



John Keel, CPA
State Auditor

A Report on

The Audit of the Department of Transportation's Texas Mobility Fund Financial Statements for the Fiscal Year Ended August 31, 2006

December 28, 2006

Members of the Legislative Audit Committee:

In our audit report dated December 1, 2006, we determined that the Department of Transportation's (Department) Texas Mobility Fund (Fund) basic financial statements for fiscal year 2006 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 Texas Mobility Fund's General Obligation Bonds (Bond Resolution) and other laws and regulations. Our procedures did not identify any material weaknesses in internal control over financial reporting or instances of noncompliance that materially affected the financial statements. However, we are making recommendations in the areas of significant financial statement transparency and interest and sinking account deposits.

Background Information

In May 2005, the Texas Bond Review Board approved the issuance of \$4 billion in Texas Transportation Commission (Commission) State of Texas General Obligation Mobility Fund Bonds through one or more issuances from the Fund. As of August 2006, the Commission has issued \$1.75 billion in bonds and has been approved by the Texas Bond Review Board to issue an additional \$2.25 billion in obligations.

The first issuance of \$1 billion was made in fiscal year 2005. The Commission issued \$900 million in fixed-rate general obligation bonds and \$100 million in variable-rate general obligation bonds. The second issuance of \$750 million in fixed-rate general obligation bonds was made in fiscal year 2006. The Resolution requires the Commission to provide audited annual financial statements of the Texas Mobility Fund.

The Department Should Improve the Transparency of Financial Statements to Show How Texas Mobility Fund Dollars Are Spent

The Department does not pay highway construction expenses directly from the Texas Mobility Fund. Instead, eligible highway construction expenses are initially paid out of the State Highway Fund, and the Texas Mobility Fund then reimburses the State Highway Fund. Although this practice does not violate any laws or regulations, it prevents identification in the financial statements of specific projects or classes of highway construction expenses for which Texas Mobility Fund dollars were used, as well as the corresponding dollar amounts. Currently, transfers of Texas Mobility Fund dollars to the State Highway Fund appear only as a single line item titled "Operating Transfer Out" on the Statements of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balance. Operating Transfer Out totaled \$1.3 billion for the fiscal year ended August 31, 2006.

SAO Report No. 07-007

Recommendations:

The Department should consider implementing one or both of the following options:

- Pay highway construction expenses directly from the Texas Mobility Fund, rather than through reimbursement of the State Highway Fund.
- Ensure that Texas Mobility Fund financial statements include a schedule (supplemental) that lists the amount of Texas Mobility Fund dollars spent on specific projects and classes of highway construction expenses.

The Department Should Implement Controls to Ensure It Deposits Accrued Interest into the Interest and Sinking Account

The Bond Resolution requires Fund management to deposit any accrued interest received from the sale of bonds to the credit of the interest and sinking (debt service) account immediately after the delivery of each series of bonds. On June 8, 2006, Fund management received \$716,535.92 in accrued interest in conjunction with the sale of \$750 million in Series 2006 bonds. The accrued interest received was deposited into the Fund's general account, rather than the interest and sinking account. Noncompliance with the Resolution increases the risk that an event permitting the acceleration of the debt could occur. Auditors brought this error to the attention of Fund management, and a correction was made in a timely manner.

Recommendation:

The Department should implement controls to ensure that any accrued interest received from the sale of bonds is deposited promptly to the proper account as required by the Resolution.

With certain modifications, the Department agrees with the recommendations in this report, and its responses are included in the attachment. If you have any questions, please contact Lisa Collier, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

Attachment

- cc: Mr. Richard "Ric" F. Williamson, Chair, Texas Transportation Commission
Ms. Hope Andrade, Member, Texas Transportation Commission
Mr. Ted Houghton, Jr., Member, Texas Transportation Commission
Mr. John W. Johnson, Member, Texas Transportation Commission
Mr. Michael W. Behrens, P.E., Executive Director, Department of Transportation

Summary of Objective, Scope, and Methodology
The objective of the audit was to issue an opinion on the Texas Mobility Fund's (Fund) basic financial statements for fiscal year 2006.
The audit scope covered the Fund's basic financial statements for fiscal year 2006.
The audit methodology included interviewing personnel, performing analyses of the accounts, reviewing relevant laws and regulations, and reviewing information systems.
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 <i>Government Auditing Standards</i> issued by the Comptroller General of the United States. The following staff of the State Auditor's Office performed the audit:
<ul style="list-style-type: none">▪ Wesley Vaughn Hodgkin, CPA (Project Manager)▪ Shelby Cherian▪ Ashlee Jones, MACy▪ Serra Tamur, MPAff, CIA, CISA▪ Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)▪ Lisa R. Collier, CPA (Audit Manager)



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Attachment

Management's Responses



DEWITT C. GREER STATE HIGHWAY BLDG. • 125 E. 11TH STREET • AUSTIN, TEXAS 78701-2483 • (512) 463-8585

December 15, 2006

John Keel, CPA
State Auditor
Texas State Auditor's Office
P.O. Box 12067
Austin, Texas 78711-2067

Dear Mr. Keel:

The following responses are provided to your draft recommendations to the Legislative Audit Committee regarding the audit of the Department of Transportation's Texas Mobility Fund financial statements for the fiscal year ended August 31, 2006.

The Department Should Improve the Transparency of Financial Statements to Show How Texas Mobility Fund Dollars Are Spent

Recommendations:

- Pay highway construction expenses directly from the Texas Mobility Fund, rather than through reimbursement of the State Highway Fund.
- Texas Mobility Fund financial statements include a schedule (supplemental) that lists the amounts spent on specific projects and classes of highway construction expenses for which Texas Mobility Fund dollars were used.

Response:

- Payment of highway construction expenses directly from the Texas Mobility Fund was considered when the mobility bonds were sold, but the cost of programming this capability outweighed any benefits to be received. The systems and procedures used to account for Texas Mobility Fund participation on construction projects are nearly identical to those used to account for Federal and local governmental participation on those same projects.
- Adding a schedule (supplemental) that lists the amounts spent on specific projects and classes of highway construction expenses for which Texas Mobility Fund dollars were used would add approximately 150 pages to the financial statements. Instead we intend to add a summary schedule of expenses by county and class of expense. Additionally a link will be provided to an Internet address that contains the schedule recommended by the State Auditor.

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The Department Should Implement Controls to Ensure It Deposits Accrued Interest into the Interest and Sinking Account

Recommendation:

- The Department should implement controls to ensure that any accrued interest received from the sale of bonds is deposited promptly to the proper account as required by the Resolution.

Response:

- The Department concurs that controls should be added and is proceeding to implement them.

Sincerely,



Michael W. Behrens, P.E.
Executive Director

cc: Ric Williamson, Chair, Texas Transportation Commission
James M. Bass, Chief Financial Officer, Finance Division, TxDOT
Owen Whitworth, Director, Audit Office, TxDOT
Duane Sullivan, Finance Division, TxDOT