



An Audit Report on

Financial Processes at the Military Department

December 2017

Report No. 18-010



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Overall Conclusion

The Military Department (Department) had significant weaknesses in its contracting processes and lacked key controls to ensure that it consistently performed required activities related to contract planning, procurement, and formation.

In addition, the Department had processes in place to help it manage assets and process payments that were allowable, properly supported, and approved. However, it should strengthen those processes to ensure that it reports all assets as required and makes payments in a timely manner.

Contracting process. Between September 1, 2016, and May 31, 2017, the Department had significant weaknesses in its contracting processes and lacked key controls to ensure that it consistently performed required activities related to contract planning, procurement, and formation. By not having sufficient contracting processes, the Department:

- Did not complete non-disclosure or conflict of interest statements for the contracts that auditors reviewed.
- Did not document the justification for its selection of a vendor for a specific project for the three architectural and engineering contracts that auditors reviewed.
- Did not consistently include (1) an abandonment or default clause, (2) a buy Texas clause, and (3) a technology access clause in contracts as the *State of Texas Contract Management Guide* required.
- Did not include terms and conditions or specific pricing information in the purchase order for a \$2.2 million emergency procurement that auditors reviewed.

Background Information

The Military Department (Department) is composed of the three branches of the military in the state of Texas. Those branches are the Texas Army National Guard, the Texas Air National Guard, and the Texas State Guard. All three branches are administered by the state adjutant general, an appointee of the governor of Texas, and are under the command of the governor. **The Department's executive director** is responsible for the daily administration of the Department and operational compliance with the cooperative agreements between the Department and the National Guard Bureau.

The Department and Texas State Guard are headquartered at Camp Mabry in Austin. The Texas State Guard functions as an organized state militia under the authority of Title 32 of the United States Code and Chapter 437 of the Texas Government Code.

For fiscal year 2017, the Department received \$98,086,104 in appropriations. The Department was authorized to have 615 full-time equivalent employees.

Sources: The Department and the General Appropriations Act (84th Legislature).

This audit was conducted in accordance with Texas Government Code, Sections 321.0131 and 321.0132.

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

Asset management. The Department had some asset management processes in place, and it ensured that it assigned assets identification numbers. However, it did not report all acquired assets to the State Property Accounting (SPA) system as required.

Payment Processing. The Department processed payments that were allowable, properly supported, and approved; however, it did not consistently pay vendor invoices within 30 days of receipt of the invoice or the goods/service. As a result of making late payments, the Department paid \$22,845 in interest to vendors from September 1, 2016, through May 31, 2017.

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

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 and Related Issue Ratings		
Chapter	Title	Issue Rating ^a
1	The Department Should Strengthen Its Contracting Processes to Ensure That It Consistently Performs Required Activities Related to Contract Planning, Procurement, and Formation	High
2	While the Department Had Processes in Place to Identify Assets and Assign Identification Numbers, It Should Strengthen Its Asset Management Processes to Ensure That It Reports All Assets in the State Property Accounting System as Required	Medium
3	The Department's Processes Ensured That the Department Processed Payments That Were Allowable, Properly Supported, and Approved; However, It Should Strengthen Its Processes to Ensure That It Makes Payments in a Timely Manner and Reports Complete and Accurate Information in CAPPS	Medium

^a A chapter 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.

A chapter 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.

A chapter 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.

A chapter 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.

Summary of Management's Response

At the end of each chapter in this report, auditors made recommendations to address the issues identified during this audit. The Department agreed with the recommendations in this report.

Audit Objective and Scope

The objective of this audit was to determine whether the Department has processes and related controls to help ensure that it administers financial transactions in accordance with applicable statutes, rules, and Department policies and procedures.

The scope of this audit covered the Department's activities related to contracting, asset management, payments, and related information systems for the first nine months of fiscal year 2017 (September 1, 2016, through May 31, 2017).

