LCRA's controls ensured that all 45 payment vouchers totaling \$3.2 million tested were properly approved and supported, and that payments were made to valid vendors. However, the LCRA does not have controls in place to ensure that it makes prompt payments for applicable goods and services as required by Texas Government Code, Chapter 2251 (the Prompt Payment Act, see text box). Additionally, the LCRA does not have a process to ensure that the related business department approves invoices from vendors in a timely manner.

The LCRA lacks controls to ensure compliance with the Prompt Payment Act.

The LCRA does not have controls in place to ensure that it makes prompt payments for applicable goods and services as required by Texas Government Code, Chapter 2251. The majority of the LCRA contracts with vendors that auditors reviewed contained a provision stating that all payments the LCRA makes are subject to Texas Government Code, Chapter 2251. The contracts also required the LCRA to make payment in full within 30 days from the date that the LCRA receives the invoice, and that payments made more than 30 days after the invoice is received are subject to a late charge calculated in accordance with the Prompt Payment Act.

However, the LCRA asserted to auditors that in its accounts payable process, invoices from vendors are processed and paid according to the invoices' due dates. The LCRA does not track in its accounting system when it receives an invoice and, therefore, cannot determine when the time period in which to pay for an applicable good or service under the Prompt Payment Act would begin.

Under the Prompt Payment Act, a governmental entity is defined as a "state agency" or a "political subdivision." A state agency is defined as "a board, commission, department office, or other agency in the executive branch of state government that is created by the constitution or a statute of this state, including a river authority." A political subdivision is defined as "a county, municipality, public school district, or special-purpose district or authority." State agencies have within 30 days to make a timely payment under the Prompt Payment Act. The LCRA considers itself a political subdivision under the Prompt Payment Act and, therefore, asserts that it has 45 days to make

³ The risks related to the issues discussed in Chapter 2 are rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concerns and reduce risks to a more desirable level.

an applicable payment. While all applicable payments tested were made within 45 days, there is a risk the LCRA would make late payments and have to pay interest if it does not adequately track the dates on which it receives invoices.

The LCRA's accounts payable process does not ensure that its business departments approve invoices from vendors in a timely manner.

The LCRA executed 203,287 payment vouchers totaling approximately \$1.7 billion from July 1, 2014, through February 29, 2016. The LCRA's controls ensured that all 45 payment vouchers totaling \$3.2 million tested were properly approved and supported, and that the payments were made to valid vendors. However, the LCRA does not have a process to ensure that the related business department approves invoices in a timely manner. Without timely approval, there is an increased risk that payment vouchers will not be processed before an invoice's due date. Three of 45 tested payments totaling \$66,999 were paid after the invoice due dates. The LCRA stated that it held those three payments; however, it did not document its justifications for the holds at the time the payments occurred.

The LCRA lacks a documented accounts payable policy.

While LCRA's Accounts Payable Department had numerous desk procedures governing specific processes, such as processing different kinds of purchase orders in the accounting system, the LCRA did not have any documented policies and expectations for the accounts payable process, including policies covering prompt payment, timely approvals, and procedures that should be completed when payments are held past the invoice due date, such as documenting the justification for the payment delay.

Recommendations

The LCRA should:

- Implement necessary controls in its accounts payable process to ensure that it makes payments as required by Texas Government Code, Chapter 2251.
- Develop written policies and procedures for the accounts payable process, including standards on when departments should approve invoices, to help ensure that invoices are paid in compliance with statutory requirements.

Management's Response

SAO Recommendation: *Implement necessary controls in its accounts payable process to ensure that it makes payments as required by Texas Government Code, Chapter 2251.*

Management Response: *LCRA agrees with this recommendation. LCRA's Accounting department will ensure compliance with Texas Government Code, Chapter 2251 by implementing a financial software upgrade that will document the invoice receipt date, calculate the payment due date under Texas Government Code, Chapter 2251, and automatically add interest to invoices when required under Texas Government Code, Chapter 2251. This software upgrade will be completed by LCRA's Accounts Payable manager by Dec. 31, 2016.*

SAO Recommendation: *Develop written policies and procedures for the accounts payable process, including standards on when departments should approve invoices, to help ensure that invoices are paid in compliance with statutory requirements.*

Management Response: *LCRA generally agrees with this recommendation. LCRA's Accounts Payable department does have documented performance guidelines and expectations for the Accounts Payable staff and timely approval expectations for the business areas. The Accounts Payable department also has documented controls of the Accounts Payable process. However, these guidelines and expectations are fragmented and exist in multiple formats. To ensure invoices are paid in compliance with statutory requirements, LCRA's Accounts Payable manager will develop a consolidated Accounts Payable policy including key controls by Dec. 31, 2016.*

Compensation Increases for Executive Management Were Properly Approved and Complied With LCRA Policies; However, the LCRA Did Not Consistently Document Its Justifications for the Increases

Chapter 3
Rating:
Medium ⁴

The LCRA had adequate controls in place to ensure that compensation increases to executive management were approved and appropriate based on its policies; however, it did not consistently document its justifications for the compensation increases at the time of the bonus awards. Additionally, the LCRA lacks a current compensation administration policy.

