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State Auditor

An Audit Report on

**The Board of Public
Accountancy: A Self-directed,
Semi-independent Agency**

July 2009

Report No. 09-044



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The Board of Public Accountancy: A Self-directed, Semi-independent Agency

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Overall Conclusion

The Board of Public Accountancy's (Board) basic financial statements for fiscal year 2008 are materially accurate. The Board has implemented well-designed key financial controls to enable it to accurately report financial statement balances.

The Board's total fund balance as of August 31, 2008, was \$6,791,635, which is the result of a 761 percent growth in the fund balance between fiscal years 2004 and 2008. Board management stated that the fund balance was a result of anticipated major expenses related to the litigation of certain legal cases.

The Board's process for setting fees is appropriately documented and is designed to comply with statutory limits on fee setting. The process is based on the anticipation of revenues, enforcement case expenditures, and operating expenditures. The Board's Executive Committee uses a method that considers budget resources to determine which fees should be adjusted to meet the Board's needs. All decisions to adjust the fees were disclosed in the Executive Committee minutes.

The Board has a process for assessing penalties in disciplinary matters. However, auditors were not allowed access to a portion of the information in the individual case files that contained support for the penalties assessed. As a result, auditors could not verify that the Board consistently follows its process when assessing penalties in disciplinary matters.

The Board also has a documented process for setting administrative penalties. The Board's current rules in the Texas Administrative Code grant the Board's executive director the authority to waive/abate penalties for the failure to pay annual fees. As a result, the Board did not collect at least \$100,000 in late fees for at least 43 certified public accountants in fiscal year 2008. However, the Texas Occupations Code states that the Board may not waive the collection of any fees or penalties, which includes penalties for the late payment of annual fees.

Background

The Board of Public Accountancy (Board) regulates the practice of public accountancy by certifying and registering individuals, professional corporations, partnerships, and sole proprietorships.

Texas Civil Statutes, Article 8930, authorized the Board to operate independently of the Texas General Appropriations Act. The Self-directed, Semi-independent Agency Project Act is subject to Chapter 325 of the Texas Government Code (the Texas Sunset Act). Unless continued in existence as provided by that chapter, the Self-directed, Semi-independent Agency Project Act expires on September 1, 2013.

The Board establishes its own budget, which must be supported with the revenues the Board generates.

The Board has a governing board of 15 members and, as of August 31, 2008, it regulated 61,925 certified public accountants.

This audit was conducted in accordance with Texas Civil Statutes, Article 8930, Section 7.

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

The Board reported accurate results for all 14 performance measures tested for fiscal year 2008. However, the Board did not maintain supporting documentation for the queries it used to calculate and report its performance measures.

Based on information provided by management, trends in the Board's reported performance between fiscal years 2005 and 2008 are reasonable. Specifically:

- The number of licenses the Board issued increased by 2 percent.
- The number of firms practicing public accountancy decreased by 5 percent.
- The total number of individuals certified or registered increased by 35 percent.
- The numbers of complaints opened and complaints closed increased by 12 percent and 20 percent, respectively.

Summary of Management's Response

The Board generally agrees with the findings and recommendations in this report. The Board's detailed management responses to the specific recommendations in this report are presented immediately following each set of recommendations in the Detailed Results section of this report.

Summary of Information Technology Review

Auditors assessed the information technology (IT) controls over the Board's information systems and other automated processes used for financial and performance measure data.

Auditors evaluated general IT controls, including logical access, program change management, physical security, and disaster recovery. Auditors also evaluated application controls, including input controls, process controls, and output controls.

The Board should improve IT controls to ensure the integrity and accuracy of its financial and performance measure data. To minimize risks, auditors communicated details about these issues in writing to the Board's management.

Summary of Objectives, Scope, and Methodology

The objectives of this audit were to:

- Verify the accuracy of certain key financial statement balances and the effectiveness of key financial controls at the Board.
- Verify the accuracy of, and evaluate trends in, selected performance measures that the Board uses.

- Evaluate the Board's process for setting fees and penalties.

The scope of the audit was fiscal year 2008. Auditors reviewed the accuracy of the Board's financial statements and performance measures. Auditors also evaluated the Board's process for setting fees and penalties and the automated systems and processes that support the functions reviewed.

The audit methodology included collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with Board management and staff.