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Detailed Results

Chapter 1

The Department Should Strengthen Its Contracting Processes to Ensure That It Consistently Performs Required Activities Related to Contract Planning, Procurement, and Formation

Chapter 1
Rating:
High ¹

The Military Department (Department) had significant weaknesses in its contracting processes and lacked key controls to ensure that it consistently performed required activities related to contract planning, procurement, and formation (see text box). While the Department had a documented contract handbook and purchasing procedures, its contracting processes were not sufficient to ensure that it consistently performed required activities. For example, neither the handbook nor the procedures:

- Required that employees involved in a solicitation sign a non-disclosure or conflict of interest statement as the *State of Texas Contract Management Guide* required.
- Contained details about how to process the different types of contracts, such as construction contracts or emergency contracts, to help ensure consistency and compliance with requirements.
- Defined how to report contracts on the Department's Web site and to the Legislative Budget Board as statute and the General Appropriations Act (84th Legislature)² required.
- Contained the procedures that Texas Government Code, Section 2261.256(a)(1), required to assess the risk of fraud, abuse, or waste.

The Department used a checklist to ensure that it completed required documents for contract planning and procurement; however, that checklist did not contain sufficient information about certain contract laws and

Contract Planning,
Procurement, and Formation

Planning - Identify contracting objectives and contracting strategy.

Procurement - Fairly and objectively select the most qualified contractors.

Contract Formation/Rate/Price Establishment - Ensure that the contract contains provisions that hold the contractor accountable for producing desired results, including all relevant terms and conditions, and establish processes that are cost-effective and aligned with the cost of providing goods and services.

Source: *State of Texas Contract Management Guide*, version 1.16.

¹ The risk related to the issues discussed in Chapter 1 is rated as High because 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.

² The General Appropriations Act (84th Legislature) contains reporting requirements for certain contracts. None of the contracts reviewed for this audit met the requirements in the General Appropriations Act for reporting to the Legislative Budget Board.

regulations. Specifically, the checklist did not include information regarding non-disclosure statements, conflicts of interest statements, State Auditor's

Office nepotism forms, and verification that the vendor filed information with the Texas Ethics Commission. The checklist also did not contain information about performing a needs assessment or developing cost estimates.

Texas Government Code,
Section 437.054

The adjutant general is the decision-making authority on all matters concerning the location and maintenance of military forces and facilities in this state. The adjutant general may set priorities for the construction, renovation, repair, and maintenance of Texas military forces armories, facilities, and improvements owned or leased by this state. The adjutant general in this capacity is a public authority and a body politic and corporate and has all powers necessary for the acquisition, construction, rental, control, maintenance, operation, and disposition of Texas military forces facilities and real property and all associated property and equipment.

In addition, the Department did not document which contracting requirements it would follow for its construction contracts. Texas Government Code, Section 437.054, gives authority to the adjutant general on all matters concerning the location and maintenance of military forces and facilities in Texas (see text box). As a result, the Department is not required to comply with state contracting laws for construction contracts. The Department asserted that, with the exception of sending solicitations to the State's Contract Advisory Team, it followed state contracting requirements when procuring construction contracts; however, it did not document that decision.³

The Department also did not have a complete or accurate list of the contracts it awarded from September 1, 2016, through May 31, 2017. Auditors created a list of contracts using the information that the Department provided and the information it reported to the Legislative Budget Board. Without a complete and accurate list of contracts, the Department may not have the information necessary to make management decisions.

While the Department performed some required contracting activities, auditors identified weaknesses related to contract planning, procurement, and formation of the contracts that auditors reviewed.

Auditors reviewed seven contracts, two of which were construction contracts. The other five contracts included three architectural and engineering contracts and two contracts for other services. Table 2 on the next page lists details about those seven contracts. Auditors also reviewed an emergency purchase for the lodging of state active duty personnel during a mission, which is discussed later in this chapter.

³ Based on a list of contracts that the auditors developed, of the \$17.4 million in contracts the Department procured from September 1, 2016, through May 31, 2017, \$10.7 million were construction contracts.

