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# Key Points of Report

## An Audit Report on the Texas Department of Economic Development's Contracting Practices for the Smart Jobs Program

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August 2000

### Overall Conclusion

Smart Jobs funds awarded by the Texas Department of Economic Development (Department) between September 1995 and August 1998 were not consistently used to successfully upgrade the skills and thereby enhance the employment opportunities of the Texas workforce. The Smart Jobs program has not achieved its objectives because the Department's primary focus was on awarding and distributing funds, with less regard for the outcomes of the services provided. As a result, participants often did not receive the type and quantity of training needed to prepare them for new or better jobs and to provide Texas employers with a more highly skilled workforce.

This audit was performed to determine the impact of weak contract management practices used in the Smart Jobs program, as previously reported in *An Audit Report on the Department of Economic Development* (SAO Report No. 00-008, January 2000). The Department is implementing a corrective action plan to improve its contract administration practices for the Smart Jobs program.

### Key Facts and Findings

- Between September 1995 and August 1998, employers who were awarded Smart Jobs contracts created significantly fewer jobs and trained significantly fewer employees than required in their contracts. For contracts reviewed, employers created only 36 percent of jobs and trained only 33 percent of workers.
- The State paid a significantly higher cost than anticipated for employees who did receive the training needed to upgrade their skills and competencies. The average actual cost to train an employee was \$2,401, 86 percent higher than the average contracted cost of \$1,290 per trainee.
- The Department also paid approximately \$5 million to contractors for training that did not meet the requirements of the contracts and for trainees who never participated in the Smart Jobs program. The overpayments resulted from ineffective contract management practices and do not appear to be the result of any fraudulent acts.

### Contact

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## Office of the State Auditor

Lawrence F. Alwin, CPA



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*This audit was conducted in accordance with Government Code, Section 321.0133.*

# Executive Summary

**S**mart Jobs funds awarded by the Texas Department of Economic Development between September 1995 and August 1998 have not been consistently used to successfully upgrade skills and thereby enhance the employment opportunities of the Texas workforce. The Smart Jobs program has not achieved its objectives because the primary focus was on awarding and distributing funds, with less regard for the outcomes of the services provided. As a result, employers created fewer jobs than they committed to create and employees often did not receive the type and quantity of training needed to provide them with new or enhanced skills.

## **The Benefits of the Smart Jobs Program Have Not Been Fully Realized**

For contracts reviewed, the actual number of jobs created and workers trained was approximately one-third of what the Department reported. Analysis of 26,393 contracted trainees, including training intended to create 19,541 new jobs, showed that employers:

- Created only 36 percent (6,975) of the new jobs they made a commitment to create
- Trained only 33 percent (8,805) of the employees they made a commitment to train

The Department reported that from September 1995 to August 1998 it awarded \$110 million to train more than 85,000 workers and create more than 48,000 new jobs. As of February 2000, the Department had closed 226 contracts executed between September 1995 and August 1998 with original grant amounts of \$47 million. Our sample consisted of 63 contracts for a total of \$34 million, representing 72 percent of the

dollar value of contracts closed as of February 2000.

The benefits of the program have not been fully realized because:

- Employers did not train the number of employees their commitments required. Because the Department measured the success of the program by the number of participants *projected* to receive training, the *actual* success of the program was significantly less.

The Department's method for measuring results based on projected trainees was consistent with reporting requirements established for Legislative Budget Board performance measures and the Smart Jobs annual report. However, this method overstated the actual results of the program. The Department developed new measure proposals for consideration by the 77th Legislature. These proposed measures focus on actual results and desired outcomes.

- Employers did not provide the type and quantity of training, that would increase or enhance the skills of the Texas workforce. Thirty-one percent of participants paid for by the Department received less than 75 percent of the employer-stipulated training hours. As a result, it is questionable whether the participants achieved the skills and competencies required in the contracts.

Employees trained for existing jobs received an average wage increase of 22 percent. However, it is difficult to conclude that this wage increase resulted from the Smart Jobs program when training required in contracts was not provided.

Finally, the State paid a significantly higher cost than anticipated for employees who actually received the training needed to upgrade their skills and competencies.

# Executive Summary, concluded

While the agreed cost in contracts averaged \$1,290 per trainee, the actual cost per trainee averaged \$2,401, 86 percent more than the average contracted rate. The actual costs also exceeded the Department's targeted measures during this timeframe, which ranged from \$1,265 to \$1,454 per trainee.

