

December 30, 1997

Members of the Legislative Audit Committee
and
Mr. James McCarley, Executive Director
North Texas Tollway Authority
P.O. Box 190369
Dallas, Texas 75219

In accordance with the provisions of Section 8.02 of Senate Bill 370, passed by the 75th Legislature, the State Auditor's Office has determined that the North Texas Tollway Authority should pay \$14,760,056 to the Texas Turnpike Authority Division of the Texas Department of Transportation. The amount of the payment was determined as a result of our audit of funds maintained by the Texas Turnpike Authority using the audit criteria specified by Section 8.02 (c) of Senate Bill 370.

The objective of this audit was to identify all funds in the possession of the Texas Turnpike Authority (Turnpike Authority) as of August 31, 1997, that belong to the Texas Turnpike Authority Division of the Department of Transportation (Turnpike Division). Effective September 1, 1997, the Turnpike Authority was abolished and the Turnpike Division was created. Also effective September 1, 1997, the North Texas Tollway Authority (Tollway Authority) was established. The Tollway Authority succeeded to specifically designated assets, rights, and other property, and assumed all related duties and obligations of the Turnpike Authority. All other assets, rights and obligations of the Turnpike Authority are to be transferred to the Turnpike Division. Our audit was based solely on funds in the Turnpike Authority's possession as of August 31, 1997, and does not include an analysis of the changes in fund equity that have taken place subsequent to that date.

The evidence we reviewed establishes that a payment by the Tollway Authority of \$14,760,056, would not adversely affect its financial compliance with all bond resolutions, bond indentures, credit agreements, and all other agreements assumed by the Tollway Authority. Additionally, a payment of \$14,760,056 would not adversely affect the Tollway Authority's ability to meet its obligations or jeopardize its bond ratings.

Attachment A provides more information on the objective, scope, and methodology of the audit; Attachment B outlines the flow of funds through the Turnpike Authority.

If you require additional information regarding this audit, please contact Frank Vito, Audit Manager, at 479-4700.

Sincerely,



Lawrence F. Alwin, CPA
State Auditor

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Attachments

SAO Report No. 98-015

Objectives, Scope, and Methodology

The objective of the review was to:

Identify all funds in the possession of the Texas Turnpike Authority (Turnpike Authority) that belong to the Texas Turnpike Authority Division of the Texas Department of Transportation (Turnpike Division).

The scope of the audit focused on funds in the possession of the Turnpike Authority as of August 31, 1997.

To accomplish our objective we employed the following methodology:

- **Statutory Interpretation**

Section 8.02 of Senate Bill 370 includes the following provision:

SECTION 8.02(c)

The state auditor's office shall, in consultation with the comptroller, conduct an audit of the records of the Texas Turnpike Authority. The state auditor may contract with a private entity to perform the audit required by this section. The audit must identify all funds in the possession of the Texas Turnpike Authority that belong to the Texas Turnpike Authority Division of the Texas Department of Transportation. The audit must be completed not later than December 31, 1997 and the (North Texas Tollway Authority) shall make any payment required to the department not later than August 31, 1999.

The payment is the amount determined by the audit to be in excess of funds required for compliance with all bond resolutions, bond indentures, credit agreements, and all other agreements assumed by the authority and that reserves held by the authority as required under or in connection with the resolutions, indentures, credit agreements, and other agreements are maintained at a level consistent with the Texas Turnpike Authority's historical practices. In determining the payments to be made under this subsection, the state auditor shall ensure that following the payment, the authority is in financial compliance with all bond resolutions, bond indentures, credit agreements, and all other agreements assumed by the authority and that reserves held by the authority as required under or in connection with the resolutions, indentures, credit agreements, and other agreements are also maintained at a level consistent with the Texas Turnpike Authority's historical practices.

This section of Senate Bill 370 vests the State Auditor with the responsibility of developing an appropriate audit methodology to determine the amount of the payment.

By following accepted rules of statutory construction, we have attempted to determine the Legislature's intent by focusing on the language in Senate Bill 370 as finally passed. Where necessary, we have reviewed the legislative history of Senate Bill 370 as a secondary source of guidance. The statute establishes a two-step process to calculate the amount of the North Texas Tollway Authority's (Tollway Authority) payment to the Turnpike Division.

