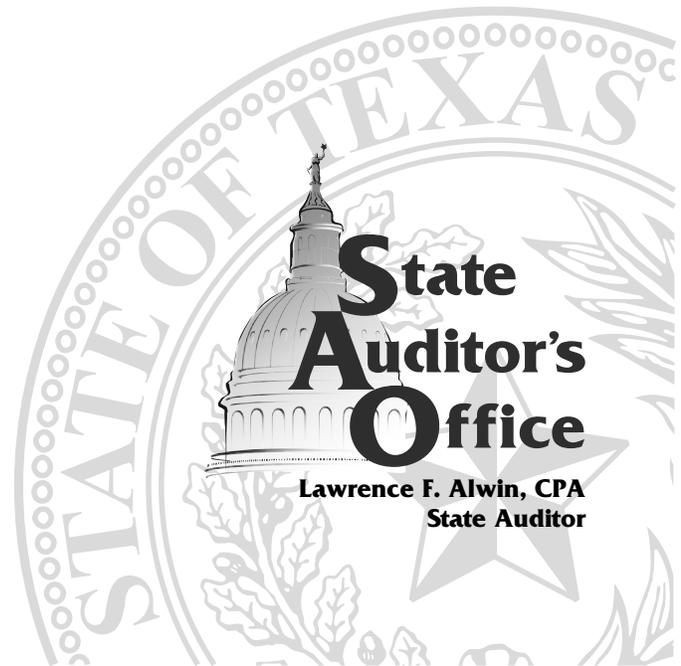


An Audit Report on

The Department of Transportation's Administration of Construction Contracts

October 2004

Report No. 05-007



The Department of Transportation's Administration of Construction Contracts

Overall Conclusion

The Department of Transportation (Department) has policies and procedures to ensure that it correctly pays contractors for allowable expenditures on construction projects, but it needs to improve controls to prevent illegal and unauthorized activity from occurring. Although we identified improvements the Department needs to make, payments to contractors that we tested at three of the Department's district offices were properly supported, approved, and calculated.

Certain weaknesses in access controls for SiteManager (the Department's construction administration system) could allow users to inappropriately create or modify construction data. As a result, there is an increased risk that a contractor could receive an improper payment without management's knowledge or appropriate approval.

The Department also needs to improve controls over inventories of materials on hand held by contractors to reduce the risk that contractors could retain advance payments for materials that they are not entitled to retain. In addition, the Department needs to improve controls to ensure that all materials used to construct Texas roadways are properly tested and approved to avoid accepting substandard construction. The Department also has an opportunity to improve its efforts to promptly collect funds and make payments when it shares the costs of highway construction projects with other parties.

Background

The Department of Transportation (Department) is a decentralized organization with 25 district offices throughout the state. Each district office oversees from 3 to 11 area offices. As of March 2004, the Department had under contract 1,211 construction projects totaling \$8.7 billion.

SiteManager is the Department's new automated construction administration system. SiteManager automates numerous aspects of the project administration process, from the time the Department awards a contract through the finalization of the project. The Department completed installation of SiteManager in all of its 25 district offices in March 2004.

The Texas Transportation Commission is the governing board responsible for overseeing the operations of the Department. The Commission has five members appointed by the Governor.

Key Points

Certain weaknesses create a risk that the Department could make incorrect payments to contractors.

We identified certain weaknesses in access controls for SiteManager that could allow users to inappropriately create or modify SiteManager data. For example, the assignment of multiple roles to individual users of SiteManager could allow users to initiate inappropriate payments to contractors. In addition, the Department does not promptly remove terminated employees' access to SiteManager, which increases the risk of unauthorized access. Too many employees in the Department's Construction Division also have system administrator access rights to SiteManager, which increases the risk of accidental or



intentional unauthorized changes to data. Improper changes to data in SiteManager could lead to incorrect or inappropriate payments to contractors.

Weaknesses in controls over construction materials impair accountability for state funds and could lead the Department to accept substandard construction.

The Department needs to improve controls over inventories of materials on hand held by contractors to reduce the risk that contractors could retain advance payments for materials that they are not entitled to retain. For example:

- Weaknesses in the Laredo district office's monitoring of a contractor's materials-on-hand inventory allowed the contractor to retain as much as \$400,684 to which it was not entitled.
- The Laredo district office was also unable to locate several items, valued at \$123,614, that were included in the materials-on-hand inventory listing for the contractor discussed above. The Department later found these items only after it sent employees from its Construction Division to the district office to assist in locating them.