The Department used the same contracting practices from September 1995 until January 2000. Although our review covered only contracts executed between September 1995 and August 1998, the results from contracts awarded during fiscal year 1999 cannot be expected to be any different. The Department awarded \$42 million to train 42,500 employees during fiscal year 1999.

## **The Department Paid \$5 Million for Training That Did Not Meet Contract Requirements**

The Department paid approximately \$5 million to contractors for trainees who did not meet contract requirements or never participated in the Smart Jobs program. This represents approximately 24 percent of the \$21 million in payments made to the contractors included in our sample of 63 contracts.

The overpayments resulted from three key problems:

- Contractors did not provide the training required by contracts.
- Contractors were paid for trainees who never participated in the training program.
- Contractors did not give trainees pay increases required by contracts.

The overpayments resulted from the Department's ineffective contract management practices, which were previously reported in *An Audit Report on*

*the Department of Economic Development* (SAO Report No. 00-008, January 2000).

Our review indicates that the overpayments do not appear to have resulted from any fraudulent acts. Rather, ineffective contract administration procedures allowed employers to be paid for training that did not meet contract requirements. The Department is implementing a corrective action plan to improve its contract administration practices for the Smart Jobs program.

## **State Auditor's Office Summary of Management's Response**

The Department's response indicates that it agrees with all of the findings and recommendations in the report. Specific responses, with outlined corrective actions taken by the Department, are included at the end of each section of this report. The Department's summary response is included immediately following Section 2.

## **Objective, Scope, and Methodology**

The objective of this audit was to determine the extent of potential fraud, waste, and/or abuse in the Smart Jobs program. We focused on determining how many employees were actually trained and how many new jobs were actually created through the use of Smart Jobs funds. In our calculation we considered an employee trained if he or she received a minimum of 75 percent of the hours the employer agreed to provide.

The scope of our audit included Smart Jobs contracts executed between September 1995 and August 1998.

## **The Benefits of the Smart Jobs Program Have Not Been Fully Realized**

Smart Jobs funds have not been consistently used to successfully upgrade the skills and thereby enhance the employment opportunities of the Texas workforce. Employers who were awarded Smart Jobs grants created significantly fewer jobs and trained significantly fewer employees than they committed to between September 1995 and August 1998, for contracts reviewed.

It is questionable whether participants achieved the skills and competencies needed to prepare them for new and better jobs because they did not always get the training required in contracts. It is also difficult to conclude that the average 22 percent wage increase paid to employees in existing jobs resulted from the program when the contracted training was not provided. The Department also paid significantly more than anticipated for trainees who actually received the training needed to upgrade their skills and competencies.

### Section 1-A:

#### **Employers Created Significantly Fewer Jobs and Trained Significantly Fewer Employees Than Their Contracts Required**

For contracts reviewed, the actual number of jobs created and workers trained was approximately one-third of what the Department reported. As of February 2000, the Department had closed 226 contracts executed between September 1995 and August 1998 with original grant amounts of \$47 million. Our sample consisted of 63 contracts for a total of \$34 million.

Analysis of 26,393 contracted trainees, including training intended to create 19,541 new jobs, showed that employers:

- Created only 36 percent (6,975) of the new jobs they made a commitment to create
- Trained only 33 percent (8,805) of trainees that they made a commitment to train

The program has not achieved its objectives because its primary focus was on distributing funds, with less regard for the outcomes of the training services provided. Consequently, program results were overstated.

**Employers failed to train the number of employees committed to at the contract award.**

Figures reported by the Department overstated the success of the program in terms of the number of trainees who received training and the number of new jobs created.

Table 1

Smart Jobs Program		Contracted Trainees	
Fiscal Year	New Jobs	Existing Jobs	Total
1998	18,189	24,252	42,441
1997	12,755	7,954	20,709
1996	17,555	5,276	22,831

Source: Smart Jobs Annual Reports for fiscal years 1996 through 1998

This is because the Department measured and reported the success of the program based on the number of participants *projected* to receive training rather than the number of actual trainees. For contracts reviewed, however, our analysis indicates that almost two-thirds of contracted trainees either

never participated in the program or did not receive the training needed to upgrade skills and competencies consistent with the enabling legislation of the program.

