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State Auditor

# The Audit of the Department of Transportation's Central Texas Turnpike System's Financial Statements For the Fiscal Year Ended August 31, 2009

A Report on

February 8, 2010

Members of the Legislative Audit Committee:

In our audit report dated December 18, 2009, we determined that the Department of Transportation's (Department) Central Texas Turnpike System's (System) basic financial statements for fiscal year 2009 were materially correct and presented in accordance with accounting principles generally accepted in the United States of America.

We also issued a report on internal control over financial reporting and on compliance and other matters as required by auditing standards. Our procedures were not intended to provide an opinion on internal control over financial reporting or to provide an opinion on compliance with certain provisions of the resolution for the System's revenue bonds, bond anticipation notes, and other laws and regulations. Our procedures did not identify any instances of noncompliance that materially affected the financial statements.

However, we identified issues related primarily to controls over the System's financial reporting that represented significant deficiencies in internal control. Those are discussed below. We did not identify any issues that represented material weaknesses in controls over the System's financial reporting.

A *significant deficiency* is a deficiency, or combination of deficiencies, that results in a more than remote likelihood that a more than inconsequential misstatement of the financial statements will not be prevented or detected by the entity's internal control. A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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

## Background Information

The Texas Turnpike Authority was created by Chapter 361 of the Texas Transportation Code and is governed by the Texas Transportation Commission (Commission). The Central Texas Turnpike System (System), which is controlled and governed by the Commission, presently consists of a single "2002 Project," which includes three elements: State Highway 45 North; Loop 1; and State Highway 130, sections 1-4. In the future, the System may also include projects to expand, enlarge, or extend the System pursuant to the Texas Turnpike Act.

The first of the System's tollways opened during fiscal year 2006; in April 2008, the last remaining segment of the 2002 Project was opened. The System reported \$66.4 million in toll revenues for the year ended August 31, 2009.

In August 2002, the Commission issued approximately \$2.2 billion in revenue bonds and bond anticipation notes to fund the development and construction of the 2002 Project. Bond indentures require the Commission to provide audited annual financial statements for the System.

As of August 31, 2009, the System had \$1.5 billion in revenue bonds outstanding and a \$972 million TIFIA (Transportation Infrastructure Finance and Innovation Act of 1998) note.

The Department should improve its internal controls over the System's accounting processes.

The design of the Department's accounting processes continues to contain elements that, when combined, create significant deficiencies in internal control. A discussion of these elements follows.

#### Procedures for the Implementation of New Accounting Software

During fiscal year 2009, the Department replaced the spreadsheets it used to maintain the System's general ledger and conduct financial reporting with a commercially produced financial accounting application. While this should strengthen the Department's future controls over its general ledger and financial reporting, auditors identified issues related to the Department's implementation of the application, supervisory oversight, and use of the application's built-in control processes. Specifically:

- To set up the new application, the Department entered beginning balances from the prior year ending (balance sheet) balances reflected in the August 31, 2008, audited financial statements. However, the beginning balance entries did not agree with the August 31, 2008, audited financial statements on a line item basis. While all variances netted to zero, individual line items did not accurately reflect the prior year audited financial statements. For example, net asset balances varied among net asset line items by as much as \$143,000,000. Accurately entering beginning balances helps to ensure that ending financial statement balances are reliable and accurate.
- The System currently has 23 separate bank accounts. However, the accounting application has 7 individual line items that compile various activities for these 23 separate accounts. Entering transactions in the aggregate does not allow the Department to utilize many of the application's built-in controls, such as the bank reconciliation function. In addition, not segregating the accounts makes it more difficult to track and maintain individual bank balances.
- The application produces an audit trail; however, there is no review of deleted or voided transactions. Reviewing deleted or voided transactions helps to ensure that those deletions or voids were intended and allowable, and that their omission will accurately depict the System's activity.
- Employees did not receive any formal training on the use of the new application. Formal training may have alleviated many of the issues noted previously.

#### Procedures for the Timeliness and Compilation of Accounting Entries

Last fiscal year, in *A Report on the Audit of the Department of Transportation's Central Texas Turnpike System Financial Statements for the Fiscal Year Ended August 31, 2008*, (State Auditor's Office Report No. 09-016, January 2009), auditors recommended that the Department enter all transactions as close as possible to the transaction date, at least monthly.

However, the Department did not implement this recommendation. While a few of the transactions were entered prior to year end, the majority of transactions, including expenses paid from the State Highway Fund (Fund 006), toll transactions, customer deposit account activity, and investment transactions, were not entered into the accounting application until after the end of fiscal year 2009.

The Department currently compiles manual journal entries whose supporting documentation consists of a collection of bank statements and automated systems that are not integrated with the System's general

ledger or the Department's accounting system. Each of these journal entries comprises a month's worth of activity, rather than activity on a transaction-by-transaction basis. For example, to record toll and investment transactions for a particular month, Department personnel (1) identify all transactions for the month from the System's 23 bank statements and reports from the toll application and (2) prepare journal entries to record these transactions in the general ledger. Entering data from source documentation rather than from a compilation enhances the reliability of reconciliations and account balances and helps to ensure that individual transactions are traceable and supportable.