Auditors reviewed all 44 compensation increases paid to 10 executives totaling \$815,531 that occurred between July 2014 and February 2016. That included 20 increases to base pay totaling \$238,198 and 24 bonus payments totaling \$577,333.

For 12 of the 44 compensation increases tested, the LCRA did not document its justification for the increase at the time of the compensation award. All 12 were bonus payments, totaling \$98,596. After auditors requested the information, the LCRA developed written justification for those 12 bonus payments. All executives received a positive annual performance evaluation and none received a disciplinary action that would affect a compensation increase.

LCRA lacks a current compensation administration policy. The previous policy was removed from the LCRA's *Employee Policy Manual* in February 2015 because it was outdated. While the outdated policy did not require justification for compensation increases, in practice LCRA uses a personnel action form that captures an explanation of the requested action to process personnel actions, including compensation increases. Having a documented, up-to-date compensation administration policy could enhance the LCRA's compensation practices.

⁴ The risks related to the issues discussed in Chapter 3 are rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concerns and reduce risks to a more desirable level.

Recommendations

The LCRA should:

- Document its justifications for compensation increases, including bonuses, at the time of the award.
- Complete its revision of its compensation administration policy and implement the revised policy.

Management's Response

SAO Recommendation: *Document its justifications for compensation increases, including bonuses, at the time of the award.*

Management Response: *LCRA agrees that compensation increases for executive management were properly approved and complied with LCRA policies. Although not required by LCRA policies, LCRA Human Resources staff has implemented procedures that ensure documentation of the justification for executive pay increases, including bonuses. The new procedures require the completion of personnel action forms or spreadsheets with appropriate documentation and justification for changes that may occur throughout the year, as well as for changes that occur as part of companywide programs.*

SAO Recommendation: *Complete its revision of its compensation administration policy and implement the revised policy.*

Management Response: *LCRA has completed its revision of the compensation administration policy and implemented the new policy on May 31, 2016. It supplements the broader compensation, work time, and reporting policy and includes information related to market-based compensation, job descriptions, determining base pay, guidance for interim-assignments, and variable pay methods.*

The LCRA's Procurement and Contracting Process Was Operating Effectively; However, the LCRA Should Update Its Desk Procedures for Procuring Fuel and Energy Contracts

Chapter 4
Rating:
Low⁵

LCRA had documented policies for the purchase of goods, services, software, construction, and professional and consulting services. For all 19 contracts for goods and services tested, which had a combined value of \$604 million, the LCRA ensured that each contract was executed by an appropriately authorized agent, it obtained conflict of interest documentation for contract approvers, it properly approved the contract prior to execution, it adequately reviewed the contract purchases, and it completed supplier evaluations required by LCRA policy.

In addition, all four long-term fuel and fuel-related contracts audited⁶ were properly acquired and effectively monitored.

In addition, the LCRA has a policy for energy commodity transactions; however, its desk procedures for procuring fuel and energy contracts, such as making purchases of coal and natural gas, had not been reviewed or updated for several years.

Recommendation

The LCRA should update its written desk procedures for procuring fuel and energy contracts to reflect the current process that its coal and natural gas purchasers use.

⁵ The risks related to the issues discussed in Chapter 4 are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

⁶ Auditors tested two contracts related to coal commodities, one coal freight contract, and one natural gas contract.

Management's Response

SAO Recommendation: *The LCRA should update its written desk procedures procuring fuel and energy contracts to reflect the current process that its coal and natural gas purchasers use.*

Management Response: *LCRA agrees with this recommendation. LCRA recognized the need to update the desk procedures governing fuel and energy procurement prior to this audit and had scheduled this task for completion. These desk procedures were updated in July 2016 to reflect current practices.*

The LCRA Complied With Its Internal Policies and Procedures for Identifying, Planning, and Executing Capital Projects

Chapter 5
Rating:
Low ⁷

The LCRA properly managed and monitored all 15 capital projects tested⁸, with a combined lifetime budget of \$303.5 million. Specifically, for the 15 projects tested, the LCRA had an approved business case analysis of the identified need, ensured that executive management authorized project expenditures, and prepared regular status reports. Additionally, changes to project scope, budget, or schedule were properly approved, and all project associated work orders were closed prior to a project's closeout.

Management's Response

LCRA appreciates the State Auditor's recognition that LCRA complies with its policies and procedures concerning capital projects that are undertaken to help meet the power, water and other needs of a growing state.

⁷ The risks related to the issues discussed in Chapter 5 are rated as Low because they present risks or results identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

⁸ Auditors tested seven capital projects that were for the Transmission Services Corporation, three projects for water infrastructure, three projects for power generation, one project for public services (a boat ramp), and one project for enterprise (an information technology system).

The LCRA Had Sufficient Access and Application Controls Over Its Information Technology; However, It Should Improve Its Change Management Process

Chapter 6
Rating:
Low ⁹

The LCRA's key controls related to passwords, user access, backup and recovery of production servers, automated jobs, and disaster recovery were working as intended.