In fact, although contractors consistently failed to train the number of workers and provide the amount of training in contract agreements, they received letters from the Department congratulating them on successfully achieving the objectives of the program. Therefore, even if a contractor trained significantly fewer employees than its commitment required, the Department still considered the contractor's performance successful.

For the 63 contracts included in our sample, employers made commitments to train

Table 2

Comparison of Actual Performance to Reported Performance		
	Reported by Department	Actual Per State Auditor
Total Jobs	26,393	8,805 (33%)
New Jobs	19,541	6,975 (36 %)

Source: Smart Jobs contractor files

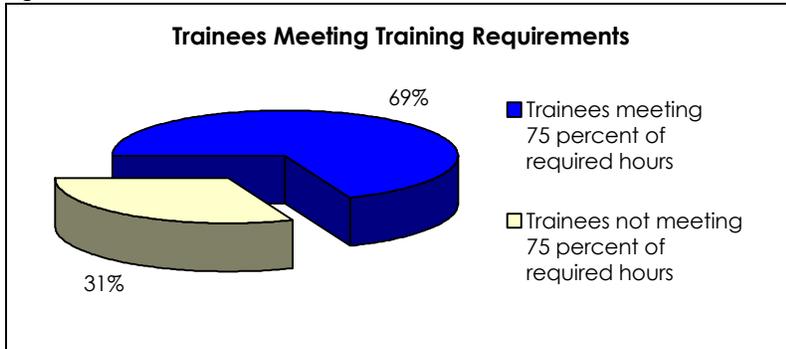
26,393 workers, but trained only 8,805, or 33 percent (see Table 2). In many instances employers trained far fewer employees than stated in contracts. For example, one employer's contract required training 575 employees, but only 1 trainee actually met the requirements of the contract.

The Department's method for measuring results based on projected trainees was consistent with reporting requirements established for Legislative Budget Board performance measures and Smart Jobs annual report. However, this method overstated the actual results of the program. The Department developed new measure proposals for consideration by the 77th Legislature that will focus on actual results and desired outcomes.

**Employers failed to provide training that increased or enhanced the skills of the Texas workforce.**

Because the Department did not focus on the outcomes of services provided, many trainees did not receive the training necessary to upgrade their skills. As illustrated in

Figure 1



Source: Smart Jobs contractor files

Figure 1, 31 percent of trainees paid for by the Department received less than 75 percent of the employer-stipulated training hours. As a result, it is questionable whether they achieved the skills and competencies required in contracts. In fact, 21 percent received 50 percent or less of the necessary hours.

The 2,926 participants in our sample who received training for

existing jobs received an average wage increase of 22 percent, regardless of the quantity and type of training received. Therefore, it is difficult to conclude that the increased wages resulted from the program when training required by the contracts was not provided.

In February 2000, the Department changed its rules to require trainees to achieve at least 75 percent of course hours for each course taken in order to be counted as a trainee. However, because there was no minimum standard prior to February 2000, the Department reimbursed employers for trainees who received substantially less training than required by contracts.

One of the biggest differences between the Smart Jobs program and other job training programs is that employers decide what training is required for their employees to achieve the skills and competencies needed. Employers then apply for funding from the Smart Jobs program and are awarded contracts. However, the Department consistently failed to hold employers accountable for providing their employees the training that they said was needed and that was the basis for an award.

For example, a contractor was awarded \$420,000 to train 255 employees and reported that 217 had been trained and retained in accordance with contract terms. However, our analysis determined that only 109 trainees had received the contracted training.

Recommendation:

- Manage the Smart Jobs program using accurate results-oriented outcome data to help ensure a greater success rate in terms of jobs created and workers trained. Adjust program strategies to better utilize appropriated funds to create more jobs and train more workers.
- Clarify the Statement of Work in contracts to increase the Department's ability to hold employers accountable for providing training that increases skills and competencies. Require contractors to report progress in a manner

consistent with the Statement of Work so that the Department can more easily determine if contractors are successful during the training period. Adjust administration efforts accordingly.

- Develop a contractor performance tracking system containing detailed trainee data, including required training hours and cumulative hours achieved. Populate and update the system using reports submitted by contractors and use it to monitor performance.