Contents

Detailed Results

Chapter 1	
The Board's Financial Statements for Fiscal Year 2008 Are Materially Accurate and Its Key Financial Controls Are Working Effectively	1
Chapter 2	
The Board Has an Adequate Process for Setting Fees; However, It Should Review Its Process for Setting Penalties	4
Chapter 3	
The Board Reported Accurate Performance Measures, and the Trends in Its Reported Performance Are Reasonable	8
Chapter 4	
The Board's Controls Over Information Technology Systems Are Adequate, But Certain Areas Need Improvement	12

Appendices

Appendix 1	
Objectives, Scope, and Methodology	13
Appendix 2	
Trends in the Board's Key Financial Information	16

Detailed Results

Chapter 1

The Board's Financial Statements for Fiscal Year 2008 Are Materially Accurate and Its Key Financial Controls Are Working Effectively

The Board of Public Accountancy's (Board) financial statements for fiscal year 2008 are materially accurate and its key financial controls are working effectively. Auditors determined that the Board's total fund balance increased by 761 percent since fiscal year 2004.

Chapter 1-A

The Board Has Well-designed Financial Control Processes and Procedures and It Accurately Reported Key Financial Statement Balances for Fiscal Year 2008

The Board's (1) Combined Balance Sheet/Statement of Net Assets-Governmental Funds and (2) Combined Statement of Revenues and Expenditures, and Changes in Fund Balances/Statement of Activities-Governmental Funds for fiscal year 2008 are materially accurate. In addition, the Board has well-designed financial control processes and procedures.

To ensure that it reports key financial statement amounts accurately, the Board has implemented well-designed financial controls over revenues, expenditures, and other financial information. Auditors tested financial controls that were designed to:

- Ensure that expenditure transactions were properly approved and recorded.
- Reconcile information in the Board's accounting systems with information in the Uniform Statewide Accounting System (USAS).
- Process the receipt and deposit of license and fee payments.
- Segregate duties between the individuals who prepare and approve revenue and expenditure vouchers.

Auditors also reviewed the following significant financial statement accounts:

- Assets: Cash on Hand, Cash in Bank, and Cash in State Treasury.
- Liabilities: Vouchers Payable, Accounts Payable, and Payroll Payable.
- Revenues: License, Fees, and Permits.

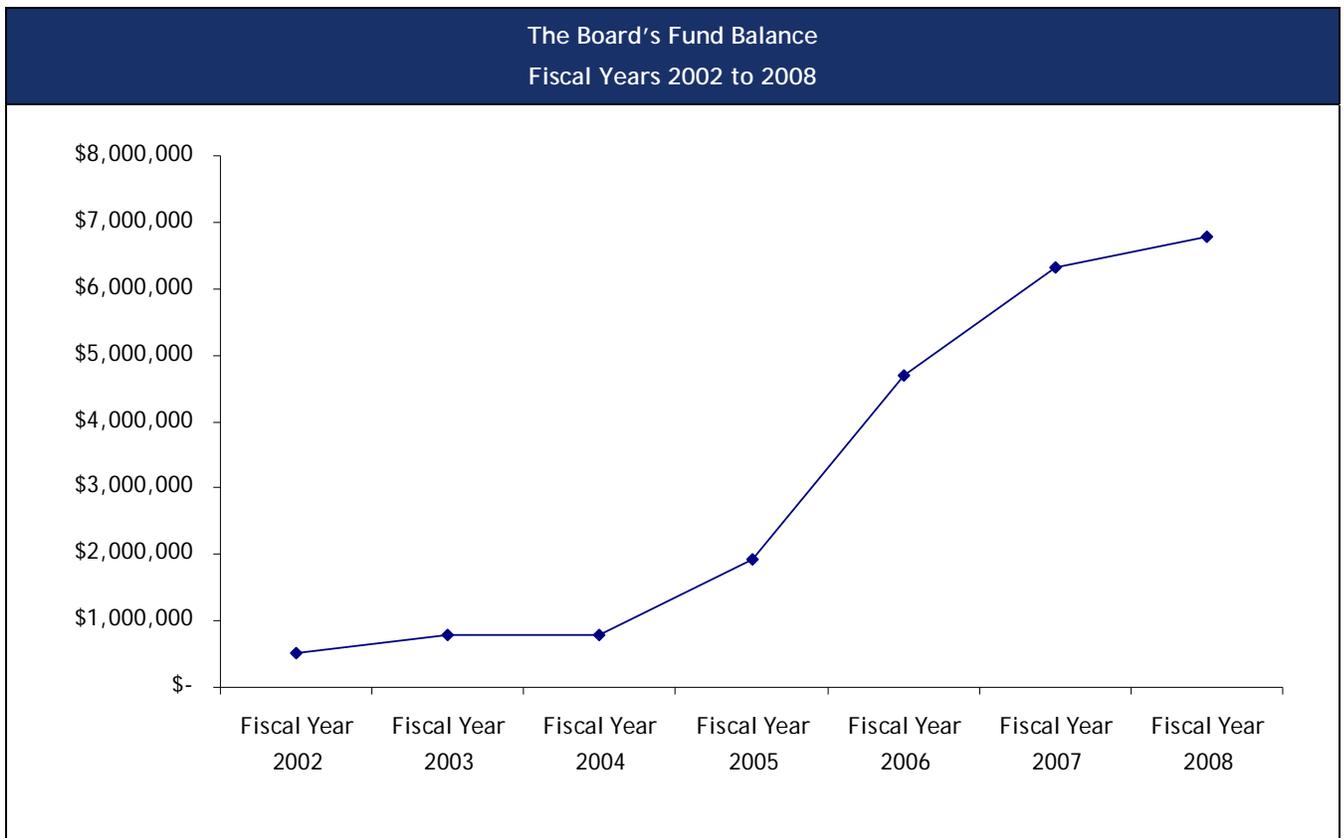
- Expenditures: Salaries and Wages, Payroll-related Costs, Professional Fees and Services, Travel, and other significant expenditure accounts.

