These are the minutes of the Texas Transportation Commission Audit Subcommittee quarterly meeting held May 25, 2011, in Austin, Texas. The meeting opened at 2:40 p.m. with the following members present:

Audit Subcommittee Members:

Fred Underwood	Commissioner, Audit Subcommittee Chair
Ted Houghton	Commissioner, Audit Subcommittee Member

Administrative Staff:

Steve Simmons, P.E.	Deputy Executive Director
Owen Whitworth	Audit Director
John Barton, P.E.	Interim Deputy Executive Director
Louis Carr, Jr.	Chief Information Officer
Dee Porter	Chief human Resources and Administrative Services Officer
David Casteel, P.E.	Assistant Executive Director for District Operations
Bob Jackson	General Counsel

Registration sheets listing others in attendance are on file with the Texas Department of Transportation Audit Office.

A public notice of this meeting containing all items on the proposed agenda was filed in the office of the Secretary of State at 1:10 p.m. on May 16, 2011, as required by Chapter 551 of the Government Code, referred to as "The Open Meetings Act".

Opening remarks were made by Commissioner Underwood.

Item 1. Approval of Minutes from May 25, 2011, Quarterly Meeting

Minutes were presented by Owen Whitworth, Audit Director, and approved by Commissioners Houghton and Underwood.

Item 2. Audit Restructuring Status

Owen Whitworth, Audit Director, reported on updates of the transfer of District, Division, Region (DDR) auditor administrative functions. The restructuring effort is well underway by completing Standard Operating Procedures (SOPs) for DDR Auditor administrative functions and reviewed by the auditors as well as the District Engineers, Division Directors, Region Directors (DEs/DDs/RDs). Their comments have been addressed and the final SOPs distributed May 13, 2011. A plan has been developed outlining the actions and dates required to affect the transfer by August 31, 2011, and the audit staff meets regularly to update/monitor the status of the implementation plan.

The SOPs include guidance on the functions of the following areas: General Services; Occupational Safety; Finance; Technology Services; and Human Resources Divisions.

The SOPs emphasize the continuity of the DE/DD/RD roles and responsibilities. DDR Auditors remain a member of the DE/DD/RD management teams and continue to be included in staff meetings and communications. DE/DD/RDs provide input to the annual audit plans and individual audits as well as input to the DDR Auditor's performance plans and evaluations. DDR

personnel will continue to provide support for computer access, equipment and supplies, pool vehicles, and safety.

Commissioner Underwood and Mr. Whitworth discussed ways that Louis Carr, Chief Information Officer (CIO), could help with the restructuring process. Mr. Whitworth stated that he has met with Mr. Carr to talk about current audit capabilities and the need to increase the expertise in Information Systems auditing.

Continuing Professional Education (CPE) was discussed and the required 40 hours of training and 24 hours of government related training per fiscal year that auditors must complete. Mr. Whitworth pointed out that training is available through the State Auditor's Office which is cost effective and relevant to auditors.

Steve Simmons, DED, Owen Whitworth, CAE, and Commissioner Underwood briefly discussed data verification of Primavera 6 and cell phone use in pool vehicles.

Item 3. Audit Peer Review Update

The 2010 Peer Review report of Internal and External Audit activities was issued in September 2010; forwarded to the Audit Subcommittee in October 2010; discussed at the February 23, 2011 quarterly subcommittee meeting, and a summary of corrective action was discussed.

The Audit Subcommittee requested a follow-up peer review to be completed by July 2011 by the original auditor, Johnny Alexander of the Oregon Department of Transportation.

Owen Whitworth reported on the implementation of new CPE training procedures and a CPE tracking database for both Internal and External sections. The development of file retention and file monitoring procedures has been put into place and files are being brought into compliance in External Audit. Donna Roberts, AIC, has gathered documentation to support the corrective action taken and sent electronically to Johnny Alexander for his review.

The revisions to the Audit Manual have been reviewed and forwarded to General Services Division (GSD) for publication. Audit tools, guidelines and quality assurance program guides have been updated.

Item 4. Internal Audits Completed, 3rd Quarter of FY 2011

There have been three audit reports issued this quarter. Each Auditor-in-Charge (AIC) presented information from their respective audit(s).

Paula Bishir-Jensen, AIC, reported on *Local Government (LG) Project Oversight Audit.* Paula Bishir-Jensen, AIC, Karin Faltynek, AIC, and Staff Auditors Cynthia Walker, Roger Stacey, Romy Grimmell and Vivian Cohn went to twelve districts to determine if oversight of Local Government Projects included sufficient controls to ensure compliance with applicable Federal, State and departmental laws, rules and guidance from FY 2008 through FY 2010.