Management's Response:

- *The Department agrees with the recommendation that strategies be undertaken to manage the Smart Jobs program using accurate, results-oriented outcome data.*

*The Department has worked with the Governor's Office of Budget and Planning and the Legislative Budget Board (GOBP/LBB) to change the Key Performance Measures of the Smart Jobs Fund program. Over the past two biennia, performance measures of the program have been changed from measures that captured the number of participants to be trained under an approved contract for new or existing jobs, to the number of trainees completing training at contract closeout. The list of Smart Jobs measures in the approved Budget Structure for FY 2002-2003 has been developed to focus on program results.*

*Beginning with the Legislative Appropriations Request for the FY 2002-2003 biennium, forecasts of trainees trained for new and existing jobs will be based on the Department's historical experience with closed contracts.*

- *The Department agrees with the recommendation to increase its ability to hold employers accountable for providing training that increases skills and competencies. The Department believes Smart Jobs training plays a significant role in enhancing the skills of the workers trained. The Department will benchmark with other employer-driven training programs and conduct focus groups to determine the most reliable way to evaluate skills and competencies.*
- *The Department agrees that it should develop a contractor performance tracking system and is incorporating this capability in the database currently under development.*

*The Department has completely revised its system of managing the data collected in the administration of the Smart Jobs program. The Department has consolidated twelve data bases previously used by isolated areas of the program to manage distinct segments of the program process. These have been consolidated into a single database which, beginning in September 2000, may be queried to reliably answer a wide variety of questions on contract status, payment histories and program performance.*

*Beginning with FY 2001 grant year awards, the Department plans to conduct risk-based analyses to determine which companies require higher levels of assistance and monitoring in order to successfully complete their contracted training. As part of this effort, the application form for a Smart Jobs grant has been redesigned so that risk characteristics, such as the age and size of the company, its financial stability and the stability of its industry, will be included in each grant application.*

Section 1-B:

**The State Paid More Than Anticipated for Trained Employees**

The State paid significantly more than anticipated for employees who actually

received the training needed to upgrade their skills and competencies. While the cost in the contracts reviewed averaged \$1,290 per trainee, the actual cost per trainee averaged \$2,401, an 86 percent increase over the average contracted rate. This cost exceeded the Department's targeted measures during this timeframe, which ranged from \$1,265 to \$1,454 per trainee.

Table 3

Hourly Wage and Average Cost per Trainee		
Ending Hourly Wage (New and Existing Jobs)	Qualified Trainees	Average Cost Per Trainee
Less than \$7.50	251	\$ 3,626.23
\$7.51 to \$10.00	3037	\$ 2,191.37
\$10.01 to \$12.50	2363	\$ 2,107.98
\$12.51 to \$15.00	820	\$ 2,543.39
\$15.01 to \$17.50	496	\$ 3,170.49
\$17.51 to \$20.00	379	\$ 2,940.81
\$20.01 to \$22.50	436	\$ 2,475.30
\$22.51 to \$25.00	276	\$ 2,121.43
\$25.01 and up	747	\$ 2,897.49

Source: Smart Jobs contractor files

Recommendation:

Continue with plans to implement contract administration procedures that prevent the cost per trainee from escalating over the life of the contract.

Management's Response:

*The Department agrees with the recommendation to implement contract administration procedures that prevent the cost per trainee from escalating over the life of the contract. The contract closeout procedures in place do not allow reimbursements to exceed contracted cost per trainee.*

*Consistent with the response to the January 2000 audit report, the Department, in cooperation with the Comptroller's Office, has implemented a contract administration procedure to review contract compliance, strictly monitor the approval of payments to contractors and verify that approved payments are consistent with contract terms. The procedures implemented to correct the conditions found and reported in the January 2000 audit report have been validated by the State Auditor's Office.*

## The Department Paid \$5 Million for Training That Did Not Meet Contract Requirements

The Department paid approximately \$5 million for training that did not meet contract terms and for trainees who never participated in the Smart Jobs program. This amount represents approximately 24 percent of the \$21 million in payments made to the 63 contractors included in our sample.

Our review indicates that the overpayments do not appear to have resulted from any fraudulent acts. Rather, ineffective contract administration procedures, as previously reported in *An Audit Report on The Department of Economic Development* (SAO Report No. 00-008, January 2000), allowed employers to be paid for training that did not meet contract requirements. The Department is implementing a corrective action plan to improve its contract administration practices for the Smart Jobs program.