In addition, the Department needs to improve controls to ensure that all materials used to construct Texas roadways are properly tested and approved. Controls over SiteManager do not ensure that material supplier information recorded in this system is accurate and up to date. In addition, users with access to the materials management module within SiteManager can alter the number of tests required for a material without any form of secondary review and approval.

The Department is not promptly collecting or paying all funds associated with advanced funding agreements.

The Department does not have an adequate system to ensure that all participants in advanced funding agreements, including the Department itself, promptly pay their share of highway construction costs. For example, the Department has not collected more than \$738,000 that it asserts the San Antonio Water System (SAWS) owes the State. In an attempt to encourage SAWS to pay the funds it owes, the Department withheld \$247,000 in payments that the Department owes SAWS for other projects for which they had agreed to share costs. However, the Department may have delayed collection of those funds by not following its own rules for withholding the payments.

Summary of Management's Response

The Department generally agrees with our recommendations.

Summary of Information Technology Review

We conducted a review of access controls over SiteManager and a limited review of SiteManager edit checks. Results of our testing indicated that the Department should improve its management of SiteManager user accounts. We identified 24 terminated users who still had access to SiteManager, as well as many users with multiple levels of access that could allow them to create, submit, and approve their own work.

The Department completed installation of SiteManager in all of its 25 district offices in March 2004.

Summary of Objectives, Scope, and Methodology

The objectives of this audit were to assess controls over the Department's payments on construction contracts. Specifically, we answered the following questions:

- Does the Department effectively monitor and control payments on construction projects?
- Does Department management have the information necessary to support decision-making related to construction projects?

Our audit scope covered the Department's Austin headquarters; the Department's Fort Worth, Laredo, and San Antonio district offices; and selected area offices. The scope of our work included the Department's accounting records and transactions, as well as other activities related to construction contracts, such as the oversight and inspection of contractors and their work, the preparation and approval of change orders, and the testing and acceptance of materials. We reviewed transactions and activities that took place during fiscal years 2003 and 2004. We also reviewed the operation and effectiveness of access controls within SiteManager.

Our methodology included collecting information, performing selected tests and other procedures, analyzing and evaluating the results against established criteria, and interviewing management and staff from the Department.

Recent SAO Work		
Number	Product Name	Release Date
04-028	An Audit Report on the Department of Transportation's Management of the Statewide Traffic Analysis and Reporting System	May 2004
03-021	An Audit Report on the Department of Transportation's Management of State Highway Fund 6	March 2003

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Detailed Results

Chapter 1

Certain Weaknesses Create a Risk that the Department Could Make Incorrect Payments to Contractors

The Department of Transportation (Department) has policies and procedures to ensure that it correctly pays contractors for allowable expenditures on construction projects, but it needs to improve controls to prevent illegal and unauthorized activity from occurring. Although we identified improvements the Department needs to

make, payments to contractors that we tested at three of the Department's district offices were properly supported, approved, and calculated.

What Is SiteManager?

SiteManager is the Department's new automated construction administration system. The Department completed installation of SiteManager in all of its 25 district offices in March 2004.

SiteManager automates numerous aspects of the project administration process, from the time the Department awards a contract through the finalization of the project. The American Association of State Highway and Transportation Officials sponsored the development of SiteManager with the participation of 18 states, New Brunswick, and the U.S. Department of Transportation's Federal Highway Administration (FHWA). Each participant shared in the \$10 million system development cost. The Department's share of development costs, plus costs for implementation, totals \$8.4 million.

Sources: *Quality Assurance Team Report 2003*, the Department of Transportation, and FHWA

We identified certain weaknesses in access controls for SiteManager (the Department's construction administration system; see text box) that could allow users to inappropriately create or modify construction data in this system. For example, the weaknesses we identified could allow a user to create unauthorized change orders or alter records of completed work. Data changes such as these could lead to a contractor's receiving an improper payment without management's knowledge or appropriate approval.

The assignment of multiple roles to individual users of SiteManager could allow users to initiate inappropriate payments to contractors.