Two fiscal years ago, auditors recommended in *A Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards* (State Auditor's Office Report No 08-311, December 2007), that the Department enter transactions from source documentation at the time of execution. However, due to the limitations of the System's previous spreadsheet-based general ledger, real-time or batch process accounting, which are accepted accounting practices, were not feasible. However, with its recent implementation of the commercially produced financial accounting application, the Department should make every attempt to implement the 2007 recommendation.

#### Security Controls Over the System's General Ledger

The System's financial accounting application requires the individual with administrator rights to perform the month-end close function. However, the Department assigned administrator rights to the same individual who was responsible for entering transactions. As a result, in order for a supervisor to complete the month-end close function, the individual responsible for entering transactions logged into the application and then allowed the supervisor to perform the close. Because the login account used to perform the month-end close function belonged to the individual responsible for entering transactions, auditors could not determine whether a supervisor actually performed the close function. The Department has since assigned administrator rights to an individual with a supervisory role.

#### Reconciliation of Revenue Transactions

Last fiscal year, in *A Report on the Audit of the Department of Transportation's Central Texas Turnpike System Financial Statements for the Fiscal Year Ended August 31, 2008*, (State Auditor's Office Report No. 09-016, January 2009), auditors recommended that the Department review existing reconciliation procedures and develop additional reconciliation procedures. The recommendations included, but were not limited to, performing reconciliations to ensure that all revenue earned from any transaction source—including cash, electronic tag, pay by mail, service center collections, and external toll entities—is collected, deposited, and recorded in the System's general ledger. The Department did not fully implement this recommendation. While the Department implemented numerous reconciliations between portions of the toll systems and the customer deposit account, the reconciliations being performed do not ensure that deposits into the System's bank accounts represent all revenue earned. For example:

- Reconciliations occur between bank accounts and the toll application during the preparation of journal entries before these entries are entered into the general ledger. As a result, there is no reconciliation of the general ledger to source documentation. If expected revenue transactions are not reconciled with deposits and recorded in the general ledger, this increases the risk that misstatements may not be detected.

- The customer deposit account reconciliation was performed on an inception-to-date basis. Therefore, auditors were unable to determine whether the reconciliations accurately reflected the prior year activity. The customer deposit account reconciliation is important because the customer deposit account includes all cash on deposit from TxTag account holders and any untransferred amounts that have been earned and collected from toll revenues for all toll roads, some of which are toll roads operated by other entities (see text box). The System records all customer account activity in its general ledger, in effect acting as trustee for those amounts belonging to TxTag depositors and other toll entities.
- Auditors were not able to test the reconciliation between the toll applications and amounts billed or collected from the System's non-TxTag partners (partners) because, according to the Department, the reconciliation was accidentally deleted from an employee's computer. Performing and safeguarding these reconciliations are important because the amounts earned do not always agree with the amounts collected (see the next bullet point). In addition, this was the second year that an accidental deletion occurred with the partner reconciliation and, as a result, auditors were unable to test the reconciliation.
- The amounts that the Department transfers from partner revenues from the customer deposit account to the System's revenue account do not agree with the amounts invoiced and collected. At month end, the System and its partners review partner transactions and create a bill, which the partners usually pay within six weeks. However, the Department has already recorded the amount it expected to receive from its partners based on reported activity, and the bill produced is rarely the same as the amount that the Department has transferred out of the customer deposit account. While the variances noted were not material to the System's financial statements as a whole, future amounts may become material as additional toll roads are added and toll road usage increases.

#### Toll Authorities

Toll users may purchase a TxTag that automatically charges toll fees when the roadways are used. TxTags are used on a variety of toll roads, many of which are not operated by the System. Examples of toll roads not operated by the System include the State Highway 183A toll road operated by the Central Texas Regional Mobility Authority, and the Camino Colombia Toll Road, the Loop 49 Toll Road, and the State Highway 45 Toll Road, which are all operated by the Department.

In addition to the above toll roads, the System has a partnership agreement with two other toll authorities that have their own toll tag systems. This partnership agreement allows tag holders from all systems to drive on all state tollways without having to own separate tags. The two authorities in the partnership are the Harris County Toll Road Authority and the North Texas Tollway Authority.

#### Supervisory Review of Accounting Entries

There was no evidence that a supervisory review was conducted once transactions had been posted into the System's financial accounting application. Without an independent review of transaction data, misstatements like the beginning balance variances discussed above may not be detected. The importance of performing independent reviews of all manual entries used in the reporting process also was communicated to the Department in *A Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards* (State Auditor's Office Report No. 09-307, December 2008).

#### Reporting Bridges as Capital Assets Depreciable

The Department relies on an internal structure based at the district and area offices to ensure that it records all bridge structures as capital assets depreciable. However, because of weaknesses in the design and operation of these internal controls, the Department did not record all bridge structures as Capital Assets Depreciable.