Chapter 1-B

The Board’s Fund Balance Grew Significantly in the Past Five Fiscal Years

The Board’s total fund balance for fiscal year 2008 was \$6,791,635, which is a 761 percent increase from its fiscal year 2004 fund balance of \$789,252. Figure 1 shows that the Board’s total fund balance remained steady from fiscal year 2002 to fiscal year 2004, and then it increased steadily through fiscal year 2008.

Figure 1



Source: The Board’s operating budget for fiscal years 2002 through 2008.

Of the Board’s total fiscal year 2008 fund balance, \$6,722,004 was unreserved and \$69,631 was reserved for encumbrances and inventories.

According to the Board, its fund balance level was established to mitigate the risk of major expenditures related to the litigation of certain cases involving the Board. In addition, on August 17, 2008, the Board reduced its licensing

fees, which management asserts is part of a five-year plan to methodically reduce its total fund balance.

See Appendix 2 for more information the Board's fund balance and expenditures for major cases from fiscal year 2002 to fiscal year 2008.

Recommendation

The Board should continue to monitor its unreserved fund balance to ensure that it is appropriate.

Management's Response

We concur. This will continue to be an ongoing policy of the Board.

The Board Has an Adequate Process for Setting Fees; However, It Should Review Its Process for Setting Penalties

The Board has implemented and follows an adequate methodology for setting license fees. However, auditors were not able to fully evaluate the Board's process for setting penalties in disciplinary matters. In addition, the Board did not collect at least \$100,000 in late fees during fiscal year 2008.

Chapter 2-A

The Board Has an Adequate Process for Setting Fees; However, It Should Develop Written Policies and Procedures for Setting Fees

The Board's process for setting license fees is based on its budgetary needs and on the statutory guidelines established in Chapter 901 of the Texas Occupations Code. The Board's Executive Committee develops a five-year operating budget projection, which is based on actual direct and indirect operating costs. The Board uses this projection to determine the amount of revenues it will need to carry out its activities. The Board then adjusts its license fees, if necessary, to collect the desired amount of revenue. The Board adjusts each type of license fee based on an analysis of the projected number of licensees and the cost related to the administration of that type of license. The Board disclosed all decisions to adjust the fees in its Executive Committee minutes. The Board also reviews the fees to ensure they are appropriate.

However, the Board lacks written policies and procedures covering fee setting as recommended by the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB). Written policies and procedures would help the Board ensure that fees are set in a consistent manner and that all fees are reviewed using specific factors to ensure that fees are set at appropriate levels.

Recommendation

The Board should develop a written policy on setting fees. The policy should include:

- A requirement to review all fees.
- An explanation of how fees will be set and what factors the Board should take into account when setting the fees.
- A statement that the Board intends to set fees to recover the full cost of services.

- A description of instances during which the Board may set a fee higher or lower than the full cost of a service.

Management's Response

We concur. The Board's Director of Administrative Services/Chief Financial Officer will be responsible for developing a written policy for Board approval. Completion date November, 2009.