The Department's division offices can weaken segregation-of-duty controls in SiteManager by giving many users the ability to log onto SiteManager in several roles simultaneously. For example:

- In one area office, the area record keeper can log onto SiteManager in the roles of area record keeper, project manager, and area engineer.
- In one district office, the district construction auditor can log onto SiteManager in one of five roles: district engineer, district construction engineer, area engineer, project manager/chief inspector, and bookkeeper.

As a result of having access to SiteManager using multiple roles, these users could create and approve fictitious change orders of up to \$50,000, create and approve daily work reports indicating that a contractor performed work related to the change order, and approve payments to contractors based on the change order. All these transactions could potentially occur without review and approval from another individual. Although the Department maintains hard copies of change order documents that are signed by a contractor and a Department representative, this would not prevent an individual with multiple roles in SiteManager from initiating inappropriate payments to a contractor when no signed change order documents exist. Although Department employees may need to perform multiple duties to

compensate for limited staffing, the Department should still ensure that no single individual has control over all phases of a transaction in SiteManager.

Supervisors are responsible for requesting SiteManager access for their staff members. The written request form asks the district security administrator to grant these users access to SiteManager using one or more roles. However, the request form does not require supervisors to acknowledge that they are ultimately responsible for how staff members use, or potentially abuse, the sign-off authority these roles grant the users in SiteManager.

The Department does not promptly remove terminated employees' access to SiteManager, which increases the risk of unauthorized access.

When employees leave the agency, the Department does not always promptly remove these individuals' access to SiteManager. We identified 24 former employees and consultants who still had access to Site Manager. The Department removed these users' access to SiteManager when we brought this matter to its attention. Failure to promptly remove terminated employees' access to SiteManager exposes SiteManager data to the unnecessary risk of unauthorized access, changes, or deletion.

Too many employees in the Department's Construction Division have system administrator access rights to SiteManager, which increases the risk of accidental or intentional unauthorized changes to data.

The Department's Construction Division gives many users excessive access and authority in SiteManager. Specifically, 15 SiteManager users have been granted the system administrator role, which gives them access to data for all construction projects in all of the Department's districts. In addition, users with system administrator access can revise other users' levels of access in SiteManager.

Giving this much authority to so many users increases the risk that accidental or intentional unauthorized changes could be made to data in SiteManager without detection by management. For example, a user assigned the system administrator role recently changed the rights of users assigned the "inquiry only" role and inappropriately gave those users the ability to change SiteManager data. The Department could not identify exactly who changed those users' roles because (1) SiteManager does not keep a historical record of such changes and (2) so many individuals have been assigned the system administrator role that could allow them to make such changes. In many cases, users with system administrator access are working in district offices and need access only to data related to projects and personnel in their districts. However, the Department has not established a way to grant a user the system administrator role but limit the user's access to data only within a certain district.

Recommendations

The Department should:

- Require supervisors who request SiteManager access for their staff members to acknowledge in writing to the district security administrator that they are ultimately responsible for how staff members use, or potentially abuse, the sign-off authority these SiteManager roles allow the users.

- Periodically generate and send to each division, district, and area office a report of users assigned multiple roles for logging into SiteManager. Division, district, and area offices should review this report to ensure that it is appropriate for these users to have multiple levels of access.
- Review and streamline the notification process regarding terminated employees and consultants. All key personnel, including the district SiteManager security administrators, should be notified each month about all employee and consultant terminations.
- Limit the SiteManager system administrator role to only those users in the Department's headquarters who require access to all projects in all districts. The Department should document the reasons for granting this level of access to each user assigned the system administrator role and review the need for such access at least annually. In addition, the Department should create a new SiteManager administrator role for district employees who need system administrator access within their districts.

Management's Response

Management of the Texas Department of Transportation (TxDOT) agrees that the concerns presented are important aspects of the estimate process as it pertains to SiteManager. These issues will be addressed in our training, SiteManager User Manual, and district procedures. TxDOT management has addressed the issues identified in the SAO report during an August 2004 statewide SiteManager meeting.

1. TxDOT management agrees and will adopt the recommendation to require supervisors who request SiteManager access for their staff members to acknowledge in writing that they are ultimately responsible for how staff members use SiteManager.

For future access requests of this nature the supervisor will be required to provide a delegation memoranda to the Security Administrator along with a signed security form. The following sentence has been added to the SiteManager Access Request document to insure this new policy is followed: "Provide hard copy delegation memoranda for the file when delegating rights."