Table 2

Seven Department Contracts That Auditors Reviewed			
Contract Description	Contract Amount	How Procured	Award Date
Construction project for Austin Fairview major maintenance and renovation project	\$5,683,568	Competitive procurement using an invitation for bid	May 24, 2017
Construction project for roof replacement at the Weatherford Readiness Center	\$600,000	Competitive procurement using an invitation for bid	October 26, 2016
Security guard services at the San Antonio Aviation Support Facility at the Martindale Army Air Field	\$81,900	Competitive procurement using an invitation for bid	January 1, 2017
Architect and engineering contract for Corpus Christi Readiness Center	\$79,069	Selected from a list of prequalified vendors	May 31, 2017
Architect and engineering contract for an energy audit at Camp Mabry	\$30,447	Selected from a list of prequalified vendors	May 2, 2017
Architect and engineering contract for the Weatherford National Guard Armory	\$25,050	Selected from a list of prequalified vendors	December 15, 2016
Copy machine rentals for state active duty mission (Operation Secure Texas Ground Support)	\$60,000	Emergency procurement using the Department of Information Resources' contract list	September 1, 2016

Sources: Information that the Department provided to auditors and reported to the Legislative Budget Board.

Auditors reviewed the contracts listed above and determined that the Department performed some required contracting activities. However, by not having sufficient processes for contracting, the Department did not consistently comply with requirements related to contract planning, procurement, and formation.

Contract Planning. The Department developed a needs assessment and cost estimate for the two construction contracts and the three architectural and engineering contracts that auditors reviewed. However, for the contract for security guard services, which the Department competitively bid, the Department did not develop a needs assessment or cost estimate as required by the *State of Texas Contract Management Guide*.

According to the *State of Texas Contract Management Guide*:

- The purpose of a needs assessment is to provide a clear definition of the contracting objectives, which are used to develop the statement of work in the solicitation and verify the performance of the contractor.
- A cost estimate is used to determine the type of procurement and the range of services that can be included in the statement of work in the solicitation.

Consistently performing needs assessments and cost estimates would help the Department ensure that procurements address identified needs at the best value to the State.

Contract Procurement. The Department performed some required procurement activities for the contracts that auditors reviewed. Those activities included (1) advertising solicitations on the *Electronic State Business Daily*; (2) reviewing vendor proposals for responsiveness and properly evaluating those proposals for competitively bid contracts; and (3) having the procurement director verify, when required, that the solicitation and purchasing methods and contractor selection process complied with state law. However, the Department did not consistently perform other required activities. Specifically:

- For the three contracts that auditors reviewed for which the Department performed a competitive solicitation, the Department did not complete non-disclosure or conflict of interest statements as the *State of Texas Contract Management Guide* required.
- For the contract that auditors reviewed that exceeded \$1 million, the Department did not ensure that (1) all purchasing personnel signed the State Auditor's Office nepotism form as Texas Government Code, Section 2262.004, required and (2) the vendor submitted a certificate of interested parties to the Texas Ethics Commission as Texas Government Code, Section 2252.908, required.
- For the three architectural and engineering contracts that auditors reviewed, the Department did not document the justification for its selection of the vendor for a specific project. According to the Department, management held discussions to select a qualified vendor; however, it did not document those discussions. In fiscal year 2016, the Department selected eight architectural and engineering firms for its prequalified list as a result of its issuing a request for qualifications.
- For one contract that the Department competitively bid, only one person evaluated the vendor proposals. The *State of Texas Contract Management Guide* recommends that three to five people evaluate proposals.

Without ensuring that personnel complete required non-disclosure, conflict of interest, and nepotism forms, the Department has an increased risk of (1) having confidential information disclosed with no recourse and (2) providing vendors with an unfair advantage in the procurement process. In addition, without documenting why it selected a specific vendor from the

prequalified list, the Department cannot ensure that it selected the most qualified architectural and engineering firm for specific projects.