However, the LCRA did not consistently ensure proper segregation of duties when making changes to key application systems. Specifically, the LCRA did not ensure segregation of duties for 4 of 20 migrated changes tested. The LCRA does not have a policy stating that information technology developers making a programming change should not be migrating their own changes to production. Effective segregation of duties is important to help provide accountability for programming and data changes and reduce the risk of unauthorized or inappropriate changes being made.

Recommendation

The LCRA should develop a comprehensive change management process that ensures appropriate segregation of duties for all systems and document that process.

Management's Response

SAO Recommendation: *The LCRA should develop a comprehensive change management process that ensures appropriate segregation of duties for all systems and document that process.*

Management Response: *LCRA agrees with this recommendation. In June 2016, LCRA management conducted a comprehensive assessment of its Information Technology change management practices that included process documentation, tracking tools, communications, training, monitoring, controls and business impact. Following this assessment, LCRA's Information Technology department developed a robust change management program.*

⁹ The risks related to the issues discussed in Chapter 6 are rated as Low because they present risks or results that if not addressed do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Major components of the program, such as a comprehensive IT change management process document and training materials, are already complete. Mandatory change management training for IT staff currently is underway. All IT staff will complete the training by Aug. 29, 2016. To ensure continued compliance, LCRA's IT management will review the IT change management practice, process and tools annually and update them as required.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether selected financial management processes and related controls of the Lower Colorado River Authority (LCRA) help ensure compliance with state requirements and LCRA policies and procedures and prevent or detect fraud, waste, and abuse.

Scope

The scope of this audit covered the LCRA's financial management activities related to billing, accounts payable, compensation, procurement, and contracting and the related information systems from July 1, 2014, through February 29, 2016. The scope also included a review of the LCRA's management of capital projects from July 1, 2013, through February 29, 2016.

Methodology

The audit methodology consisted of gaining an understanding of the LCRA's processes over billing for energy, raw water, and irrigation customers; accounts payable; compensation; capital projects; and procurement and contracting for goods, services, software, construction, professional and consulting services, and fuel and energy. The audit methodology also consisted of collecting and reviewing related LCRA policies and procedures; conducting interviews with LCRA staff; reviewing documentation related to financial management processes; and performing selected tests and other procedures.

Data Reliability

Auditors assessed the reliability of the LCRA's PeopleSoft financial accounting system data by (1) reviewing key data fields, (2) interviewing LCRA officials knowledgeable about the data, (3) comparing the data to the LCRA's annual audited financial report. Auditors determined that the data was sufficiently reliable for the purposes of this audit. Auditors used data from the LCRA's PeopleSoft system to conduct testing of electric billing, irrigation billing, raw water billing, compensation, supply management contracts, and payment vouchers. Auditors used data from other LCRA systems to review supporting documentation and determined that the data in those other systems was sufficiently reliable for purposes of this audit.

Sampling Methodology

To assess the LCRA's financial processes related to electric and raw water billing, auditors selected a nonstatistical, random sample of invoices from July 1, 2014, through February 29, 2016. Auditors used professional judgment to select a sample of records to assess the financial processes related to irrigation billing, procurement and contracting, and capital projects. The sample of contracts tested included contracts above \$100,000 that included a variety of contracted goods and services. For capital projects, auditors selected capital projects recommended in LCRA capital plans for fiscal years 2014, 2015, and 2016 across water, transmission, and generation areas.

To test the accuracy of the LCRA's accounts payable process, auditors selected a nonstatistical, random sample of payment vouchers that was stratified to reflect representation of the LCRA's operating units. Auditors used professional judgment to select a number of payment vouchers to ensure coverage of all operating units.

The sample items tested generally were not representative of the population and, therefore, it would not be appropriate to extrapolate those results to the population.

Information collected and reviewed included the following:

- The LCRA's Employee Policy Manual.
- Public Utility Council of Texas docket documents.
- Purchase and sale agreements for renewable energy credits.
- Energy invoices with transmission- and generation-related charges.
- LCRA board of directors meeting minutes and agendas.
- LCRA billing procedures.
- Raw water customer contracts.
- Water meter read logs.
- Reports from CIS, a utility system, and MasterLink, which the LCRA uses for reporting meter reads.
- Irrigation customer contracts.
- Raw water customer invoices.

- Daily water measurement data sheets.
- Reports from the LCRA's Water Application Management System.
- Irrigation customer invoices.
- Expenditure data, payment information, and vendor information from the LCRA's PeopleSoft financial accounting system.
- Payment vouchers and related invoices.
- Vendor tax identification information.
- Supporting documentation for compensation increases, including personnel action forms, offer letters, market data, and annual performance evaluations.
- The LCRA's *Supply Management Manual*.
- Contract solicitation documents.
- Conflict of interest disclosures.
- Ethics statements for purchasing agents.
- Change orders for purchase orders.
- Contract administration plans.
- Supplier contracts and evaluations.
- Documentation related to fuel and energy contracts.
- Business case analysis and transmission system improvement plans for capital projects.
- Monthly status reports on capital projects.
- Documentation related to changes in scope, budget, or schedule for capital projects.