2. TxDOT management agrees and will adopt the recommendation to periodically generate and distribute a report of SiteManager users to each Division, District and area office. Additional instructions will be provided to Department Security Administrators regarding the use of this report.

3. TxDOT management agrees and will adopt the recommendation to review and streamline the notification process regarding terminated employees and consultants. SiteManager access will be included on all documentation involving employees who voluntarily or involuntarily leave the employment of TxDOT. This will require the Department Security Administrators to confirm that the user's account has been deactivated.

4. TxDOT management agrees and will adopt the recommendation to limit the SiteManager System Administrator role to only those users who require state-wide

access to all projects. We will eliminate the District System Administrator group from SiteManager entirely. We will also remove the System Administrator group from the SiteManager drop down list available to Security Administrators. In the future, System Administration rights will be granted by the ISD Data Base Administrator at the request of the SiteManager Technical Coordinator only. We will also evaluate all existing System Administrators and reduce the total of System Administrators by half.

TxDOT management has instructed staff to ensure that all recommendations as listed above are implemented no later than March 2005.

Weaknesses in Controls over Construction Materials Impair Accountability for State Funds and Could Lead the Department to Accept Substandard Construction

The Department needs to improve controls over inventories of materials on hand held by contractors to reduce the risk that contractors could retain advance payments for materials that they are not entitled to retain (see text box). Department policy places almost all responsibility for complying with materials-on-hand requirements on the contractor and requires little or no monitoring by Department personnel.

Materials on Hand

Materials on hand are materials, such as gravel and sand, that a contractor purchases and stockpiles for future use on a construction project. The Department makes advance payments to contractors for these materials to help offset the large capital outlays that contractors make to assemble and stockpile these items. Advance payments for materials on hand can involve millions of taxpayer dollars. Therefore, contractors should use good judgment and adhere to sound record-keeping practices for materials on hand.

Contractors must maintain a written inventory of materials on hand for which they have been paid. In addition, contractors must store stockpiled materials in a way that ensures materials are not lost, damaged, or commingled with materials for other projects. The Department's district offices are required to spot check materials-on-hand inventories to ensure that contractors are (1) correctly recording materials on hand and (2) properly storing the materials.

As contractors use stockpiled materials, they are required to remove the materials from their materials-on-hand inventories. District offices, in turn, are required to deduct amounts previously advanced to contractors for those materials from the regular monthly payments to the contractors.

During the final closeout of a project, the Department must reduce to zero any amounts remaining in materials-on-hand inventories. Therefore, the Department should recover all materials on hand advances made to contractors. However, if district offices do not spot check materials-on-hand inventories during a project, contractors could retain advances that they are not entitled to retain.

In addition, the Department needs to improve controls to ensure that all materials used to construct Texas roadways are properly tested and approved. Weaknesses in controls over the testing of materials used in construction projects and the tracking of sources of materials may allow contractors to use or install materials that do not meet contract specifications.

Chapter 2-A

Poor Monitoring of Materials on Hand Increases the Risk that Contractors Could Retain Funds to which They Are Not Entitled

Our testing at two of three Department district offices revealed weaknesses in the monitoring of materials on hand that increase the risk that contractors could retain funds to which they are not entitled. For example, the San Antonio district office performs regular spot checks of materials-on-hand inventories. However, the district office in Fort Worth does not perform audits or spot checks of contractors' materials on hand and relies entirely on project personnel to identify discrepancies.

The district office in Laredo performs some monitoring, but weaknesses in the monitoring of one contractor's materials-on-hand inventory allowed the contractor to retain as much as \$400,684 to which it was not entitled. As of June 2004, the Laredo district office had advanced this contractor more than \$2 million for materials on hand.

The \$400,684 to which the contractor was not entitled included the following amounts:

- \$324,671 for concrete paving gravel that the district office carried in the materials-on-hand inventory from at least February 2002 to June 2004, a period of more than 28 months. Neither the contractor nor the district office could locate this material, although the contractor had claimed it was stored on the project site.

- \$73,058 for asphalt hot mix that the contractor may have installed but did not deduct from the materials-on-hand inventory. The district office was not able to prove whether the contractor installed this material or whether it was still on hand.
- \$2,955 for plywood signs and concrete ground boxes that the district office paid for but that the contractor and district office were unable to locate.