The first step is to identify funds that the Tollway Authority is entitled to retain to ensure compliance with all bond resolutions, bond indentures, credit agreements, and all other agreements assumed by it. With the exception of the Capital Improvement Fund, all funds in the possession of the Turnpike Authority as of August 31, 1997, are required to be maintained under trust agreements or are otherwise dedicated for specific purposes. Our analysis of these funds identified no unusual transactions in anticipation of the payment to the Turnpike Division required by Senate Bill 370. Fluctuations in these fund balances appeared to follow historical practices.

The second step is to identify the amount of "reserves" that the Tollway Authority is entitled to retain "as required under *or in connection with* the resolutions, indentures, credit agreements, and other agreements ... *at a level consistent with the Texas Turnpike Authority's historical practices*" (Senate Bill 370; emphasis added).

It is an accepted rule of statutory construction that every part of a statute must be given meaning. In order for this provision to have meaning, it must be assumed that the Legislature intended for the Tollway Authority to retain certain "reserves" over and above those funds required for compliance with bond resolutions and other agreements.

- **Determination of the Reserves Balance in the Capital Improvement Fund**

We determined that the Capital Improvement Fund is the only fund in the possession of the Turnpike Authority as of August 31, 1997, that is not specifically restricted. Therefore, in accordance with our interpretation of the statute, any payment to the Turnpike Division under Section 8.02(c) must come from the Capital Improvement Fund.

It thus became our responsibility to determine what portion of the balance in the Capital Improvement Fund as of August 31, 1997, can reasonably be characterized as "reserves." Because the term "reserves" is not defined in Senate Bill 370, we first looked to how the term is typically used from an accounting standpoint.

Generally, the term "reserve" is defined as that portion of the fund balance that is not available for expenditure or is legally segregated for a specific use. In the strictest sense, none of the funds in the Capital Improvement Fund satisfy this traditional accounting definition. However, legislative history indicates that the term "reserves" was used in a broader sense than the traditional accounting definition and that the members of the conference committee on Senate Bill 370 regarded a substantial portion, but clearly not all, of the Capital Improvement Fund as constituting reserves.

During the audit, Tollway Authority officials asserted that the Turnpike Authority had historically regarded \$35 million as being the minimum amount, or “floor,” which should be maintained in the Capital Improvement Fund to ensure that the Turnpike Authority retained the financial flexibility to protect against contingencies. This assertion was supported by certain documentation which tends to corroborate that bond rating agencies and insurers have historically relied upon the existence of such cash reserves when evaluating the financial strength and credit-worthiness of the Turnpike Authority. Correspondence between the Turnpike Authority and members of the Legislature in February 1997, which was well before the audit provision was added to Senate Bill 370, also provides some documentary support for the Tollway Authority’s assertion that \$35 million is the amount that the Turnpike Authority had historically regarded as the minimum amount needed to be retained in the Capital Improvement Fund. Furthermore, and perhaps most importantly, the existence of a \$35 million “floor” in the Capital Improvement Fund is supported by a review of balances maintained in the Capital Improvement Fund over time.

Section 8.02(c) of Senate Bill 370 provides that the State Auditor is to ensure that, following the payment, “. . . reserves held by the authority as required under or in connection with the resolutions, indentures, credit agreements, and other agreements are . . . maintained at a level consistent with historical practices.” Thus, the statute appears to dictate an audit methodology focusing on historical practices. As a result, we examined the Capital Improvement Fund to ascertain what portion of the fund has historically been regarded as “reserves.”

- **Historical Practices**

In analyzing balances historically maintained in the Capital Improvement Fund, we considered a number of possible methodologies. For example, we examined average year-end balances, average monthly balances, and average minimum balances. We also considered a number of time periods in seeking to find the most representative approach. These included:

- 60-month period (supported by the Government Finance Officers Association’s [GFOA] *Disclosure Guidelines for State and Local Government Securities*)
- 98-month period (from July 1, 1989, to August 31, 1997; the period since the Turnpike Authority signed the trust agreement that secures all of its outstanding revenue bonds)
- 120-month period (supported by the Governmental Accounting Standards Board’s [GASB] *Codification of Governmental Accounting and Financial Reporting Standards*, which requires ten years of presentation for statistical tables for inclusion in an entity’s comprehensive annual financial report [CAFR])