Chapter 2-B

The Board Has a Process for Assessing Penalties in Disciplinary Matters; However, Auditors Could Not Determine Whether the Board Consistently Follows This Process

The Board has a process for assessing penalties in disciplinary matters. However, auditors were not allowed access to a portion of the information in the individual case files that contained support for the penalties assessed. As a result, auditors could not verify that the Board consistently (1) follows its process when assessing penalties in disciplinary matters and (2) consistently complies with the requirements established in the Texas Occupations Code, Section 901.552 (Public Accountancy Act) when assessing these penalties. Specifically, auditors could not verify whether the Board considered:

- The seriousness of the violation, including:
 - ♦ The nature, circumstances, extent, and gravity of any prohibited act.
 - ♦ The hazard or potential hazard to the public.
- The economic damage to property caused by the violation.
- The history of previous violations.
- The amount necessary to deter a future violation.
- Efforts to correct the violation.
- Any other matter that justice may require.

The Board assesses an administrative cost and may assess an administrative penalty against licensees involved in a disciplinary matter before the Board. The Board assesses the administrative cost based on the actual hours spent by the Board's attorney on the case. This part of the process is adequate and was appropriately documented by the Board.

In addition, auditors reviewed a portion of the information in 32 case files for disciplinary matters that resulted in the assessment of an administrative cost

and/or penalty in fiscal year 2008. Based on that information, auditors determined that the Board conducted an adequate investigation to identify the specific violation of the Public Accountancy Act or the Texas Administrative Code and assessed reasonable administrative costs.

Recommendation

The Board should ensure that it considers all factors listed in the Public Accountancy Act when setting penalties in disciplinary matters.

Management's Response

We concur. The Board's General Counsel will be responsible for developing a written policy for Board approval. Completion date November, 2009.

Chapter 2-C

The Board's Process for Collecting Late Penalties in Some Cases May Need Clarification

The Board has a documented process for setting administrative penalties, which includes penalties for the late payment of annual fees. To retain an active license, a certified public accountant must pay the Board an annual fee. The Board's current rule in Title 22, Texas Administrative Code, Section 515.9, grants the Board's executive director the authority to waive/abate penalties for a licensee's failure to pay annual fees by the due date or failure to comply with mandatory continuing professional education requirements.

However, the statute that governs the Board—Texas Occupations Code, Section 901.154(c)—states that the Board may not waive the collection of any fees or penalties, which includes penalties for the late payment of license fees. It is unclear whether the Board has the authority to delegate this authority given that the Texas Occupations Code does not grant the Board the discretion to waive any fee or penalties.

During fiscal year 2008, the Board did not collect at least \$100,000 in late penalties for at least 43 certified public accountants. Board management stated that its executive director has reviewed assessed penalties for late payment of annual fees and decided whether the licensees must pay the fees and penalties since 1995. The Board's general counsel stated the fees not collected were considered abated fees.

**Excerpts from
the Texas Occupations Code and
the Texas Administrative Code**

Texas Occupations Code, Section 901.154(c), states:

The Board may not waive the collection of any fees or penalties provided by this chapter.

Title 22, Texas Administrative Code, Section 515.9, states:

If a certificate, license, or registration was suspended or revoked for non-payment of annual license fees or failure to comply with [Texas Administrative Code, Section 501.94], upon written application the executive director will decide on an individual basis whether the fees and penalties must be paid for the license years of suspension or revocation and whether any fee exemption is applicable.

Recommendations

The Board should:

- Ensure that its practices regarding the waiving of late fees comply with the Texas Occupations Code.
- Consider obtaining a legal opinion from the Office of the Attorney General regarding the sections of the Texas Occupations Code and the Texas Administrative Code that need clarification.

Management's Response

We concur. The Executive Director has the authority to abate a penalty which was not applicable in the initial circumstance. For example, licensees on suspension or revocation are prohibited from paying fees as a result of a disciplinary action. Additionally, there are documented disruptions in the postal system, instances where accommodations are made for licensees as a result of natural disaster such as Hurricanes Katrina, Rita, and Ike, and personal tragedies beyond the control of the licensee. No license fees are waived or abated.

When considering the monetary impact of this recommendation, consideration should also be given to lost opportunity cost.

The Board's Executive Director will be responsible for implementing this recommendation.

The Board Reported Accurate Performance Measures, and the Trends in Its Reported Performance Are Reasonable

The Board reported accurate results for all 14 performance measures tested for fiscal year 2008. A performance measure result is considered accurate if the variance between the reported results and actual results is within 5 percent. In addition, based on explanations provided by the Board's management, the trends in the Board's reported performance from fiscal year 2005 to fiscal year 2008 are reasonable.