In addition, several other items valued at \$123,614 were located and accounted for only after the Department's Construction Division sent employees to the Laredo district office to assist in locating the items. Project personnel should know at all times the location and status of all items included in the materials-on-hand inventory.

Partly because of our review, the Laredo district office deducted \$807,880 from the contractor's July 2004 billing for overpayments it made for materials on hand. In addition, the district will no longer make advance payments to the contractor for additional materials on hand.

These exceptions occurred, in part, because Department policy places almost all responsibility for complying with materials-on-hand requirements on the contractor with little or no monitoring by Department personnel. The policy relies on the contractor for accurate reporting, checking, and adjustments to material balances. When contractors inappropriately retain funds to which they are not entitled, the Department cannot put those funds to use on other highway construction projects.

The Department could increase assurance that materials-on-hand inventories are accurate by requiring district offices to use a risk-assessment methodology to identify projects to review. Currently, Department policy requires district offices to perform spot checks of materials on hand for only one project per area office per year. For example, the Laredo district office oversees three area offices. As of May 2004, the district office had 30 active projects valued at more than \$233 million. Current Department policy requires spot checking only 3 of those 30 projects during the year. This may be adequate for some districts but not for others.

One important factor to consider in a risk assessment is the likelihood of fraud or abuse. For example, the importance of monitoring the contractor's materials-on-hand inventory on the project at the Laredo district office discussed above is highlighted by the fact that, in 2002, fraud related to materials on hand was prosecuted on this project. Because advance payments to contractors for materials on hand can involve millions of dollars on a single road construction project, the Department must take precautions to adequately secure these assets.

Recommendations

The Department should:

- Modify its materials-on-hand policy to require more frequent reviews or spot checks of contractors' materials-on-hand balances. District offices should:
 - ♦ Base reviews on the dollar value of the materials-on-hand account and a risk assessment performed to determine which projects to review.

- ♦ Design spot checks to ensure that materials-on-hand quantities are reasonable and perform spot checks as often as necessary to ensure that contractors' comply with materials-on-hand procedures.
- ♦ Document that contractors accurately measure and calculate materials-on-hand inventories.
- Require area offices to verify materials-on-hand quantities and dollar values each month by comparing the contractor-submitted quantities with the remaining quantities and dollar values of the items of work completed for the month. This could identify overstated items and serve as a check that contractors are drawing down their materials-on-hand balances as they install the materials.
- Require district offices to implement regular audits of materials on hand for major construction projects based on a risk assessment to determine which projects should be spot checked and how often.

Management's Response

TxDOT management agrees and will adopt the recommendations of the State Auditor's Office. Districts currently perform spot checks of material on hand payments as specified within their District procedures in accordance with policy provided in Chapter 7 of the Department's Estimates Manual. The Estimates Manual will be updated no later than March 2005 to require that each District develop a procedure to audit material on hand payments. Specific components for District procedures will be provided in this policy.

Response Specific to Fort Worth District Observations

While Fort Worth District personnel do not perform regular spot checks of material on hand inventories, area office personnel conduct material on hand examinations to ensure that proper payments are made. This complies with current policy contained in Chapter 7 of the Department's Estimates Manual. These procedures will be modified to comply with changes being made to Chapter 7.

Response Specific to Laredo District Observations

The \$807,880 deduction identified in the SAO report in the July 2004 estimate for overpayments included a deduction of approximately \$60,000 for material used during the month of July 2004.

Immediate Action to be Taken on the Identified Project

The contractor will be allowed to carry only the remaining material on hand balance as of the July 2004 estimate. Because of the contractor's failure to comply with the Special Provision to Item 9, "Measurement and Payment," Article 9.5, no further material on hand payments will be allowed for the duration of the project.

The District Director of Operations conducted a material on hand audit during the month of September 2004 to ensure compliance with this

directive. If warranted, additional checks will be conducted until the project is completed and finalized.

Immediate Action to be Taken District-wide

The Director of Operations in the Laredo District has implemented a district-wide training program, which covers TxDOT material on hand policies as outlined in the Estimates Manual and the Construction Contract Administration Manual. The training is currently being provided to inspectors, bookkeepers and district personnel involved in construction management. As new material on hand policies are developed, additional training will be provided to area and district personnel.