Auditors identified four bridges on System tollways that were in the Department’s Bridge Inspection and Appraisal System that the Department omitted from Capital Assets Depreciable on its financial statements for fiscal year 2009 and previous fiscal years. According to the Department, the total value of those bridges was \$5,493,000, and the resulting Accumulated Depreciation and Depreciation Expense was \$282,060 in fiscal year 2009. These amounts did not materially affect the System’s financial statements as a whole. In addition, the System has since made all necessary corrections; therefore, the System’s financial statements for the year ended August 31, 2009, have been accurately reported.

It should be noted that this issue applies to the Department as a whole and is not specific to the System. As part of its Statewide Single Audit Report for the fiscal year ended August 31, 2009, to be released later this year, the State Auditor’s Office will discuss the Department’s ability to accurately record and report bridges as Capital Assets Depreciable, including bridges on System tollways, and the affect on the Department’s financial statements as a whole.

**Implementation of Prior Year Recommendations**

Overall, the Department has not fully implemented recommendations included in *A Report on the Audit of the Department of Transportation’s Central Texas Turnpike System Financial Statements for the Fiscal Year Ended August 31, 2008* (State Auditor’s Office Report No. 09-016, January 2009). Table 1 lists the implementation status of each prior recommendation.

Table 1

Implementation Status of Fiscal Year 2008 Recommendations As of December 2009	
Fiscal Year 2008 Recommendation	Implementation Status
The Department should review its methodology and processes for preparing financial statements in accordance with generally accepted accounting principles.	Not Implemented. (See discussion above.)
The Department should enter all transactions into its general ledger and customer deposit account spreadsheets as close as possible to the transaction date, at least monthly.	Not implemented. (See discussion above.)
The Department should implement security measures to protect information in the general ledger and customer deposit account activity spreadsheets after they have undergone review, such as a password and write-protecting cells containing data.	Partially implemented. The System has increased security over the general ledger by purchasing financial accounting application software, which has built-in protection after an accounting period has been closed. However, the System lacks adequate security measures over reconciliations
The Department should review existing procedures and develop additional procedures including, but not limited to, reconciliations to ensure that all revenue earned from any transaction source—including cash, electronic tag, pay by mail, service center collections, and external toll entities—is collected, deposited and recorded in the System’s general ledger.	Partially implemented. (See discussion above.)
The Department should perform independent reviews of all manual entries that are used in the reporting process, regardless of how the entries are compiled and stored.	Not implemented. (See discussion above.)

## Recommendations

The Department should:

- Record each bank account separately in the System's general ledger and develop and implement procedures for utilizing the application's built-in bank reconciliation function.
- Develop and implement procedures for:
  - ♦ Conducting regular supervisory reviews of deleted and voided transactions.
  - ♦ Entering transactions from source documentation and discontinuing the practice of entering transactions as a compilation of monthly activity.
  - ♦ Reconciling all activity from the System's general ledger to source documentation, such as bank statements and reports from the System's toll application.
  - ♦ Ensuring that all reconciliations are done on a monthly basis, are fully supported, and are protected from deletion.
  - ♦ Ensuring that it reports all bridges as Capital Assets Depreciable.
  - ♦ Transferring and recording partner revenues and ensuring that all amounts recorded and transferred from the customer deposit account reconcile to the amounts invoiced to the System's partners each month.
- Ensure that supervisory reviews of the System's posted transactions occur and that the reviews are documented.

### Summary of Objective, Scope, and Methodology

The objective of the audit was to issue an opinion on the System's basic financial statements for fiscal year 2009.

The audit scope covered the System's basic financial statements for fiscal year 2009.

The audit methodology included interviewing personnel, reviewing relevant laws and regulations, reviewing information systems, and performing analyses and tests of financial statement balances and transactions.

The audit was conducted in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

The following staff of the State Auditor's Office performed the audit:

- Mary Ann Wise, CPA, CFE (Project Manager)
- Mary Goldwater (Assistant Project Manager)
- Rebekah Cartwright
- Roger Ferris, CPA
- Elizabeth Hunt
- Ashlee C. Jones, MAcy, CGAP, CFE
- Anthony W. Rose, MPA, CPA, CGFM
- Michael A. Simon, MBA, CGAP
- Kamal Malik, CPA (Information Systems Audit Team)
- Serra Tamur, MPAff, CIA, CISA (Information Systems Audit Team)
- Leslie Ashton, CPA (Quality Control Reviewer)
- Verma Elliott, MBA, CIA, CGAP (Audit Manager)

## Management's Response

*The Department concurs with the audit recommendations and will complete the recommended actions by May 31, 2010.*

*Responsible Title: Finance Division Director*

We appreciate the cooperation we received from the Department. If you have any questions, please contact Verma Elliott, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA  
State Auditor

Attachment

cc: Members of the Texas Transportation Commission  
Ms. Deirdre Delisi, Chair  
Mr. Ned S. Holmes  
Mr. Ted Houghton  
Mr. William Meadows  
Mr. Fred Underwood  
Mr. Amadeo Saenz, Jr., P.E., Executive Director, Department of Transportation



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