The overpayments resulted from three key areas:

- Contractors did not provide the training required by the contract. Although most contracts contained specific curricula for trainees, the Department typically did not hold contractors accountable for providing the training required by the contracts. As a result, the Department paid approximately \$4.1 million to contractors for trainees who did not receive at least 75 percent of the required training.

Over 85 percent of the contracts reviewed had instances of payment to contractors who did not meet contract requirements. For example, a contractor was reimbursed the full contract amount of \$299,980 for training 120 employees. However, only 33 were trained in accordance with the contract.

- Contractors were paid for trainees who never participated in the training program. The Department paid contractors \$929,000 for trainees who never participated in the Smart Jobs program. Contract terms allowed employers to incur a 15 percent attrition rate based on the number of projected trainees rather than the number of actual participants. However, contractors typically did not enroll all of the participants required by the contracts. As a result, contractors were routinely paid an attrition allowance based on trainees who never existed. Out of 63 contracts reviewed, only 22 contractors had enrolled the number of participants required by their contracts. Several contractors enrolled significantly fewer participants than required in their contracts, and were therefore overpaid.

For example, an employer contracted to train 1,000 employees but had only 370 trainees participate in the Smart Jobs program. The Department overpaid this contractor \$179,000 because it calculated allowed attrition on the projected number of trainees rather than the actual number of participants.

Another employer was overpaid \$222,000 because the Department incorrectly calculated the allowable attrition amount, failing to follow its own closeout process.

- Trainees did not always receive the pay increase required by contracts. Smart Jobs rules require employers to give employees certain wage increases after completion of training. However, in some instances the Department paid the employer even though wage requirements were not met. For example, one contractor was paid \$397,000 for training 299 employees. However, 128 of those trainees were not given the 10 percent wage increase required by the contract.

Recommendation:

Reimburse employers for training only when it is conducted in accordance with program requirements. Continue implementing recommendations previously reported in *An Audit Report on The Department of Economic Development* (SAO Report No. 00-008, January 2000).

Management's Response:

*The Department will continue to implement the recommendations of the January Audit Report.*

*New contract monitoring policies and procedures are being developed in accordance with the corrective action plan and with the assistance of the State Auditor's Office and the Comptroller of Public Accounts. These procedures will establish a strict and consistent set of criteria for reimbursement of expenses incurred by grantees for training.*

*The Department agrees with the SAO's January 2000 audit report recommendation to establish a minimum standard for successful training. In February 2000, the Governing Board formally adopted a standard of 75% of contracted training received as a reasonable, minimum standard for successfully accomplishing a Smart Jobs contract in its program rules. All contracts closed since the release of the January 2000 audit report have been closed in accordance with procedures established in the corrective action plan.*

*Also in February 2000, the Governing Board formally adopted rules clarifying the calculation of allowable attrition. This calculation is now based on the number of actual trainees participating in the program and not the number of trainees proposed in the contract.*

*Under current contract closeout procedures adopted in accordance with the corrective action plan, contractors must submit documentation such as actual payroll records to substantiate that pay raises required in the contract have been given to the trainees. Without this documentation, the employers are not allowed to claim training costs associated with their employees.*

## Summary of Management's Response



### STATE OF TEXAS DEPARTMENT OF ECONOMIC DEVELOPMENT

August 21, 2000

Lawrence F. Alwin, CPA  
Office of the State Auditor  
1501 N. Congress, Ste. 4.224  
Robert E. Johnson Building  
Austin, Texas 78701

Dear Mr. Alwin:

The Department agrees with the recommendations of the *Audit Report on Smart Jobs Contracting* of August 2000.

The Smart Jobs program has worked closely with your staff and the Comptroller's Office to correct the conditions of the contract management systems to guarantee performance and accountability consistent with statutory requirements and the highest expectations of State government. I am pleased to report that all contracts closed since the release of the January 2000 *Audit Report on the Department of Economic Development* have been closed in accordance with procedures established in the Smart Jobs corrective action plan.

The Department is currently considering a number of options for proposing statutory changes to improve the effectiveness of the Smart Jobs program. These options will be developed in anticipation of the 77<sup>th</sup> Legislative Session in coordination with the Governing Board, program stakeholders and interested members of legislative oversight committees.