Chapter 3-A

The Board Reported Accurate Results for All 14 Performance Measures Tested; However, It Did Not Maintain Supporting Documentation for the Queries It Used to Calculate and Report These Measures

The Board reported accurate results for all 14 performance measures tested for fiscal year 2008 (see Table 1). However, the Board did not retain the queries it used to extract the data used to calculate its reported performance results. As a result, there were variances between the reported results and the actual results recalculated by the auditors. Because the variances were within 5 percent, the reported results were considered accurate. By not retaining these queries, however, the Board cannot ensure the future accuracy of performance measure results. In addition, the Board did not have detailed written policies and procedures describing how the reported measures can be calculated and reported. The Board had some written procedures, but these procedures lacked detailed information to ensure that performance measure results can be calculated and reported accurately and in a consistent manner.

Table 1

Performance Measure Results Reported by the Board of Public Accountancy (Agency 457)		
Performance Measure	Results Reported in the Board's Fiscal Year 2008 Annual Financial Report	Were Reported Results Within 5 Percent of Auditor Calculation?
Certified Public Accountants	61,925	Yes
Public Accountants	13	Yes
Offices	9,713	Yes
Other States/Foreign Countries	64	Yes
Corporations	2,745	Yes
Partnerships	535	Yes
Sole Proprietorships	6,158	Yes
CPA Certifications	1,382	Yes

Performance Measure Results Reported by the Board of Public Accountancy (Agency 457)		
Performance Measure	Results Reported in the Board's Fiscal Year 2008 Annual Financial Report	Were Reported Results Within 5 Percent of Auditor Calculation?
Reciprocity	309	Yes
Registration-Other States/Foreign Countries	0	Yes
Successful Candidates	1,694	Yes
Unsuccessful Candidates	8,362	Yes
Complaints Opened	3,881	Yes
Complaints Closed	4,001	Yes

Source: The Board's annual financial report for fiscal year 2008

The Board should ensure that its reported results include an explanation on how it calculates the number of unsuccessful candidates to ensure that the number reported is not misleading.

The Board calculates the number of unsuccessful candidates who take the certified public accountant (CPA) exam each quarter. Most candidates complete one part of the four-part CPA exam at a time. However, the Board classifies a candidate as unsuccessful if that candidate has not passed all four parts of the CPA exam. A candidate who takes and passes one part of the exam during a quarter is still counted as an unsuccessful candidate. As a result, candidates who successfully pass all four parts of the exam during a given year are counted as an unsuccessful candidate three times during that year and as a successful candidate only once, which inflates the number of unsuccessful candidates for that year.

Recommendations

The Board should:

- Develop and implement detailed policies and procedures for all steps involved in the calculation and reporting of all performance measures.
- Maintain supporting documentation for queries used to report these measures.
- Ensure that its reported results include an explanation on how it calculates the number of unsuccessful candidates to ensure that the reported number is not misleading.

Management's Response

We concur. The Board's Director of Information Resources will be responsible for developing the recommended policies and the Director of Qualifications will be responsible for developing the explanation on how unsuccessful candidates are counted. Completion date November, 2009.

Chapter 3-B

Trends in the Board's Reported Performance Are Reasonable

Based on information provided by the Board's management, the trends in the Board's reported performance from fiscal year 2005 to fiscal year 2008 are reasonable. For example, the total number of licenses issued by the Board increased 2 percent from 70,081 in fiscal year 2005 to 71,715 in fiscal year 2008. This increase was mainly due to more candidates taking the exam and an increase in the rate of candidates passing the exam. In addition, the Board attributed the increase to a policy that allows candidates to take parts of the exam in different sittings, instead of requiring candidates to take all four parts at the same sitting.