While controls and SOPs are in place, there were six findings and recommendations: 1) Project oversight performed by districts lacked coordination and communication because there is not a centralized office to distribute information. Administration should dedicate staff as the LG project Office of Primary Responsibility (OPR) and place them at an organizational level with influence. 2) One district misused the driveway permit process to construct a turn lane which violated state law. Office of General Counsel (OGC) is drafting legislation to amend the law. 3) Some districts were inputting project data into the Miscellaneous Contract Information System (MCIS) (Financial Information Management System (FIMS), Segment 41) to track Advance Funding Agreements (AFAs) possibly causing distorted information. General Services

Division-Contract Services Section has directed district to not use MCIS/FIMS for that function and to delete any existing AFAs. 4) Some of the AFAs/contracts did not include all federally required language. There was no language allowing local entities to bill TxDOT during the project; subsequently they billed TxDOT after the project was complete. GSD-CSS should review and include appropriate federal language and reimbursement request language in all pass through sub-recipient contracts agency wide. 5) The project scope and cost information in some AFAs was insufficient for project management. GSD-CSS should make minor revisions to the current AFA budget page to include line items for all projects. 6) Some projects did not have Disadvantaged Business Enterprise (DBE) goals in place or in compliance. Office of Civil Rights (OCR) should coordinate with the districts when sending the Memorandum of Understanding (MOU) to the LG; create a transmittal log; maintain a record of their review of these bid proposals; research in-house options for electronic submissions, and coordinate the development of an electronic process with Technology Service Division (TSD).

Commissioner Underwood requested Paula Bishir-Jensen, AIC, to meet with him to discuss the Disadvantaged Business Enterprise aspects further at a later date.

Owen Whitworth, Audit Director, reported on the *Material and Test Audit;* however, Robert Manzo, AIC, conducted the audit. The Audit team members included Polita Flemming and Milan Hawkins, Staff Auditors.

This audit was postponed from January to September 2010 while Construction (CST) implemented changes in response to the State Auditor's Office A-133 audit results. Audit work resumed last fall although CST still had corrective to complete.

The objective was to determine whether materials are from approved sources, are sampled and tested in compliance with project requirements; material samplers are certified for the test performed; pay estimate approvals and processing are separated, and all American Recovery and Reinvestment Act (ARRA) special provisions are included and monitored in ARRA contracts.

The findings and recommendations include: 1) Not all sampling test results (performed after June 1, 2010) are shown in SiteManager. All test results should be recorded in SiteManager, and when using the Copy Sample option, the Master Sample ID should be clearly indicated. 2) The test recording process misrepresents the responsibilities assigned to individual(s) that perform the sampled by, tested by, reviewed by, and/or authorized by functions. The SiteManager Materials Management manual should address when the Area Engineer is deferring their authority to operational staff and scope of that assignment; the remarks field could be used on the test template to document an individual's participation. 3) Sample test deficiencies are not resolved in an expedient manner. The area office personnel should make it a practice to resolve deficiencies during the preparation of the monthly progress estimates. The district labs should synchronize with the Central Lab a more effective way to address Quality Monitoring related issues. Steve Simmons, DED, Commissioner Underwood and Mr. Whitworth discussed and clarified the documentation processes.

Six observations were presented for consideration in improving the efficiency of operations and when assessing updates to the Phase II Sampling and Testing guide.

Augustine Nwoko, Lead Auditor, reported on the *Centralization of Public Transportation Coordinator Function Audit.* The objective of this audit focused on the Public Transportation

Division's (PTN) procedures for managing the newly centralized Public Transportation Coordinators (PTCs).

The PTCs are charged with carrying out public transportation grant management activities by providing a contact in the field to administer state and federal grant agreements and contracts; provide project oversight and compliance monitoring; provide technical assistance to internal and external (transit agencies) and the public, and to facilitate coordination and planning efforts as required by the Federal Transit Administration.

Effective June 1, 2009, PTC duties were transferred from the districts to PTN. Before the transfer, there were 33 full time employees assigned to various levels of the public transportation duties in the districts. As a result 22 full time PTCs located in the field report directly to PTN.

There were two observations and recommendations: 1) SOPs for many key aspects of the new PTN structure have not been developed. Overall, PTN is heading in the right direction. It was recommended that SOPs be developed that document how the PTC structure is operating including the roles and responsibilities for the PTCs, supervision and division management, and monitoring tools for review of PTC work products that can be applied timely based on past performances. 2) Risk assessments for performing compliance monitoring under the new structure have not been updated. It is recommended that PTN perform a risk assessment of the existing PTCs and update its compliance monitoring schedule accordingly.