Contract Formation. The Department did not include all essential clauses in the contracts that auditors reviewed or properly report its contracts on its Web site or to the Legislative Budget Board as required. Specifically:

- For the six contracts that auditors reviewed that contained terms and conditions⁴, the Department did not consistently include (1) the abandonment or default clause, (2) the buy Texas clause, and (3) the technology access clause (see text box for information about the clauses), as the *State of Texas Contract Management Guide* required. Not including essential contract clauses increases the risk that the State's interests may not be protected and that the contractor may not comply with requirements.
- The Department did not report any of the contracts it procured in fiscal year 2017 (including the seven contracts that auditors reviewed) on its Web site as Texas Government Code, Section 2261.253, required.
- The Department did not report two of the three architectural and engineering contracts that auditors reviewed to the Legislative Budget Board as required. Texas Government Code, Section 2254.006, required that the Department report those three contracts, which were for professional services, to the Legislative Budget Board 10 days after the award. As of August 2017, the Department was not required to report the other four contracts that auditors reviewed to the Legislative Budget Board.

Essential Terms and Conditions

Abandonment or Default - This clause provides a state entity the right to cancel a contract without notice if the contractor abandons or defaults on the contract.

Buy Texas - This clause requires the contractor to purchase products and materials produced in the State of Texas when available at a price and time comparable to products and materials produced outside of the state.

Technology Access - This clause addresses the requirement that state entities procure products that comply with State of Texas accessibility requirements for electronic and information resources specified in Title 1, Texas Administrative Code, Chapter 213.

Source: *State of Texas Contract Management Guide*, version 1.16.

Reporting its contracts on its Web site and to the Legislative Budget Board as required would help the Department increase the transparency of its contracting processes.

⁴ One contract reviewed was an emergency procurement using the Department of Information Resources' contract list and did not require terms and conditions.

The Department made an emergency procurement for \$2.2 million for which the purchase order did not contain terms and conditions or pricing information.

In addition to the seven contracts discussed above, auditors also reviewed a \$2.2 million emergency procurement the Department made in October 2016. That emergency procurement was for lodging for state active duty personnel during the Operation Secure Texas Ground Support mission.

Certain emergency procurements are exempt from some state requirements, such as posting the procurement on the *Electronic State Business Daily*. However, the Department's purchase order for the lodging did not contain any terms and conditions and other basic information about pricing, such as the maximum price per day or the location of the lodging.

Without terms and conditions or detailed pricing information, the Department greatly reduced its ability to monitor the vendor, and the Department could not hold the vendor accountable and had no recourse in the event of poor performance or other issues. In addition, because the purchase order did not contain pricing information, the vendor did not have any limits on its pricing. The Department also did not ensure that the vendor submitted a certificate of interested parties to the Texas Ethics Commission as Texas Government Code, Section 2252.908, and Title 1, Texas Administrative Code, Chapter 46, required.

Recommendations

The Department should:

- Document which state laws and regulations it will follow for construction contracts.
- Develop and implement documented policies and procedures for contracts that, at a minimum:
 - ♦ Require a needs assessment and cost estimate be performed.
 - ♦ Require employees involved in the solicitation to sign a non-disclosure and conflict of interest statements.
 - ♦ For contracts that exceed \$1 million, require employees involved with the procurement to sign the State Auditor's Office nepotism form and require and verify that vendors file certificates of interested parties with the Texas Ethics Commission.
 - ♦ Require a written justification for the selection of architectural and engineering vendors for projects.

- ♦ Require more than one person to evaluate vendor proposals.
- ♦ Establish a process to ensure that contracts contain all essential clauses.
- Develop and implement contracting policies and procedures for assessing the risk of fraud, abuse, or waste as Texas Government Code, Section 2261.256(a)(1), requires.
- Develop and implement policies and procedures to ensure that it has a complete and accurate list of all contracts it awarded.
- Report contracts on its Web site and to the Legislative Budget Board as required.
- Include terms and condition and detailed pricing information in each of its purchases and contracts, including purchase orders for emergency procurements.