Other trends in the Board's performance measures include the following:

- The total number of firms practicing public accountancy in Texas decreased by 5 percent from 9,974 in fiscal year 2005 to 9,438 in fiscal year 2008. The Board attributed this decrease to a change in the Public Accountancy Act (Texas Occupations Code, Section 901.351), which does not require a firm to obtain a CPA license if it does not perform attest services and does not present itself as a CPA firm.
- The total number of individuals certified or registered by the Board increased 35 percent from 1,253 in fiscal year 2005 to 1,691 in fiscal year 2008. The Board attributed this increase to a higher number of individuals taking and passing the exam and to an increase in the number of individuals certified through reciprocity.
- The number of successful candidates passing the CPA exam increased 70 percent from 994 in fiscal year 2005 to 1,694 in fiscal year 2008 because an increasing number of candidates took the exam each year and there was an increase in the rate of candidates who passed the exam.
- The number of complaints opened increased 12 percent from 3,469 in fiscal year 2005 to 3,881 in fiscal year 2008. These include two types of complaints—disciplinary and administrative—both of which increased. Board management stated that the increase in disciplinary cases in fiscal years 2007 and 2008 was a result of the Board identifying more cases involving the unlicensed practice of public accountancy in Texas. Generally, disciplinary cases involve allegations of professional incompetence, criminal convictions, violations of accounting or auditing

standards, or violations of a state statute or rule. Administrative cases involve nonpayment of annual license fees, failure to complete the annual license renewal or registration application, failure to satisfy peer review requirements, or insufficient continuation of professional education hours.

- The number of complaints closed increased 20 percent from 3,341 in fiscal year 2005 to 4,001 in fiscal year 2008. The increase is partially due to the Board assigning a staff member to the investigation and resolution of alleged violations of the Public Accountancy Act, which resulted in more cases being closed in fiscal year 2008.

The Board's Controls Over Information Technology Systems Are Adequate, But Certain Areas Need Improvement

The Board has adequate general information technology (IT) controls, including logical access controls, program change controls, physical controls, and disaster recovery controls. However, the Board should strengthen some application and general controls to ensure the continued integrity of data used for reporting financial information and performance measure data.

Application Controls

While the Board's application controls are adequate, annual penetration testing by the Department of Information Resources identified some access weaknesses and provided recommendations for strengthening these controls. The Board stated it is implementing these recommendations.

General Controls

The Board lacks complete password policies and procedures. In addition, its password management controls are weak. To minimize security risks, auditors communicated details about these weaknesses in writing directly to the Board's management.

In addition, the Board has developed a comprehensive disaster recovery plan and was able to successfully recover data from backups. However, it did not test its disaster recovery plan annually as required by Title 1, Texas Administrative Code, Section 202.24.

Recommendations

The Board should:

- Develop detailed, written password policies and procedures and strengthen its password management controls.
- Test its disaster recovery plan at least annually, as required by Title 1, Texas Administrative Code, Section 202.24.

Management's Response

We concur. The Board's Director of Information Resources will be responsible for developing the recommended policies and the testing of the disaster recovery plan. Completion date November, 2009.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to:

- Verify the accuracy of certain key financial statement balances and the effectiveness of key financial controls at the Board of Public Accountancy (Board).
- Verify the accuracy of, and evaluate trends in, selected performance measures that the Board uses.
- Evaluate the Board's process for setting fees and penalties.

Scope

The scope of the audit was fiscal year 2008. Auditors reviewed the accuracy of the Board's financial statements and performance measures and evaluated trends in selected performance measures. Auditors also evaluated the Board's process for setting fees and penalties and the automated systems and processes that support the functions reviewed.

Methodology

The methodology included collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with Board management and staff.

Information collected and reviewed included the following:

- The Board's trial balance, detailed general ledger, and fiscal year 2008 annual financial report.
- Uniform Statewide Accounting System reports and Texas Safekeeping Trust Company statements.
- Expenditure and payable vouchers.
- Revenue collection supporting documents.
- The Board's *Accounting and Administrative Procedures Manual*.
- The Board's 2008 budget report.

- Data and supporting documents for the Board's open and closed administrative and disciplinary cases.
- Data and supporting documents for the Board's reported performance measures.

Procedures and tests conducted included:

- Gaining an understanding of the Board's overall control structure (control environment, control procedures, and accounting systems).
- Testing internal controls and significant accounts to determine the accuracy of financial data in the Board's fiscal year 2008 annual financial report.
- Testing significant accounts balances and classes of transaction, including testing detailed supporting transactions.
- Testing performance measures data that the Board was required to include in its 2008 report to the Legislature, and testing the internal controls in the system that produced the data.
- Evaluating the Board's process for setting fees and penalties.
- Testing the Board's fees structure and reviewing the penalties assessed to ensure that the penalties are in compliance with the guidelines established by the Texas Occupations Code, Chapter 901 (the Public Accountancy Act), and by the Texas Administrative Code.