Analyzing each of these methodologies resulted in balances that have ranged over time from a low of \$25 million to a high of \$44.5 million. After exploring these various

methodologies, we concluded that using the average monthly balance of the Capital Improvement Fund over the period of July 1, 1989, to August 31, 1997, provided the most representative picture of the Turnpike Authority's historical practices. The trust agreement entered into on July 1, 1989, establishes:

- All reserve funds in connection with the bond resolution and bond indentures of the Turnpike Authority
- The required minimum level of reserve for each fund
- The priority of distribution of revenues to these funds

The date of the trust agreement establishes a point in time from which the current practices of the Turnpike Authority were established, and this 98-month time frame constitutes the most representative period to use as a basis to determine the historical practices of the Turnpike Authority.

The average monthly balance of the Capital Improvement Fund over the 98-month period from July 1, 1989, to August 31, 1997, was \$ 34,174,674. From the evidence reviewed, this is the balance in the Capital Improvement Fund that is most representative of historical practices. This balance also corroborates other evidence supporting the Tollway Authority's assertion that \$35 million in "reserves" were historically maintained in the Capital Improvement Fund.

- **Computation of the Payment Amount**

Due to the lack of clarity in the statute and the absence of compelling documentary evidence, the amount of the Tollway Authority's payment to the Turnpike Division cannot be calculated with the degree of precision that one would ideally anticipate from an audit. Having reviewed all the evidence submitted, we conclude that there is sufficient support for the assertion that the Turnpike Authority historically regarded \$35 million as being the minimum amount that should be maintained in the Capital Improvement Fund. The balance in the Capital Improvement Fund as of August 31, 1997, was \$49,760,056. Accordingly, the remainder of the funds, or \$14,760,056, should be paid to the Turnpike Division.