Item 5. Annual Report of Audit Subcommittee

The *Audit Subcommittee Charter* requires an annual report of activities. This report is a summary of subcommittee activities from May 2010 to May 2011.

Owen Whitworth, CAE, presented the annual report which covers: a) Financial Reporting and Internal Control; b) Internal Audit; c) Legal; d) Reporting Responsibilities, and e) Other Responsibilities.

OGC reported that the annual report has complied with this requirement.

It was suggested that in order to transmit the Annual Report of Audit Subcommittee, an accompanying cover letter should be signed by both Audit Subcommittee Members. Commissioners Underwood, Houghton and Mr. Whitworth agreed.

Item 6. Internal Compliance Program (ICP) Update

Steve Simmons, Deputy Executive Director and Internal Compliance Officer, presented the *Internal Compliance Program Update.*

The TxDOT Watch Program received 65 items during the period between February 2, 2011, and April 30, 2011. Of those 65 items, 43 reports were investigated; results reported and were closed out during this time period. The remaining cases are in the investigation process. Allegations in 10 reports were substantiated or partially substantiated.

There were safety issues, conflict of interest, gifts/benefits/favors and unprofessional conduct reported on. There was a technical issue with Chemtel who delivers the TxDOT Watch complaints. However Chemtel has been temporarily sending them in a different form. The Office of General Counsel and the Audit Office are also being kept informed by an email string while Chemtel's issues are being addressed.

Commissioner Underwood inquired about employee training. Mr. Simmons conveyed that training has elevated certain issues and employees are bringing forward instances of violations and employees have made great strides since the ethics training was put into place. Commissioner Underwood also asked if TxDOT is too restrictive on some behaviors; Mr.

Simmons and Bob Jackson agreed TxDOT is not too restrictive. Mr. Jackson commented that some penal codes are somewhat complicated, so if there are any questions about ethics violations, managers and employees are encouraged to call OGC for advice.

The Executive Internal Compliance Committee; (members include Steve Simmons, Deputy Executive Director; Bob Jackson, OGC Director; Owen Whitworth, Audit Director, George Ebert, Human Resources Division Director, and Suzanne Mann, OGC Attorney), has reviewed policies to see if policies were uniform and where changes may be needed.

Commissioner Houghton commended all the TxDOT managers for their monitoring. He went on to say that, "Out of all the ICP complaints, less than a quarter of one percent were substantiated. I think we're doing a good job. . . . The managers should be congratulated."

Item 7. Financial Audits Completed by the State Auditor's Office (SAO)

Sandra Vice, Assistant State Auditor, presented the staff members to present their respective audit(s). There have been four audit reports completed this year.

Angelica Ramirez, Audit Manager, reported on and oversaw the work on the *Central Texas Turnpike System Audit.* The objective was to issue opinions on the Central Texas Turnpike System's (System) and the Texas Mobility Fund's (Fund) basic financial statements for fiscal year 2010. The overall conclusion was the basic financial statements of the Texas Mobility Fund (Fund) for fiscal year 2010 were materially correct and presented in accordance with accounting principles generally accepted in the United States of America.

The SAO identified issues related to controls over the System's accounting and financial reporting processes that represented significant deficiencies in internal control. The SAO did not identify any issues that represented material weaknesses in controls over the System's financial reporting. The findings and recommendations were: 1) TxDOT did not depreciate six bridges (with a total cost $6.1 million) in a manner that was in conformity with generally accepted accounting principles. The six bridges belong to the System but were depreciated in the State Highway Fund (Fund), which is not part of the System. Use proper accounting methods; comply with all authoritative literature including bond covenants, and adequate resources to sufficiently research all applicable accounting standards as needed to obtain guidance on accounting and reporting issues. 2) TxDOT does not have a detailed, written manual specific to the System and its unique activities. A detailed written manual specific to the System is imperative if the System is to produce accurate and consistent financial statements. Develop and fully implement detailed written policies and procedures. Changes in procedures should be documented and approved in writing by management. 3) TxDOT incorrectly calculated its interest accruals and related line items. Because the items were not material, adjustments were not made to the financial statements as of August 31, 2010. Use consistent calculation methodologies for all year-end accrual entries, such as interest accruals. Recommendations include: Enter transactions from source documentation and discontinue the practice of entering transactions as a compilation of monthly activity. Reconcile all activity from the System's general ledger to source documentation, and ensure that all such reconciliations are done a monthly basis and are fully supported. Ensure that supervisory reviews of the System's posted transactions occur on a timely basis and that the reviews are adequately documented. 4) Management should ensure that prior audit recommendations are adequately addressed. TxDOT has not implemented seven of the eight prior recommendations included in the August 31, 2009 report (SAO Report No.10-022, February 2010). 5) Management should ensure that the System is in compliance with its bond covenants. Information should not be comingled in the System. 6) TxDOT employees

should be adequately trained. Discontinue the practice of maintaining two sets of accounting records and rely exclusively on the System's accounting system of record. This is only related to the Central Texas Turnpike System.