Criteria used included:

- The Public Accountancy Act (Texas Occupations Code, Chapter 901).
- Title 22, Texas Administrative Code, Part 22.
- The Board's policies and procedures.
- Government Finance Officers Association (GFOA) publications.

Project Information

Audit fieldwork was conducted from April 2008 through May 2008. 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.

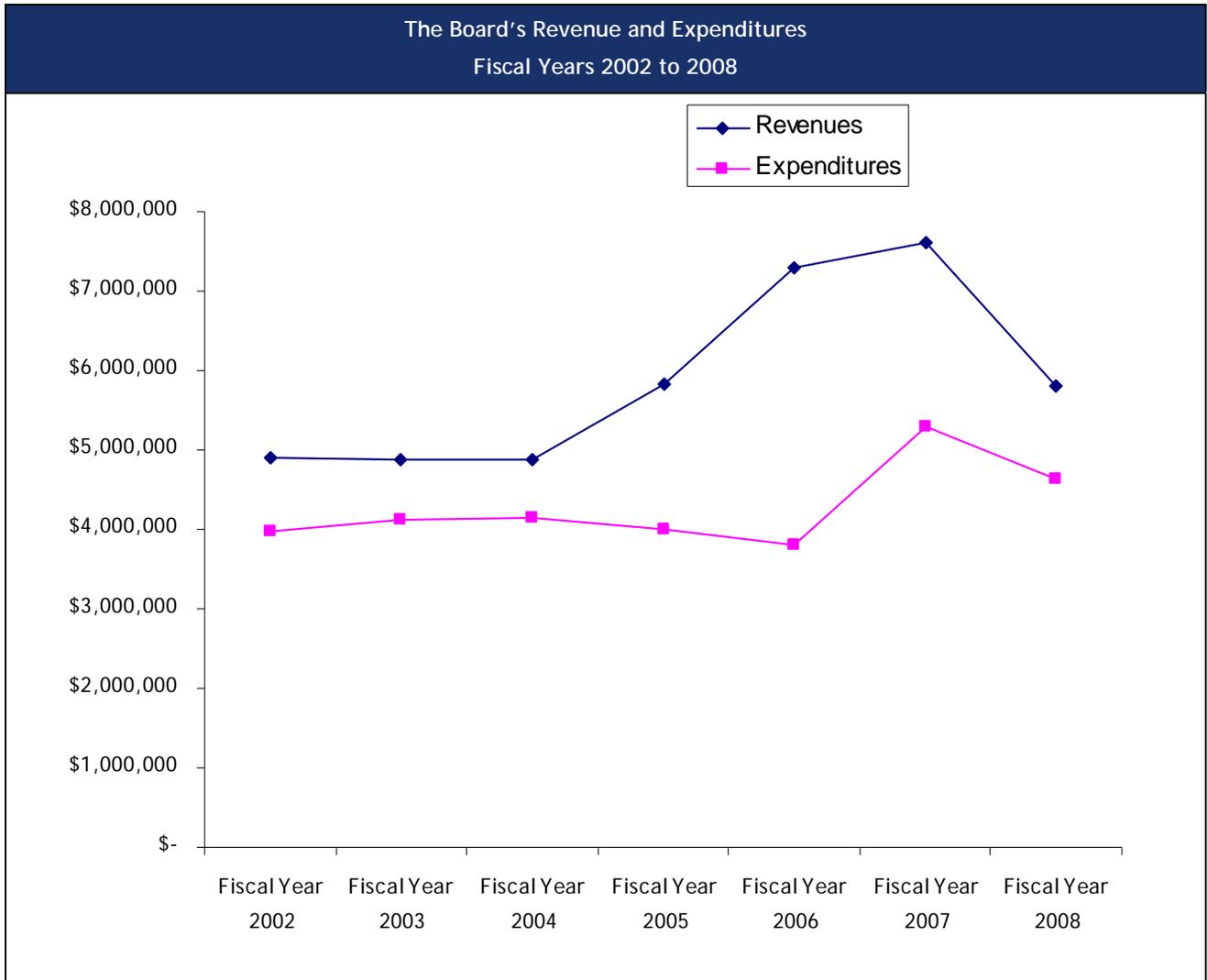
The following members of the State Auditor's staff performed the audit.