The Department also invites the State Auditor's Office to conduct a follow-up audit of the contract management procedures currently in effect over the Smart Jobs program.

I commend your staff for their diligence in facing the challenges posed by the Smart Jobs program. Please contact me if I may be of any assistance.

Sincerely,

A handwritten signature in black ink that reads "Jeff Mosley".

Jeff Mosley  
Executive Director

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**Response to Executive Summary Section**

The Smart Jobs funds used by the Texas Department of Commerce between September 1995 and August 1997 and the Texas Department of Economic Development were used as a work force development incentive for Texas employers. The Department recognizes that the Smart Jobs program has historically had weak contract management practices. We welcome the recommendations of this audit and have taken actions to correct each of the conditions identified in this report.

Although the 75 percent minimum training standard discussed in this report was neither a statutory nor a contractual requirement in effect during the period under audit, we agree it is an appropriate measure of performance. In February 2000, the Governing Board formally adopted this standard in its rules in response to the SAO recommendations. Applying this standard to the sample has clarified the need to strengthen the program's contract management procedures. We are committed to developing additional indicators to measure program success.

The Department has developed a corrective action plan and has taken action as a result of SAO Audit Report No. 00-008, January 2000, and inquiries by the Governing Board and legislative leadership. Working closely with the State Auditor's Office and the Comptroller of Public Accounts, we are correcting the conditions of the contract management system to guarantee performance and accountability consistent with statutory requirements and the highest expectations of State government. All contracts closed since the release of the January 2000 audit report have been closed in accordance with procedures established in the corrective action plan.

August 21, 2000

## Objective, Scope, and Methodology

### Objective

The audit objective was to examine the results of the Smart Jobs program and determine if employers awarded contracts were reimbursed for training workers who were not trained in accordance with program requirements.

The audit primarily focused on answering the following questions:

- How many new jobs has the Smart Jobs program created and how much have wages increased?
- Has the Smart Jobs program reimbursed employers who have not met program objectives?
- Have employers committed potential fraudulent acts?

### Scope

The scope of this audit included completed Smart Jobs contracts covering fiscal years 1996 through 1998. By reviewing closed contracts, we were able to determine if employers created the jobs they committed to create and trained the trainees they committed to train.

### Methodology

The audit methodology consisted of gaining an understanding of the Smart Jobs program and reviewing documents submitted by employers. Closed contract files were tested to determine how many new jobs were actually created and how many employees were actually trained.

Information collected to accomplish our objective included the following:

- Documentary evidence such as Smart Jobs annual reports, contracts, applications, memoranda, Reports of Workers Trained, invoices, purchase vouchers, correspondence between program staff and contractors, and performance measurement information
- Smart Jobs program-generated data on fiscal years 1996 through 1998 closed contracts, reimbursements to participating employers, and contract results
- State statutes and Smart Jobs program rules

Procedures and tests conducted:

- Testing of selected closed contracts with paid attrition greater than \$15,000 to determine actual contractor performance of jobs created, workers trained, and wages paid
- Analysis of training received by individual employees compared to contract requirements. We used 75 percent of the minimum contracted number of hours that could be traced to individual trainees to determine if employees achieved the skills and competencies called for in each contract.
- Examination of selected purchase vouchers.
- Compliance with applicable statutes and rules.

Analysis techniques used:

- Financial analysis
- Comparative analysis
- Data analysis of individual trainee data

Criteria used:

- Government Code, Section 481
- Texas Administrative Code, Title 10, Part V, Chapter 186, Smart Jobs Fund Program
- General Appropriations Acts, 1996–1997 and 1998–1999 Bienniums, 74th and 75th Legislatures, respectively
- Smart Jobs contract terms and provisions

**Other Information**

Fieldwork was conducted from March 2000 to July 2000. The audit was conducted in accordance with generally accepted government auditing standards. There were no significant instances of noncompliance with these standards.

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

- Nick L. Villalpando, CPA (Project Manager)
- Michael Dean, MPAff
- Bill Mesaros, Ph.D.
- Joe Pena
- Brian Chamberlin, CIA
- Carlos Contreras, CIA
- Dennis O'Neal, CIA
- Bruce Truitt, MA, MPAff, Quality Control Reviewer
- Cynthia L. Reed, CPA, Audit Manager
- Craig D. Kinton, CPA, Audit Director

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