Procedures and tests conducted included the following:

- Interviewed LCRA staff to identify the LCRA's financial processes, including financial and administrative internal controls.

- Tested a sample of energy, raw water, and irrigation customer invoices to determine whether the LCRA accurately invoiced its customers in a timely manner.
- Tested a sample of purchase vouchers to determine whether the LCRA made payments to vendors that were approved, supported, and made in a timely manner.
- Tested a sample of purchase vouchers to determine whether the LCRA made payments to valid vendors.
- Tested executive compensation increases that occurred from July 1, 2014, through February 29, 2016, to determine whether the increases were authorized and supported.
- Tested a sample of employee compensation increases to determine whether they were substantiated and appropriate for the employee's position.
- Tested a sample of contracts to determine whether they were executed and signed by an authorized LCRA purchasing agent and whether they were properly solicited and approved.
- Tested change orders related to a sample of contracts to determine whether they were properly authorized and did not exceed the approved contract limit.
- Tested a sample of contracts to determine whether all purchased goods and services were received and whether an annual supplier evaluation was performed, if required.
- Tested a sample of capital projects to determine whether the LCRA followed its internal policies and procedures for identifying, planning, and executing capital projects. That included determining whether capital projects were adequately monitored and whether changes were appropriately approved.
- Reviewed selected information technology controls.

Criteria used included the following:

- LCRA bylaws, policies, and procedures.
- Texas Water Code, Chapter 49.
- Texas Water Code, Chapter 152.

- Texas Special District Local Laws Code, Chapter 8503.
- Texas Government Code, Chapter 2251.
- Commission on Environmental Quality *Water District Financial Management Guide*.

Project Information

Audit fieldwork was conducted from March 2016 through June 2016. We conducted this performance audit 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 following members of the State Auditor’s staff performed the audit:

- Kathy Aven, CIA, CFE (Project Manager)
- Charles H. Wilson, MPAff (Assistant Project Manager)
- Isaac A. Barajas
- Mike Gieringer, MS, CFE
- Bryan McGloin, MBA, MS
- Joseph Smith, MS, MBA
- Krista L. Steele, MBA, CPA, CFE, CIA, CGAP
- Scott Weingarten, CPA, CGAP
- Richard Wyrick
- Brenda Zamarripa, CGAP
- J. Scott Killingsworth, CIA, CGAP, CGFM, (Quality Control Reviewer)
- Verma L. Elliott, CPA, CIA, CGAP, MBA (Assistant State Auditor)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

The Lower Colorado River Authority (LCRA) is governed by a 15-member board of directors appointed by the governor and confirmed by the Texas Senate. It is a wholesale provider of electricity and raw water and, through its nonprofit Transmission Services Corporation, is a transmission service provider within the Electric Reliability Council of Texas. It also manages a network of parks and operates an environmental services lab.

In fiscal year 2015, the LCRA had \$1.02 billion in operating revenues: \$989.2 million from electric power generation and transmission; \$27.1 million from water, wastewater, and irrigation; and \$29.1 million from other sources. In addition, the LCRA had \$24.1 million in bad debt expense in fiscal year 2015. The LCRA had \$784.3 million in operating expenses in fiscal year 2015.

The LCRA issues long-term, tax-exempt debt to fund the majority of its capital spending. As of June 30, 2015, the LCRA had approximately \$3.7 billion, including principal and interest, in current debt obligations outstanding. Of that amount, the LCRA had outstanding bonds of \$3.3 billion—\$1.8 billion in bonds that the Transmission Services Corporation had issued and \$1.5 billion in bonds that the LCRA had issued.

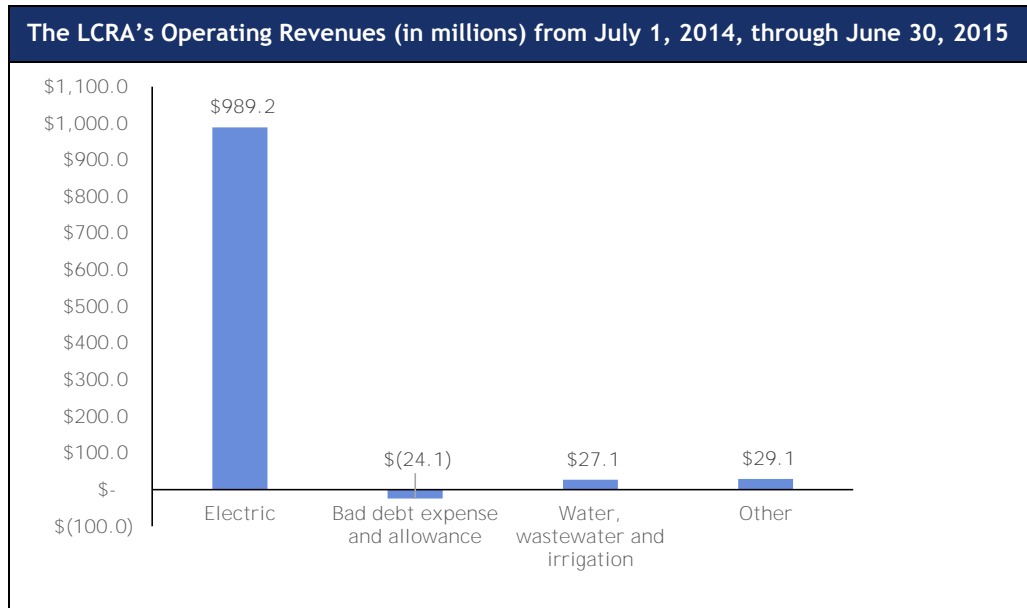
The LCRA operates several nonprofit corporations related to its energy business. Specifically:

- The Transmission Services Corporation, a nonprofit corporation for transmission operations, is regulated by the Public Utility Commission of Texas and provides regulated transmission, transformation, and metering services. It also provides unregulated engineering, construction, project management, maintenance, and other services. The Transmission Services Corporation is governed by a board of directors composed in its entirety of the LCRA board.
- GenTex Power Corporation, a nonprofit corporation that is a wholly owned affiliated corporation of the LCRA, is governed by a nine-member board appointed by the LCRA board. GenTex Power Corporation owns 50 percent of Lost Pines 1 Power plant in Bastrop County that began operations in June 2001.
- Wholesale Energy Services Corporation, a nonprofit corporation that is a wholly owned affiliated corporation of the LCRA, was created in 2012 to market and sell electric power outside of the LCRA's traditional service area. The Wholesale Energy Services Corporation is governed by a board of directors composed in its entirety of the LCRA board.

Operating Revenues and Expenses for the LCRA and the LCRA's Transmission Services Corporation

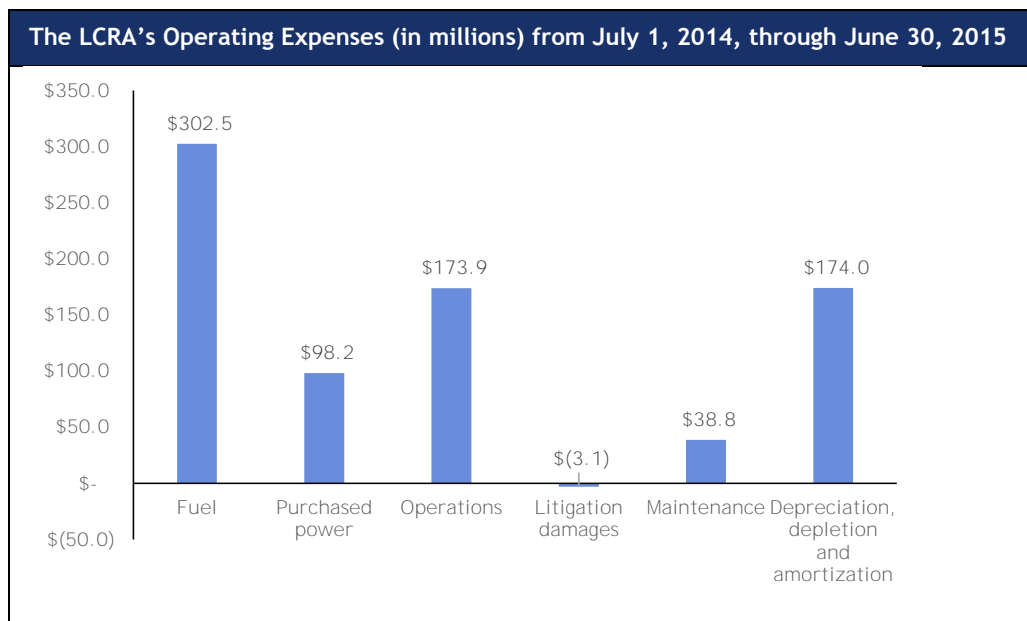
From July 1, 2014, through June 30, 2015, the Lower Colorado River Authority (LCRA) had \$1.02 billion in total operating revenues and \$784 million in total operating expenses (see Figures 1 and 2).

Figure 1



Sources: LCRA financial statements as of and for the years ended June 30, 2015, and June 30, 2014.