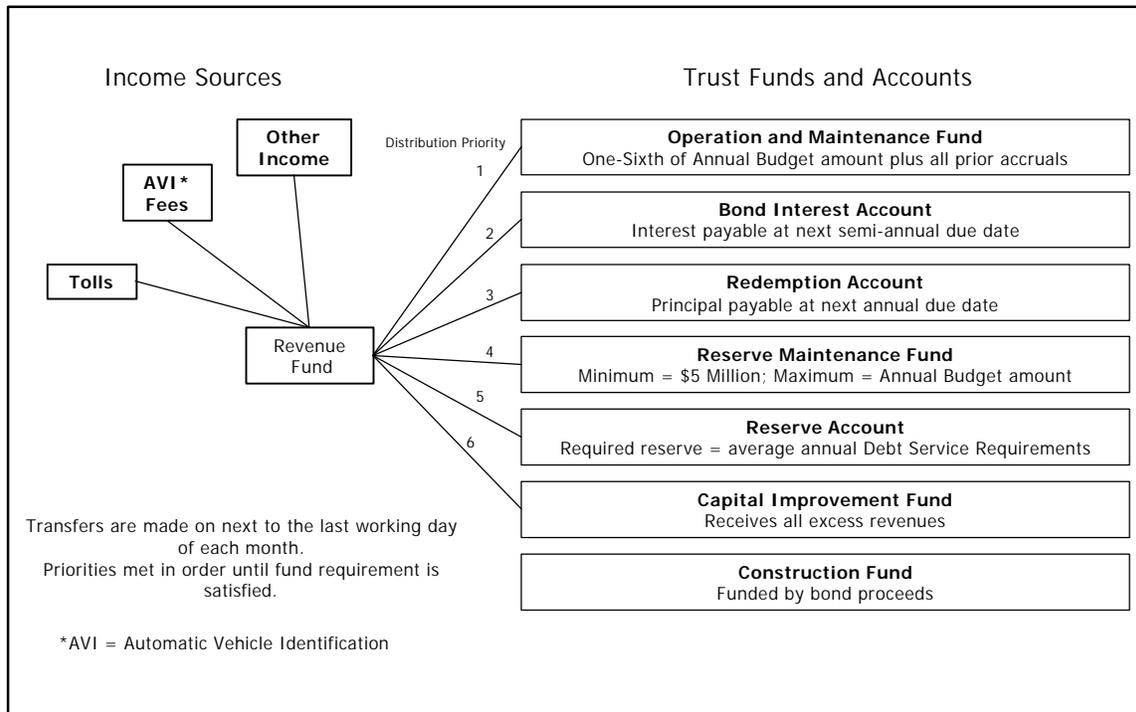
- **Effect of Payment on Bond Ratings**

The deliberations of the conference committee on Senate Bill 370 make it clear that the Legislature did not want to deplete the Turnpike Authority's reserves to the point of impairing the newly created Tollway Authority's ability to meet its obligations or jeopardize its bond ratings. The evidence we reviewed, including statements issued by the rating agencies, establishes that a payment by the Tollway Authority of \$14,760,056 would not adversely affect the Tollway Authority's ability to meet its obligations or jeopardize its bond ratings.

Texas Turnpike Authority¹

Dallas North Tollway System Flow of Funds

Source: Dallas North Tollway 1989 Trust Agreement



Operation and Maintenance Fund

Monthly revenues are distributed to this fund in accordance with Section 507.

This fund is used to pay Current Expenses, which are defined by the Trust Agreement as “. . . all ordinary and usual expenses of maintenance and repair, insurance, bridge painting, all operating, policing, administrative, and engineering expenses, all payments and deductions as provided in the laws pertaining to the State Retirement System, fees and expenses of the Trustee, legal and accounting expenses, and any other expenses or obligations required to be paid by the Authority under the provisions of this Agreement or by law . . .”

A balance equal to one-sixth (1/6) of the amount of the total annual budget must be maintained in this fund. (Section 506)

Bond Interest Account

¹The Dallas North Tollway System is comprised of the Dallas North Tollway, the Addison Airport Tunnel and the President George Bush Turnpike. All references to “Section(s)” in this Exhibit refer to provisions of the 1989 Trust Agreement and its five (5) Supplements, securing the Series 1989, 1990, 1993, 1994, 1995, and 1997 DNT System Bonds.

Monthly revenues are distributed to this account in accordance with Section 507. This account is used to pay semi-annual debt service interest on July 1 and January 1.

Redemption Account

Monthly revenues are distributed to this account in accordance with Section 507. This account is used to pay annual debt service principal on January 1.

Reserve Maintenance Fund

Monthly revenues are distributed to this fund in accordance with Section 507.

This fund is used to pay “. . . the cost of repairs, painting, renewals, replacements, improvements, and other costs and expenses necessary for safe or efficient operation of the Tollway or to prevent loss of revenues, for engineering expenses relating to the functions of the Authority, for equipment, expenses of maintenance, and operating expenses not occurring at annual or shorter periods” (Section 509).

A balance of \$5 million must be retained in this fund.

Reserve Account

This account “. . . shall be used finally to retire the last of the outstanding bonds, and/or for the purpose of paying interest on and principal of the bonds whenever and to the extent that the moneys held for the credit of the Bond Interest Account and the Redemption Account shall be insufficient for such purpose” (Section 508).

The required balance is defined by the Turst Agreement as “. . . an amount equal to the average annual Debt Service Requirements of all bonds outstanding . . .”

Capital Improvement Fund

Monthly revenues are distributed to this fund in accordance with Section 507.

This fund is used to pay “. . . the cost of repairs, enlargements, extensions, resurfacing, additions, renewals, improvements, acquisitions of right of way, reconstruction and replacements, capital expenditures, engineering, studies, and other expenses relating to the powers or functions of the Authority in connection with the Tollway, or for any other purpose now or hereafter authorized by law” (Section 510).

Use of these funds for other than Dallas North Tollway-related projects requires consent of the

County Commissioners of Dallas and Collin Counties.

Construction Fund

Bond proceeds are deposited to this fund and are used to pay the costs of issuance, capitalized interest during the construction period, and the costs of acquiring and constructing improvements, extensions, enlargements or additions as authorized. (Sections 401, 402, 403, 404)

Any balances remaining in this fund after the construction projects are finished shall be used to pay interest on outstanding bonds or to purchase and cancel outstanding bonds. (Section 412)

Revenue Fund

All gross revenues must be deposited to this fund (Section 503). At the end of every month, distribution of these revenues must be made to the Operations and Maintenance Fund, Debt Service Fund, Reserve Maintenance Fund, and/or Capital Improvement Fund in accordance with Section 507.