Management's Response

Recommendation: Document which state laws and regulations the Department will follow for construction contracts.

Management Response: *Management agrees. The TMD Purchasing & Contracts Division will work with agency counsel to review and modify all agency terms and conditions, including which state laws and regulations it will follow.*

Implementation Date: 28 February 2018

Responsible Party: Contract Manager

Recommendation: Develop and implement documented policies and procedures for contracts that, at a minimum:

- ***Require a needs assessment and cost estimate be performed***
- ***Require employees involved in the solicitation sign a non-disclosure and conflict of interest statements***
- ***For contracts greater than \$1 million, require that employees involved with the procurement sign the State Auditor's Office Nepotism form, and require and verify that vendors file with the Texas Ethics Commission***

- **Require that there be a written justification for the selection of architectural and engineering vendors for projects**
- **Require more than one person to evaluate vendor proposals**
- **Establish a process to ensure that contracts contain all required clauses**

Management Response: *Management agrees. The TMD Purchasing & Contract Division updated the agency's Contract Management Guide in August 2017. The updated guide includes processes that address many of the recommendations. Before completion of the audit, the Purchasing and Contracting Division implemented processes to ensure compliance with the requirements related to:*

- *Signing non-disclosure and conflict of interest statements*
- *Signing Nepotism forms for contracts over \$1 million*
- *Obtaining a written justification for the selection of architectural and engineering*
- *Requiring more than one person to evaluate vendor proposals*

The following processes are being developed and will be implemented:

- *A needs assessment and cost estimate prior to the solicitation*
- *A process to ensure contracts include all required clauses*

TMD also will develop desk procedures and review, revise or establish new forms.

Implementation Date: 31 March 2018

Responsible Party: Contract Manager

Recommendation: Develop and implement contracting policies and procedures for assessing the risk of fraud, abuse, or waste as required by Texas Government Code, Section 2261.256 (a)(1).

Management Response: *Management agrees. The TMD Purchasing & Contracts Division has developed a risk register tool and process that it will implement in agency projects.*

Implementation Date: 28 February 2018

Responsible Party: Contract Manager

Recommendation: Develop and implement policies and procedures to ensure that the Department has a complete and accurate listing of all contracts awarded.

Management Response: *Management agrees. TMD is modifying a report to ensure that the Department has a complete and accurate list of all contracts awarded.*

Implementation Date: 28 February 2018

Responsible Party: Contract Manager

Recommendation: Report contracts on its Web site and to the Legislative Budget Board as required.

Management Response: *Management agrees. TMD has developed an online system to post all agency contracts on its website and is revising its process to ensure that all contracts are properly and accurately reported on the LBB website.*

Implementation Date: 31 January 2018

Responsible Party: Contract Manager

Recommendation: Include terms and condition and detailed pricing information in each of its purchases and contracts, including purchase orders for emergency procurements.

Management Response: *Management agrees. TMD will develop new processes to ensure detailed pricing information is included in each of its purchases and contracts, including special mission and emergency procurements.*

Implementation Date: 30 March 2018

Responsible Party: Contract Manager

While the Department Had Processes in Place to Identify Assets and Assign Identification Numbers, It Should Strengthen Its Asset Management Processes to Ensure That It Reports All Assets in the State Property Accounting System as Required

**Chapter 2
Rating:
Medium ⁵**

The Department did not report all acquired assets to the State Property Accounting (SPA) system as Texas Government Code, Section 403.273, required and in accordance with the Office of the Comptroller of Public Accounts' (Comptroller's Office) *SPA Process User's Guide* (see text box).