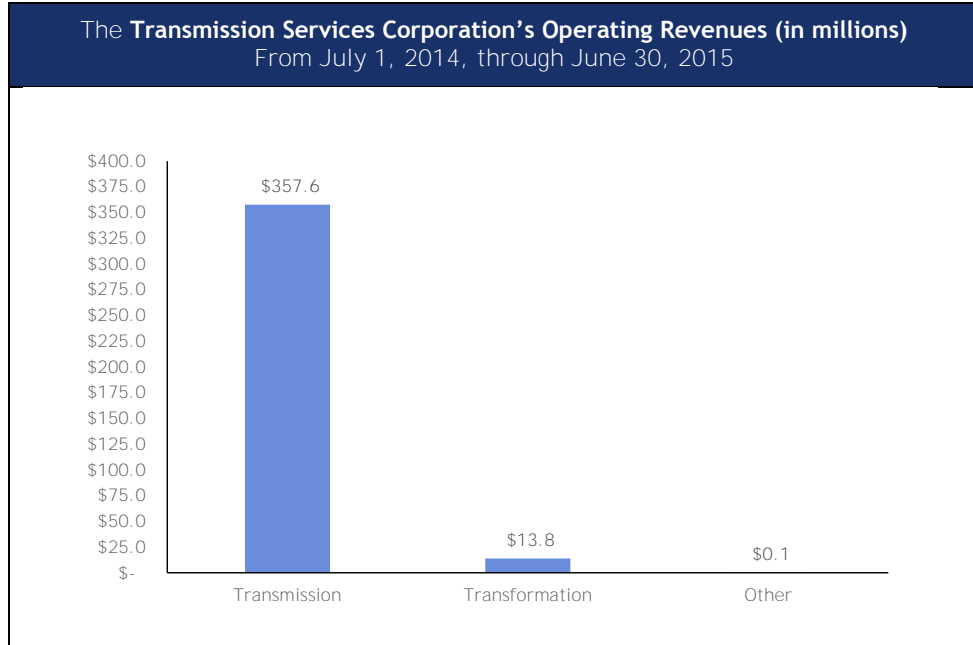
Figure 2



Sources: LCRA financial statements as of and for the years ended June 30, 2015, and June 30, 2014.

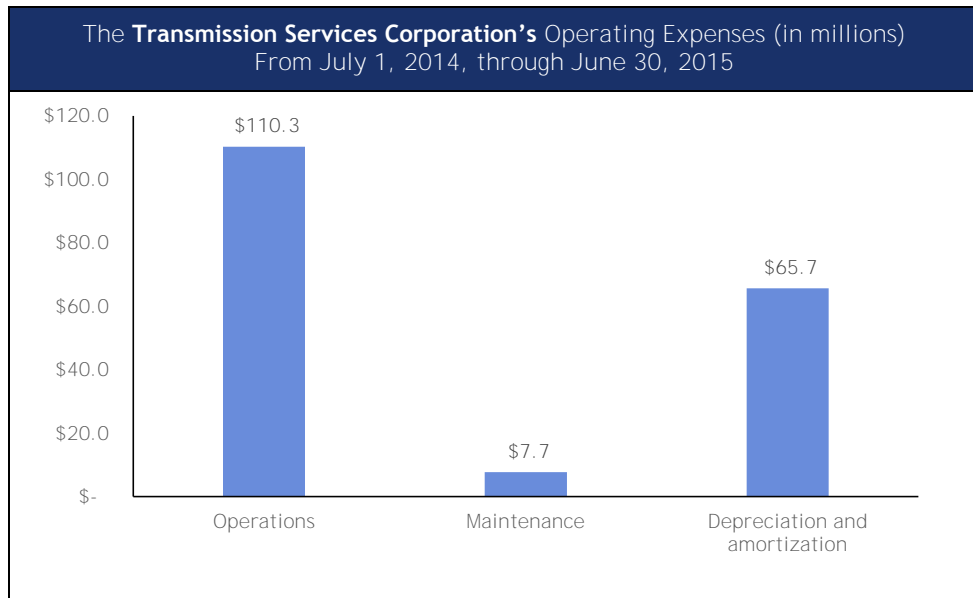
From July 1, 2014, through June 30, 2015, the LCRA's Transmission Services Corporation had total operating revenue of \$371.5 million and total operating expenses of \$183.7 million (see Figures 3 and 4).

Figure 3



Sources: LCRA financial statements as of and for the years ended June 30, 2015, and June 30, 2014.