Chapter 2-B

Weaknesses in Controls over Materials Testing Could Allow the Department to Accept Projects that Do Not Meet Specifications

Weaknesses in controls over the testing of materials used in construction projects and the tracking of material suppliers may allow contractors to install materials that do not meet contract specifications. It is important to track all materials used on the project to ensure that the Department receives the specified quality of materials. According to the Department, materials account for as much as 80 percent of the cost of a typical road construction project. Installing materials that do not meet specifications could lead to greater maintenance costs in the months and years after the project is completed.

The Department's tracking of material suppliers may not always be accurate and up to date.

The Department does not have controls in place to ensure that information regarding material suppliers and producers recorded in SiteManager is accurate and up to date. Because there is no control in SiteManager that would alert users to check or verify material suppliers, the Department must rely on its personnel to carry out this function. However, we found that personnel do not always keep information on material suppliers updated in SiteManager. As a result, the Department may unknowingly allow the contractor to install materials obtained from an unapproved supplier.

Material Approval

The Department has a Quality Monitoring Program (QMP) that was designed to improve the efficiency of Department operations. The QMP provides requirements and procedures for accepting materials from suppliers that have demonstrated continuous quality and uniformity. The QMP allows districts to use materials from rated sources qualified through QMP without project-specific testing.

Source: Department of Transportation Construction Contract Administration Manual (September 2002)

When the Department contracts to build a road, the contractor provides the Department with a report listing all materials it will use on the project, including the names of material suppliers. The Department loads this information into SiteManager and reviews it to make sure the contractor plans to obtain all materials from Department-approved suppliers.

However, the contractor may subsequently obtain materials from additional suppliers. Although Department policy requires project personnel to maintain up-to-date records of all materials received and used on a project, personnel do not always record these changes or additions in SiteManager. Delivery tickets, which contractors receive from suppliers when they deliver materials, provide the best documentation of material source.

Without complete and accurate supplier data in SiteManager, Department personnel are unable to review the data to ensure that all materials placed on the project came from approved suppliers. For example, SiteManager may report that materials came only from approved suppliers when, in fact, some materials came from a supplier that has not been approved by the Department. This increases the risk that materials may not meet required specifications or that the Department could unknowingly accept substandard construction.

SiteManager may not prevent unauthorized changes to planned material tests.

Users with access to the materials management module within SiteManager can alter the number of tests required for a material without any form of secondary review or approval. As a result, the Department may not always perform the correct number of material tests. This would violate the Department's policy, which requires project personnel to inspect, test, and approve all materials. This policy also states that any materials used without prior testing and approval or written permission may be ordered removed and replaced at the contractor's expense.

We did not specifically test for or find examples in which this has occurred. Nevertheless, this control weakness could allow needed material tests to go unperformed, leading the Department to accept construction that contains substandard materials.

It is reasonable to expect that on-site conditions may lead engineers to conclude correctly that the number of tests required by SiteManager needs adjusting. However, the lack of review and approval for such adjustments may allow inappropriate adjustments to the testing schedule to go undetected.

Recommendations

The Department should:

- Establish a method for reviewing and approving changes to the testing schedule for a given material. The Department's district offices should tightly control access to testing schedules, limiting access to only those individuals who have the appropriate level of expertise to alter material testing schedules.
- Require project personnel or district auditors to conduct audits or spot checks of material delivery tickets retained by contractors and reconcile the delivery tickets to SiteManager. Districts should select projects to audit based on an assessment of risk, while ensuring that all projects are subject to audit. This will increase assurance that the Department has a complete record of all materials used on a project, including the actual suppliers of these materials.
- Require district or area offices to spot check or audit material-testing records to ensure that all materials placed on a project are received from approved suppliers and are tested in compliance with the Department's requirements.
- Work with the developers of SiteManager to improve this system's material-testing module by adding a control to prevent changes to the planned number of material tests without review and approval from appropriate personnel.