The Department had a process in place to identify assets in the Centralized Accounting and Payroll/Personnel System (CAPPS), and it ensured that it assigned assets identification numbers. However, those processes were not adequate to ensure that the Department accurately reported all assets in SPA as required. Specifically:

- The Department did not consistently use the correct coding in CAPPS, which resulted in the Department's recording some non-assets as assets in SPA. For example:
 - ♦ Auditors identified 5 transactions totaling \$3,852 for which the Department incorrectly coded purchases as assets.
 - ♦ Auditors identified 3 transactions totaling \$359,237 for which the Department incorrectly coded improvements to current assets and added them to SPA as new assets.
- The Department did not have documented policies and procedures for (1) recording new assets and (2) deleting from SPA assets that it no longer used.

The Department's asset management process relied on controls in CAPPS to (1) identify a new asset that should be assigned an asset identification number and (2) upload into SPA all new asset information the Department entered into CAPPS. That process adequately ensured that the Department assigned asset identification numbers as required. However, in October

Asset Reporting Requirements

Texas Government Code, Section 403.273(g), states: At all times, the property records of a state agency must accurately reflect the property possessed by the agency. Property may be deleted from the agency's records only in accordance with rules adopted by the [Office of the Comptroller of Public Accounts (Comptroller's Office)].

The Comptroller's Office's State Property Accounting (SPA) Process User's Guide states: Each state agency (and university choosing to report to SPA) is responsible for ensuring that its fiscal year-end capitalized asset balance(s) reflected in SPA are accurate and materially correct. The balance(s) must reflect the agency's financial position when reported in the annual financial report, capital asset note.

⁵ The risk related to the issues discussed in Chapter 2 is 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 concern and reduce risks to a more desirable level.

2016, the Department determined that the control in CAPPs that was designed to update asset information in SPA was not functioning properly. The Department had not developed any compensating processes or controls to ensure that it entered all assets in SPA as required. Auditors identified 181 assets totaling \$9.2 million that the Department purchased from September 1, 2016, through May 31, 2017, that it had not entered in SPA.

Not having a complete, accurate inventory of assets in SPA increases the risk that the Department's annual financial reports will not accurately reflect its financial position. Additionally, not accurately tracking capitalized and controlled assets increases the risk of loss or theft. The Department asserted that it began conducting a complete inventory of all its assets in 2017 due to the unreliability of the information in SPA. In addition, the Department asserted that it stopped all disposals of assets until after that inventory is complete.

Recommendations

The Department should:

- Strengthen its asset management processes, and document those processes, to:
 - ♦ Verify that it enters the correct coding for all assets in CAPPs.
 - ♦ Reconcile its asset lists in CAPPs and SPA.
- Develop and implement detailed policies and procedures for the acquisition and disposition of assets.
- After completing the inventory of assets, update the assets reported in SPA as needed.

Management's Response

Recommendation: Strengthen its asset management processes, and document those processes, to:

- ***Verify that it enters the correct coding for all assets in CAPPs***
- ***Reconcile its asset listings in CAPPs and SPA***

Management Response: *Management agrees. TMD will develop a process to verify all coding entries made into CAPPs. TMD currently is reconciling all*

asset listings in CAPPs and SPA. The agency asset manager will perform quarterly reconciliations of CAPPs and SPA data.

Implementation Date: 31 May 2018

Responsible Party: Asset Manager

Recommendation: Develop and implement detailed policies and procedures for the acquisition and disposition of assets.

Management Response: Management agrees. TMD currently is updating its Standard Operating Procedures to include detailed instructions for the agency and its end-users.

Implementation Date: 28 February 2018

Responsible Party: Asset Manager

Recommendation: After completing the inventory of assets, update the assets reported in SPA as needed.

Management Response: Management agrees. TMD will develop a process to ensure that all assets inventoried are updated and accurately reported in SPA as needed.