Discussion included how bridges are funded, depreciated, the maintenance of, and the requirements to have a list of assets to be depreciated. Follow-up on the audits and solutions to correct issues were also discussed. It was also noted that each deficiency was not significant; however, cumulatively they were. Steve Simmons, DED, commented that recommendations were previously discussed during the exit meeting with the SAO auditors. Ms. Vice also commented that any time during an audit at TxDOT, the SAO would be happy to brief the Commission.

Bill Hunter, Project Manager, presented the *Comprehensive Annual Financial Report (CAFR).* The basic financial statements presented in CAFR for the State of Texas present fairly, in all material respects, the financial position and activities of the State for the fiscal year ended August 31. 2010.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

TxDOT did not include five completed pass-through toll roads totaling $189 million, which understated fiscal year 2010 capital assets by $9 million, and $365 million in construction (in progress) for roads under pass-through toll agreements. TxDOT did not adequately report $1 billion in bonds issued through the Texas Private Activity Bond Surface Transportation Corporation. TxDOT should improve the process for identifying and reporting bridges. Lastly, auditors identified significant deficiencies in system access and password management.

Brian Ragland, Finance Director, contributed to the discussion and noted that the Governmental Accounting Standards Board has not provided guidance on these issues.

Commissioner Houghton recommended that staff should take the State Auditor's recommendations and report completed roads as an asset liability until the Governmental Accounting Standards Board and the State Comptroller's Office weighs in. Commissioner Underwood concurred and requested Mr. Ragland to keep the subcommittee informed of the State Comptroller's decision.

Audrey O'Neill, Project Manager presented the *Statewide (Federal) Single Audit.*

As a condition of receiving federal funds, the State is required to obtain an annual audit of federal funds. The objective of the audit was to determine whether the State complied with federal regulations and had appropriate internal controls over two programs. Ms. O'Neill explained the types of finding and opinions for the subcommittee: Internal Control Findings, Compliance Findings and Opinions.

Highway Planning and Construction Cluster of federal programs; TxDOT spent $2.4 billion in federal finds in fiscal year 2010. Generally, the State complied in all material respects with federal requirements. TxDOT had material control weaknesses and material non-compliance in two areas tested: TxDOT did not communicate required award information to its subrecipients, and it did not always monitor its subrecipients (local project oversight) to ensure that they complied with all federal requirements. TxDOT did not always ensure that it tested materials as required by its approved quality assurance program. Control weaknesses also existed in SiteManager.

Auditors also identified three findings involving internal control weaknesses and non-compliance that were not material to the Highway Planning and Construction Cluster of federal programs. TxDOT did not always ensure that its contractors submitted payroll certifications as required by the Davis-Bacon Act. TxDOT has a significant backlog in the project completion reports (PR-20) that it must submit to the Federal Highway Administration. TxDOT also incorrectly reported some expenditures funded by the ARRA (Recovery Act). There were some significant improvements from fiscal year 2009 to fiscal year 2010. Some programmers for TxDOT's Federal Project Authorization and Agreement system had access to move system code into the production environment, which represented a violation of segregation of duties.

Airport Improvement Program; TxDOT spent $79.4 million in federal funds in fiscal year 2010. The State complied in all material respects with federal requirements for the Airport Improvement Program during fiscal year 2010. As a result, our opinion on compliance for this program was unqualified.

TxDOT did not ensure that its vendors or contractors were not suspended or debarred from federal procurements; could not provide support for one financial report that was submitted to the FAA; incorrectly reported airports as subrecipients of Recovery Act funds when the Department actually had made direct expenditures to benefit those airports, and did not consistently monitor its airport sponsors in accordance with its FAA approved policy to detect revenue diversion.

Prior Year Follow-up Results: The SAO followed-up on 13 findings. The department fully implemented corrective action plans for three findings and partially implemented corrective action plans for ten findings.

Mr. Whitworth proposed that if there was a due date for SAO's audit findings to be implemented, to have the Audit Office follow-up a month before and a status update would then be included in the Audit Subcommittee monthly report.

Closing Comments:

Commissioner Underwood stated that the next Audit Subcommittee meeting will be held August 24, 2011. The members thanked all for attending the meeting.

The meeting adjourned at 4:22 p.m.

APPROVED:

Fred Underwood

Commissioner Fred Underwood, Chair
Texas Transportation Audit Subcommittee