Internal Audit Report

Tolling Facilities- Federal Reporting

TxDOT Internal Audit Division
Objective
To determine if TxDOT is in compliance with federal reporting requirements in obtaining annual verification of all statewide tolling facilities expenditures of toll revenues and maintenance certifications ending June 30, 2017.

Opinion
Based on the audit scope areas reviewed, control mechanisms are effective and substantially address risk factors and exposures considered significant relative to impacting reporting reliability, operational execution, and compliance. The organization's system of internal controls provides reasonable assurance that most key goals and objectives will be achieved despite significant control gap corrections and improvement opportunities identified. Control gap corrections and improvement opportunities identified are likely to impact the achievement of the organization's business/control objectives, but management has agreed to corrective action plans to address the relevant risks within six months.

Overall Engagement Assessment
Satisfactory

<table>
<thead>
<tr>
<th>Finding</th>
<th>Control Design</th>
<th>Operating Effectiveness</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finding 1</td>
<td>Annual Validation of Tolling Facilities Expenditures and Maintenance Certification</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Management concurs with the above finding and prepared management action plan to address deficiencies.

Control Environment
Tolling facilities, which are defined as roads, bridges, tunnels, or ferries that charge a fee (or toll) for use, must comply with annual reporting requirements included in 23 U.S.C. § 129(a)(3), which governs federal participation in toll activity. During Fiscal Year (FY) 2016, collection of annual maintenance certifications and audited financial statements transitioned from the Toll Operations Division (TOD) to the Project Finance, Debt & Strategic Contracts Division (PFD). In November 2016, PFD developed procedures for collecting, tracking, and verifying the tolling facilities annual certification of maintenance and financial information required to comply with federal regulations.

To facilitate the annual collection and verification process, PFD developed a web-based document management system that easily allows the tolling facility to upload required documentation and accommodates a streamlined federal review and approval process for compliance with 23 U.S.C. § 129(a)(3). Each tolling facility owner/operator uploads the annual audited financial statement, maintenance verification, and maintenance certification during the annual collection period in June each year. FHWA acknowledged PFDs advancement of this federal reporting requirement.
Summary Results
Audit testing completed requiring management action.

<table>
<thead>
<tr>
<th>Finding</th>
<th>Scope Area</th>
<th>Evidence</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>Federal Reporting</td>
<td>Review of the annual collection process and tolling facilities documentation received as of June 30, 2017 noted the following:</td>
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<tr>
<td></td>
<td></td>
<td>• 11 of 26 (42%) tolling facilities had not yet uploaded their audited financial statement information and maintenance certifications</td>
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<tr>
<td></td>
<td></td>
<td>• TxDOT’s annual verification of supporting documentation provided by tolling authorities had not been completed at the time of testing</td>
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Audit testing completed not requiring management action.

<table>
<thead>
<tr>
<th>Scope Area</th>
<th>Evidence</th>
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<tbody>
<tr>
<td>Federal Reporting</td>
<td>PFD created a process to maintain compliance with Federal Highway Administration (FHWA) reporting requirements including:</td>
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<td></td>
<td>• Section 129 Compliance Monitoring Procedures and Checklist</td>
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<td></td>
<td>• List of tolling facilities with federal participation subject to 23 U.S.C. § 129(a)(3)</td>
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<tr>
<td></td>
<td>• An automated web-based document management system</td>
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<td></td>
<td>• Annual reporting period in June each year</td>
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Audit Scope
The audit scope focused on TxDOT’s responsibility for reporting maintenance verifications, certifications, and financial audits of federally funded toll facilities to the Federal Highway Administration (FHWA) as required by federal law in 23 U.S.C. § 129(a)(3).

Scope 1: Federal Reporting - tested reporting of annual audited financial statements and maintenance certifications for 26 Texas Toll road facilities identified as of May 31, 2017.

The audit was performed by Rita Ruiz and Cynthia Scheick (Engagement Lead). The audit was conducted during the period from May 5, 2017 to July 10, 2017.

Methodology
The methodology used to complete the objectives of this audit included:

• Examination of federal law, specifically 23 U.S.C. § 129(a)(3)
• Review of PFDs Section 129 Compliance Monitoring Procedures
• Interviews with the Strategic Contract Section Director, Procurement Program Manager and Program Controls Manager within PFD and Toll Operations Specialist with TOD to gain an understanding of the process for collection and review of maintenance verifications, certifications, and financial statements required for 23 U.S.C. § 129(a)(3) compliance
Review of PFD’s list of tolling facilities with federal participation subject to 23 U.S.C. § 129(a)(3)
Examination of maintenance certifications and audited financial statements of toll facilities obtained during the audit

**Background**

This report is prepared for the Texas Transportation Commission and for the Administration and Management of TxDOT. The report presents the results of the Tolling Facilities – Federal Reporting audit which was conducted as part of the Fiscal Year (FY) 2017 Audit Plan.

For a tolling facility to be eligible for federal participation, there are limitations on the types of expenses that can be made using revenues received from its operation. Subject to verification through an annual audit, the limitations on a tolling facility’s expenditures of toll revenues includes:

- Debt service, including the funding of reasonable reserves and debt service on refinancing
- A reasonable return on investment of any private person financing the project
- Any costs necessary for the improvement and proper operation and maintenance of the toll facility
- If the toll facility is subject to a public-private partnership, payment of revenues owed to the other party under the relevant public-private partnership agreement
- If the public authority certifies annually that the tolled facility is adequately maintained, revenues can be spent for any other purpose for which federal funds may be obligated by a state under title 23, U.S.C.