Implementation Date: 31 May 2018

Responsible Party: Asset Manager

The Department's Processes Ensured That *the Department Processed Payments That Were Allowable, Properly Supported, and Approved; However, It Should Strengthen Its Processes to Ensure That It Makes Payments in a Timely Manner and Reports Complete and Accurate Information in CAPPS*

Chapter 3
Rating:
Medium ⁶

The Department had processes in place to ensure that its payments were allowable, properly supported, and approved. All 60 payment transactions that auditors tested that occurred from September 1, 2016, through May 31, 2017, totaling \$427,363 were properly supported and accurately coded. In addition, for those requiring it, all payments tested had the required approvals and were allowable according to the purchase order or contract. The Department also had controls within CAPPS to help ensure the accuracy of payments that required a match between the quantity ordered and dollar amount on the purchase order with (1) the quantity that was received and (2) the dollar amount to be paid.

However, the Department should ensure that it makes payments within 30 days of receipt of the invoice or the good/service to reduce the amount of interest incurred and develop a process to reconcile transaction information in CAPPS and the Uniform Statewide Accounting System (USAS) on a monthly basis.

Prompt payments. The Department did not consistently pay vendor invoices within 30 days of receipt of the invoice or the good/service. As a result of the overdue payments, the Department incurred interest as required by

Texas Government Code, Section 2251.026 (the Prompt Payment Act, see text box for more information).

Specifically, the Department made 14.5 percent of its payments made from September 1, 2016, through May 31, 2017, later than 30 days after receiving the invoice or the good/service. Those payments were 21 days late, on average. As a result of those late payments, the Department paid \$22,845 in interest to vendors. While the Department had adequate, documented procedures as of January 2017 for processing invoices within 30 days, it did not ensure that staff consistently followed those procedures.

Prompt Payment Act

Texas Government Code, Section 2251.021, states that a payment by a governmental entity is overdue on the 31st day after the later of:

- (1) the date the governmental entity receives the goods under the contract;
- (2) the date the performance of the service under the contract is completed; or
- (3) the date the governmental entity receives an invoice for the goods or service.

In addition, Texas Government Code, Section 2251.026, states that: A state agency is liable for any interest that it accrues on an overdue payment under this chapter and shall pay interest from funds appropriated or otherwise available to the agency at the same time the principal is paid.

⁶ The risk related to the issues discussed in Chapter 3 is 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 concern and reduce risks to a more desirable level.

CAPPS and USAS Transaction Differences. The Department did not have a process in place to ensure that it resolved transaction differences between CAPPS and USAS. The Comptroller's Office's month-end closing/reconciliation procedures require state agencies to reconcile their internal accounting systems to USAS on a monthly basis. However, as of July 2017, the Department had not reconciled 2,985 transactions between the two systems. As a result, the Department cannot rely on the financial information in CAPPS.

Recommendations

The Department should:

- Process its payments to vendors within 30 days after the later of receiving the goods, completion of the service, or receipt of the invoice for the goods or service.
- Consistently follow its procedures for processing payments.
- Develop and implement a process to reconcile transactions in CAPPS and USAS on a monthly basis.

Management's Response

Recommendation: Process payments to vendors within 30 days after the later of receiving the goods, completion of the service, or receipt of the invoice for the goods or service.

Management Response: *Management agrees. Staff will receive training to ensure understanding of Prompt Payment Law.*

Implementation Date: 31 January 2018

Responsible Party: Accounts Payable Manager

Recommendation: Consistently follow Department procedures for processing payments.

Response: *Management agrees. Current procedures will be revised so that processes are clear and streamlined to ensure payments are accurate and on time.*

Implementation Date: 31 March 2018

Responsible Party: Accounts Payable Manager

Recommendation: Develop and implement a process to reconcile transactions in CAPPS and USAS on a monthly basis.

Response: Management agrees. Management will identify and train personnel to be responsible for the reconciliation between USAS and CAPPS.

Implementation Date: 30 June 2018

Responsible Party: Accounts Payable Manager

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Military Department (Department) has processes and related controls to help ensure that it administers financial transactions in accordance with applicable statutes, rules, and Department policies and procedures.

Scope

The scope of this audit covered the Department's activities related to contracting, asset management, payments, and related information systems for the first nine months of fiscal year 2017 (September 1, 2016, through May 31, 2017).