Figure 4

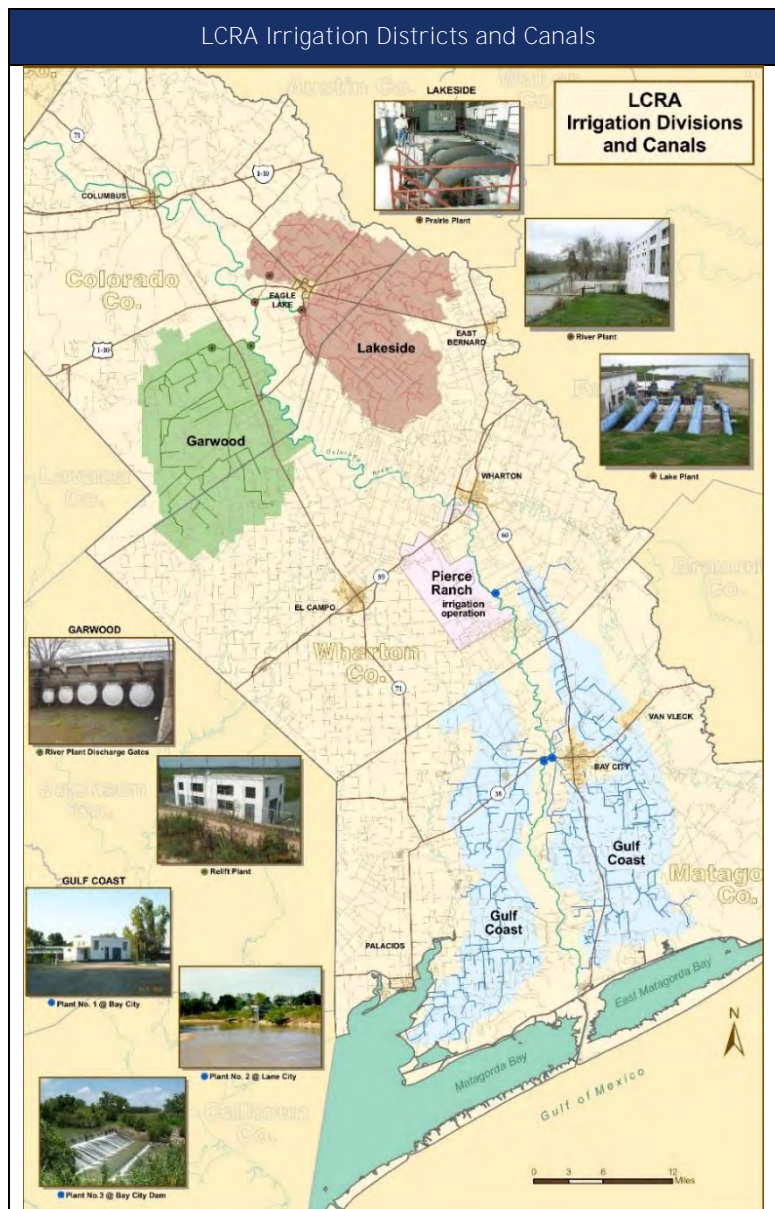


Sources: LCRA financial statements as of and for the years ended June 30, 2015, and June 30, 2014.

LCRA Irrigation Divisions

Figure 5 shows the irrigation divisions that the Lower Colorado River Authority (LCRA) services. The LCRA supplies water to portions of Matagorda, Wharton, and Colorado counties. The irrigation facilities are organized into four service areas: Gulf Coast, Lakeside, Garwood, and Pierce Ranch. The LCRA operates the Gulf Coast, Lakeside, and Garwood systems, while Pierce Ranch is privately operated.