Annually, public authorities with jurisdiction over tolling facilities are responsible for an audit that attests that their toll facility was adequately maintained and that facility expenditures complied with limitations specified in the law. TxDOT is required to provide results of the audits to FHWA, retain the audit reports, and make them available for audit by the FHWA.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the International Standards for the Professional Practice of Internal Auditing. 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. Recommendations to mitigate risks identified were provided to management during the engagement to assist in the formulation of the management action plans included in this report. The Internal Audit Division uses the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework version 2013.

A defined set of control objectives was utilized to focus on reporting, operational, and compliance goals for the identified scope areas. Our audit opinion is an assessment of the health of the overall control environment based on (1) the effectiveness of the enterprise risk management activities throughout the audit period and (2) the degree to which the defined control objectives were being met. Our audit opinion is not a guarantee against reporting misstatement and reliability, operational sub-optimization, or non-compliance particularly in areas not included in the scope of this audit.
Detailed Finding and Management Action Plans (MAP)

Finding No. 1: Annual Validation of Tolling Facilities Expenditures and Maintenance Certification

Condition
Completion of the annual verification of supporting documentation provided by public authorities of tolling facilities expenditures of toll revenues and maintenance certifications, per compliance with 23 U.S.C. § 129(a)(3)(B), has not occurred for the collection cycle beginning June 30, 2017.

Effect/Potential Impact
Federal Highway Administration (FHWA) would not be able to ascertain if all statewide tolling facilities had provided the necessary information to assess their compliance with expenditures of toll revenues and maintenance certification requirements per federal code. This could result in the discontinuance of toll collection by FHWA for those tolling facilities who did not comply.

Criteria
23 U.S.C. § 129(a)(3)(A) provides limitations on the use of toll revenues to include debt service, funding of reasonable reserves, a reasonable return on investment of any private person financing the project, for the costs necessary for the improvement and proper operation and maintenance of the toll facility, and for payment owed to other parties by the party holding the right to toll revenues under a public-private partnership agreement.

In addition, 23 U.S.C. § 129(a)(3)(B) states that “A public authority with jurisdiction over a toll facility shall conduct or have an independent auditor conduct an annual audit of toll facility records to verify adequate maintenance and compliance with subparagraph (A) noted above, and report the results of the audits to the Secretary.

Cause
Toll Operations Division (TOD), which had collected toll facility documentation on a rolling basis, stopped collecting the financial and maintenance documentation when the responsibility was transferred to Project Finance, Debt & Strategic Contracts Division (PFD) in March 2016. PFD initiated an annual process to collect and verify the tolling facilities documentation in October 2016; however, collection of documentation did not start until June 1, 2017.

Evidence
On June 1, 2017 PFD implemented an annual process to collect audited financial statements and maintenance certifications for the prior 12-month period. The following was noted based on review of the new process and documentation collected as of June 30, 2017:

- 11 of 26 (42%) tolling facilities had not uploaded their audited financial statement information and maintenance certifications
- TxDOT’s annual verification of supporting documentation provided by tolling authorities had not been completed at the time of testing
Management Action Plans (MAP):

MAP Owner: Benjamin Asher, Director, Project Finance, Debt & Strategic Contracts Division

MAP 1.1: Project Finance, Debt & Strategy Contracts Division (PFD) will complete their verification of supporting documentation provided by public authorities in accordance with procedures and take action on any non-compliance issues with 23 U.S.C. § 129(a)(3) as interpreted by TxDOT.

Completion Date: January 15, 2018

MAP 1.2: Project Finance, Debt & Strategy Contracts Division (PFD) will confirm with the Federal Highway Administration (FHWA) their interpretation and intent for TxDOT’s process for 23 U.S.C. § 129(a)(3).

Completion Date: Action Completed

MAP Owner: Amanda Landry, Accounting Section Director, Finance Division

MAP 1.3: The Financial Management Division will complete the following:

- Prepare Toll Revenue and Expenditures Report (Report) for fiscal 2017 and annually thereafter for TxDOT owned unaudited toll facilities
- Submit Report to external financial statement auditors to perform agreed upon procedures engagement
- Prepare a management summary of policy for compliance with, 23 U.S.C. § 129(a)(3) on the unaudited facilities signed by Director of Accounting
- Provide completed Report, agreed upon procedures report and management summary to PFD for upload to Section 129 Sharepoint site
- Provide audited financial statements for TxDOT owned toll facilities subject to annual financial audits to PFD for review and upload to Section 129 Sharepoint site

Completion Date: January 15, 2018
**Observation and Recommendation**

**Audit Observation (a): Prior Year Compliance with 23 U.S.C. § 129(a)(3)**
Due to the development and initiation of a new process in June 2017, Project Finance, Debt & Strategy Contracts Division (PFD) should look to implement this process for prior year compliance with 23 U.S.C. § 129(a)(3).

**Effect/Potential Impact**
Federal Highway Administration (FHWA) may request this documentation and might not be able to ascertain if all state-wide tolling facilities had provided the necessary information and that it was verified per the federal code. In the event FHWA determines insufficient documentation or verification exists, FHWA could take action that may result in the discontinuance of toll collection for those tolling facilities.

**Recommendation**
Continue to work with FHWA to understand their expectation for the application of the new process to be applied to prior years.
## Summary Results Based on Enterprise Risk Management Framework

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<th>ERM Component</th>
<th>Control Activities</th>
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<td>Business Objective/Goal-Setting</td>
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<td>Supporting Evidence/Records Retention</td>
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<td>Segregation of Duties/System Access</td>
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<td><strong>Monitoring</strong></td>
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<td><strong>Scope Area Assessment</strong></td>
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### Closing Comments

The results of this audit were discussed with/provided to the Project Finance, Debt & Strategic Contracts Division (PFD) Director on August 17, 2017. The Internal Audit Division appreciates the cooperation and assistance received from PFD during this audit.