Methodology

The audit methodology included collecting information and documentation; interviewing Department staff regarding financial and operational processes; testing documentation related to contracts, expenditures, and the Department's asset management; reviewing access to key financial systems; and analyzing and evaluating the results of audit tests.

Data Reliability and Completeness

Auditors used expenditure information in the Uniform Statewide Accounting System (USAS) and the Centralized Accounting and Payroll/Personnel System (CAPPS). Auditors (1) reviewed the query language for the CAPPS data, (2) reviewed the Department's user access to USAS and CAPPS, and (3) compared the data in USAS and CAPPS and determined that the data was sufficiently reliable for the purposes of this audit.

Auditors used the Department's contract data from CAPPS. As discussed in Chapter 1, the Department did not have a complete or accurate list in CAPPS of contracts it awarded from September 1, 2016, through May 31, 2017. Auditors compared the contract data to the contract information the Department reported to the Legislative Budget Board and compared selected information from the Department's contract files to the information in CAPPS. Auditors determined that some contract data in CAPPS contained incorrect award amounts and incorrect award dates, and it did not include at least one contract. The contract data was determined to be not reliable for the purposes of this audit. As a result, auditors created a list of contracts

using contract data in CAPPs and the contract data reported to the Legislative Budget Board. That was the most complete population available to auditors during the course of the audit; therefore, auditors used it for testing.

Sampling Methodology

Auditors selected a nonstatistical, random sample of 60 non-payroll payments from CAPPs designed to be representative of the population. Additionally, auditors selected a random sample of 12 transactions from the population of transaction differences between CAPPs and USAS. Test results may be projected to the population, but the accuracy of the projection cannot be measured.

Auditors selected a risk-based sample of eight contracts from the population of contracts that auditors developed. The sample items were not necessarily representative of the population; therefore, it would not be appropriate to project the test results to the population.

Auditors tested the entire population of assets the Department reported it acquired from September 1, 2016, through May 31, 2017.

Information collected and reviewed included the following:

- The Department's policies and procedures.
- Documentation related to the Department's contracts and expenditures.
- Expenditure data from CAPPs and USAS.
- Contract data from CAPPs.
- The Department's inventory of recorded assets in the State Property Accounting (SPA) system.

Procedures and tests conducted included the following:

- Interviewed Department staff to identify the Department's financial and operational processes, including financial and administrative internal controls.
- Tested documentation related to the Department's expenditures to determine compliance with the Department's policies and procedures and state laws and regulations.
- Tested documentation related to the Department's contracts to determine compliance with the *State of Texas Contract Management Guide* (version 1.16), state laws, and regulations.

- Reviewed the Department's purchases and identified a population of assets purchased. Tested that population against the assets listed on the Department's SPA report to determine compliance with the Department's procedures and state laws and regulations.

Criteria used included the following:

- Department policies and procedures.
- Office of the Comptroller of Public Accounts' *State of Texas Procurement Manual*, *State of Texas Contract Management Guide*, and *SPA Process User's Guide*.
- Texas Government Code, Chapters 403, 437, 2155, 2251, 2252, 2261, and 2262.
- Title 34, Texas Administrative Code, Chapters 5 and 20.
- Legislative Budget Board contract reporting requirements.

Project Information

Audit fieldwork was conducted from May 2017 through November 2017. 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:

- Becky Beachy, CIA, CGAP (Project Manager)
- Link Wilson (Assistant Project Manager)
- Michael Gieringer, CFE
- Taylor L. Huff
- Michael Edward Karnes, CPA
- Kelley Ngaide, CIA, CFE
- Michelle Ann Duncan Feller, CPA, CIA (Quality Control Reviewer)

- Brianna C. Pierce, CPA (Quality Control Reviewer)
- Michael Simon, MBA, CGAP (Audit Manager)

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

Table 3

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)/function(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.

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 Zerwas, House Appropriations Committee

The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Military Department

Major General John F. Nichols, Adjutant General

Mr. Bill Wilson, Executive Director



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