Management's Response

1. *TxDOT management agrees and will adopt the recommendations of the State Auditor's Office. The Department's Construction Contract Administration Manual will be revised to incorporate the appropriate aspects of the recommendations. Publication of these revised manuals is tentatively scheduled for March 2005.*

2. *TxDOT management agrees and will adopt the recommendations of the State Auditor's Office. The Department's Estimates Manual and the Construction Contract Administration Manual will be revised to incorporate the appropriate aspects of the recommendations. Publication of these revised manuals is tentatively scheduled for March 2005.*

3. *TxDOT management agrees and will adopt the recommendations of the State Auditor's Office. The Department's Construction Contract Administration Manual will be revised to incorporate the appropriate aspects of the recommendations. Publication of these revised manuals is tentatively scheduled for March 2005.*

4. *We will continue to work within the AASHTO Transport community to improve the SiteManager material-testing module. The department is further addressing testing requirements through ad hoc reports and programs and other laboratory testing systems.*

The Department Is Not Promptly Collecting or Paying All Funds Associated with Advanced Funding Agreements

The Department does not have an adequate system to ensure that all participants in advanced funding agreements, including the Department itself, promptly pay their share of highway construction costs. Failure to settle promptly with participants in advanced funding agreements could reduce either the amount of funds available to the Department for other transportation projects or the amount of funds available to the other party. For example, the Department has not collected more than \$738,000 that it asserts the San Antonio Water System (SAWS) owes the State. In an attempt to encourage SAWS to pay the funds it owes, the Department withheld \$247,000 in payments that the Department owes SAWS for other projects for which they had agreed to share costs. However, the Department may have delayed collection of those funds by not following its own rules for withholding payments.

Advanced Funding Agreements

Cities, counties, and other political subdivisions agree to share in the costs of highway construction projects with Department district offices through advance funding agreements. Most of these agreements require the other party to pay its share in advance, based on an estimate of the project's cost.

At the end of the project, the district prepares a Statement of Cost that shows each party's share of the actual costs. After receiving concurrence from the Department's Finance Division, the district office either pays the other party or requests additional funds, depending on whether the project's final cost was more or less than originally estimated.

The Department neither issued a demand letter to SAWS to request payment nor referred SAWS's unpaid debt to the Office of the Attorney General for further collection efforts. Department rules require the Department to take these steps before it can withhold payments to debtors.¹ In addition, the Department has not taken advantage of the "warrant hold" procedures offered by the Office of the Comptroller of Public Accounts (Comptroller's Office).² Following warrant hold procedures would enable the Comptroller's Office to block any state warrants from being issued to SAWS until SAWS pays the debts it owes to the State, thus providing an additional incentive to pay.

The Department's Finance Division is responsible for monitoring to ensure that the districts settle with other parties as outlined in the Statement of Cost. However, the Finance Division does not have sufficiently accurate information to monitor the success of districts in collecting funds owed by other parties. A tracking log that this division uses to monitor activities related to advance funding agreements contains incomplete and inaccurate information regarding when and how much district offices collect from other parties. Although the division is dependent on district offices to report their attempts to settle with other parties, it does not have policies and procedures in place to ensure that districts regularly report accurate information. As a result, district offices occasionally fail to report their information on advanced funding agreements.

¹ See Texas Administrative Code, Title 43, Section 5.10.

² Warrant hold procedures are authorized by Texas Government Code, Section 403.055.

Recommendations

The Department should:

- Improve its system for tracking advanced funding agreements and the success of district offices in collecting funds owed to the State by conducting training and establishing policies and procedures to ensure that districts report accurate information to the Department's Finance Division regarding advanced funding agreements.
- Develop and require districts to follow policies and procedures for debt collection and the withholding of payments that meet the requirements of the Texas Administrative Code. To provide additional incentive for debtors to pay amounts owed to the State, the Department should consider using the "warrant hold" procedures of the Comptroller's Office.

Management's Response

We concur with the finding detailed in the report. Proposed policies which address the audit recommendations will be included into the Financial Management Policy Manual. The draft policy will require districts to follow policies and procedures for debt collection and the withholding of payments that meet the requirements of the Texas Administrative Code including the placement of warrant holds on the responsible entities. We will also send a memo to the Districts advising them of the requirements. We plan to have the policy finalized, manuals updated and any notifications sent by January 1, 2005.

Draft procedures and training aids have been prepared to provide better guidance to the Districts for accurately calculating and completing their respective Statements of Cost (SOC) which are tools used to reconcile balances owed under the Advanced Funding Agreements. These procedures and aids contain specific steps and records necessary to accomplish this task and the signatures required for the SOC to be considered complete. We plan to have these procedures and training aids distributed in conjunction with the distribution of the policies noted in the previous paragraph (January 1, 2005).