- Amadou N'gaide, MBA, CFE (Project Manager)
- Nick Ballard, MBA (Assistant Project Manager)
- Benjamin Carter
- Joe Kozak, CPA (Information Systems Audit Team)
- Dana Musgrave, MBA (Quality Control Reviewer)
- Nicole Guerrero, MBA, CIA, CGAP, CICA (Audit Manager)

Trends in the Board's Key Financial Information

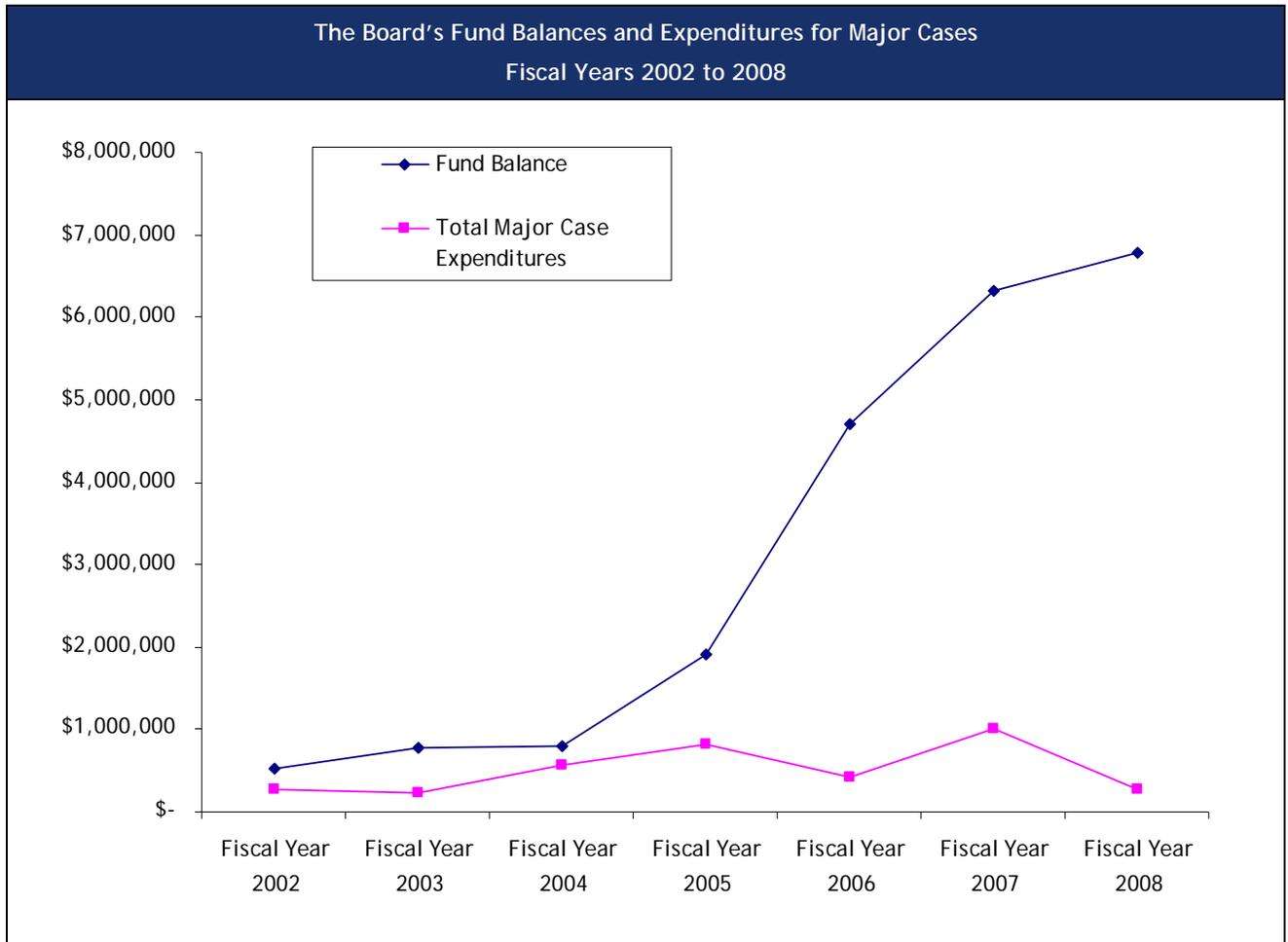
Figures 2 and 3 describe the trends in the Board of Public Accountancy's (Board) revenues, expenditures, and fund balance from fiscal years 2002 to 2008.

Figure 2



Sources: The Board's operating budgets for fiscal years 2002 through 2008.

Figure 3



Sources: The Board's operating budgets for fiscal years 2002 through 2008.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Rene Oliveira, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

The Board of Public Accountancy

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