Figure 5

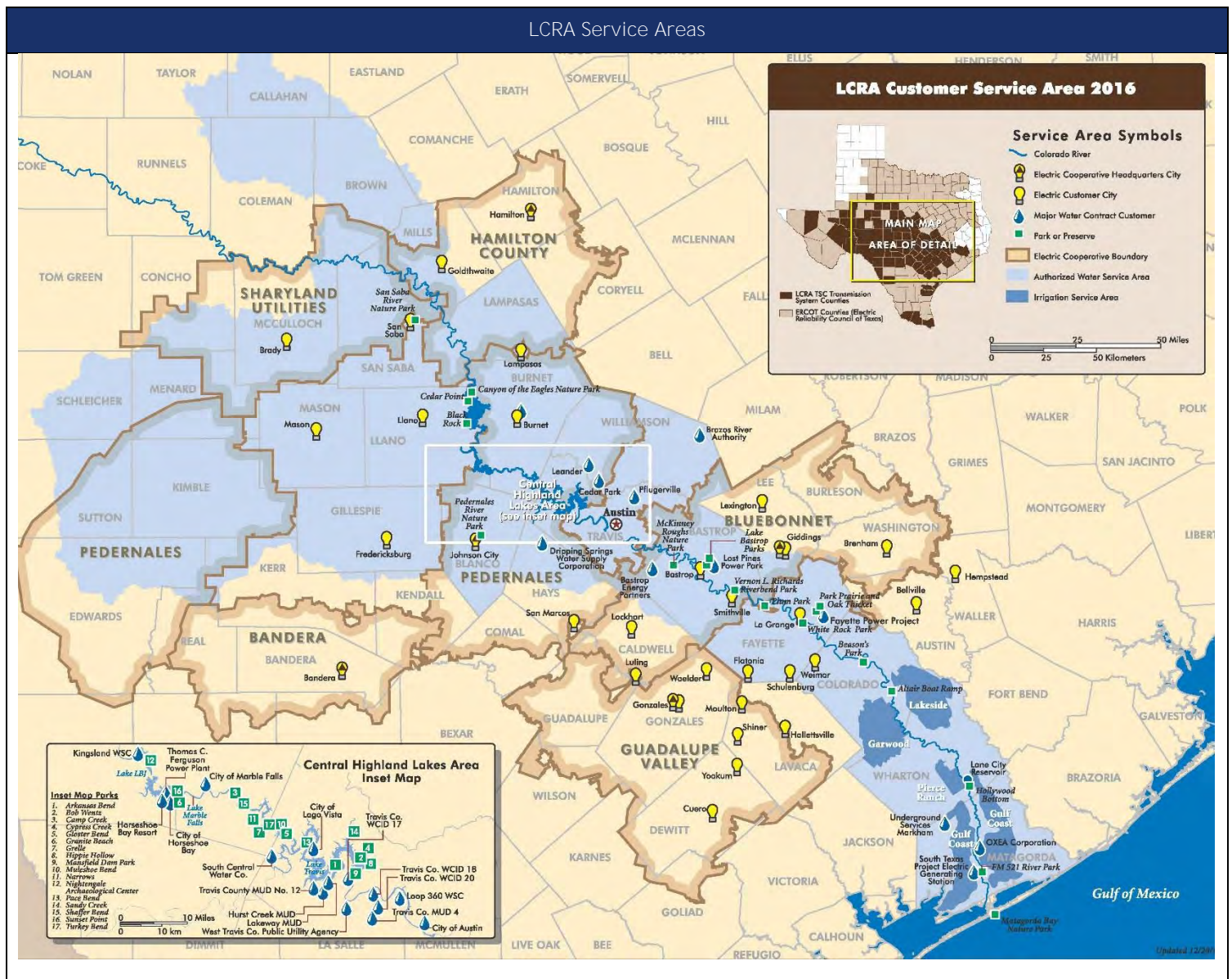


Source: The LCRA.

Appendix 6
LCRA Service Areas

Figure 6 shows the Lower Colorado River Authority's (LCRA) service areas (traditional electric and water), electric customers (co-op and municipal), water customers, irrigation districts, and parks.

Figure 6



Source: The LCRA.

Statutes Relevant to an Audit of the LCRA

Below is an excerpt from Texas Government Code, Chapter 325 (governing the **Sunset Advisory Commission's authority to review river authorities**).

Sec. 325.025. RIVER AUTHORITIES SUBJECT TO REVIEW. (a) A river authority listed in Subsection (b) is subject to a limited review under this chapter as if it were a state agency but may not be abolished.

(b) This section applies to the:

- (1) Angelina and Neches River Authority;
- (2) Bandera County River Authority and Groundwater District;
- (3) Brazos River Authority;
- (4) Central Colorado River Authority;
- (5) Guadalupe-Blanco River Authority;
- (6) Lavaca-Navidad River Authority;
- (7) Lower Colorado River Authority;
- (8) Lower Neches Valley Authority;
- (9) Nueces River Authority;
- (10) Palo Duro River Authority of Texas;
- (11) Red River Authority of Texas;
- (12) Sabine River Authority of Texas;
- (13) San Antonio River Authority;
- (14) San Jacinto River Authority;
- (15) Sulphur River Basin Authority;
- (16) Trinity River Authority of Texas;
- (17) Upper Colorado River Authority; and
- (18) Upper Guadalupe River Authority.

(c) The limited review under this chapter must assess each river authority's:

- (1) governance;
- (2) management;
- (3) operating structure; and
- (4) compliance with legislative requirements.

(d) A river authority shall pay the cost incurred by the commission in performing a review of the authority under this section. The commission

shall determine the cost, and the authority shall pay the amount promptly on receipt of a statement from the commission detailing the cost.

(e) A river authority reviewed by the commission under this section may not be required to conduct a management audit under Chapter 292, Title 30, Texas Administrative Code.

Added by Acts 2015, 84th Leg., R.S., Ch. 1148 (S.B. 523), Sec. 1, eff. June 19, 2015.

Below are excerpts, from the Texas Special District Local Laws Code, Chapter 8503 (the **LCRA's enabling statute**).

Sec. 8503.015. AUDITS. (a) The authority is subject to the audit provisions of Subchapter G, Chapter 49, Water Code.

(b) The authority is subject to the audit provisions of Chapter 321, Government Code. This subsection expires January 1, 2017.

Sec. 8503.0021. APPLICATION OF SUNSET ACT. (a) The authority is subject to review under Chapter 325, Government Code (Texas Sunset Act), but may not be abolished under that chapter. The review shall not include the management of the generation or transmission of electricity under the wholesale electricity operation of the authority and the authority's affiliated nonprofit corporations. The review shall be conducted under Section 325.025, Government Code, as if the authority were a state agency scheduled to be abolished September 1, 2019, and every 12th year after that year.

(b) In anticipation of the sunset review under Subsection (a), based on the results of an audit, including a performance-related audit, conducted by the state auditor before December 1, 2016, the state auditor may make recommendations to the legislature, including whether a review conducted under Subsection (a) should include the financial operation and management of the generation or transmission of electricity under the wholesale electricity operation of the authority and the authority's affiliated nonprofit corporations.

(c) The authority shall pay the cost incurred by the Sunset Advisory Commission in performing the review under Subsection (a). The Sunset

Advisory Commission shall determine the cost, and the authority shall pay the amount promptly on receipt of a statement from the Sunset Advisory Commission detailing the cost.

Added by Acts 2015, 84th Leg., R.S., Ch. 1148 (S.B. 523), Sec. 7, eff. June 19, 2015.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Otto, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

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