A system will be developed to accurately track the progress of District offices in collecting funds due to TxDOT. This will include a method for communicating to the Districts when certain collection deadlines have passed and the appropriate subsequent action. The system will be developed and operational by January 1, 2005.

Training on the SOC process was conducted recently at the Construction Conference in San Antonio and the Finance Meeting in Austin. We plan to hold more training sessions to give ample opportunity for the appropriate District personnel to attend. An open invitation has been extended to District personnel to meet with us to work through specific SOC's together. District staff has visited the Austin office to work through some specific SOC issues. Finance staff has visited several Districts for the same purpose.

Appendix

Objective, Scope, and Methodology

Objective

Our objective was to assess controls over the Department of Transportation's (Department) payments on construction contracts. Specifically, we answered the following questions:

- Does the Department effectively monitor and control payments on construction projects?
- Does Department management have the information necessary to support decision-making related to construction projects?

Scope

We performed audit procedures at the Department's headquarters in Austin; the Department's Fort Worth, Laredo, and San Antonio district offices; and selected area offices. The scope of our work included the Department's accounting records and transactions, as well as other activities related to construction contracts, such as the oversight and inspection of contractors and their work, the preparation and approval of change orders, and the testing and acceptance of materials. We reviewed transactions and activities that took place during fiscal years 2003 and 2004. We also reviewed the operation and effectiveness of access controls protecting SiteManager, the Department's automated construction administration system.

Methodology

Our methodology included interviewing Department staff; collecting and reviewing information; performing tests, procedures, and analyses of selected completed and on-going construction projects; and visiting district and area offices.

Information collected and reviewed included the following:

- Texas Department of Transportation, *Construction Contract Administration Manual*
- Department SiteManager manuals and guides
- *Quality Assurance Team Report 2003*
- Department, district, and area office processes, procedures, practices, and regulations related to the Department's administration of construction projects, contracts, and contractors
- Internal reports, documentation, and manuals of the Department and district offices

- Department internal audit reports
- Data from SiteManager and from the Uniform Statewide Accounting System

Procedures and tests conducted to accomplish our objectives included the following:

- Comparisons of SiteManager users with current Department employees to identify individuals with unauthorized access to SiteManager
- Risk assessments of construction contract data in order to select contracts for further testing
- Reviews of policies, procedures, and current practices for adequacy of controls
- Reconciliations of contract bid and price data to contract data recorded in SiteManager
- Observations of procedures conducted by Department personnel at construction sites
- Tests of a sample of monthly estimate payments made to contractors to determine whether the payments are properly approved and supported by daily work reports
- Tests of a sample of daily work reports to determine whether they accurately document completed work
- Tests of a sample of change orders to determine whether they are properly authorized, processed, and documented
- Tests of final estimate payments for selected completed projects to determine whether the payments are accurate and paid only after projects are accepted properly
- Inventories of material-on-hand balances for selected construction projects

Criteria used included the following:

- The Department's Standard Specifications for Construction of Highways, Streets, and Bridges
- Texas Administrative Code
- Texas Government Code
- Department rules, procedures, and manuals
- Other standard audit criteria and best practices

Other Information

We conducted fieldwork from March 2004 through July 2004. This audit was conducted in accordance with generally accepted government auditing standards. The following members of the State Auditor's staff performed this audit:

- Walton Persons, CPA (Project Manager)
- Lucien Hughes (Assistant Project Manager)
- Kathy Aven, CIA
- Manijeh Azmoodeh
- Becky Beachy
- Anthony D. Chavez, CIA, CGAP
- Serra Tamur, MPAff, CISA, CIA
- Worth Ferguson, CPA (Quality Control Reviewer)
- Sandra Vice, CIA, CGAP (Audit Manager)

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Talmadge Heflin, House Appropriations Committee
The Honorable Brian McCall, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Texas Transportation Commission

Mr. Ric Williamson, Chair
Ms. Hope Andrade, Commissioner
Mr. Ted Houghton, Commissioner
Mr. John W. Johnson, Commissioner
Mr. Robert Nichols, Commissioner

Department of Transportation

Mr. Michael W. Behrens, P.E., Executive Director



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