LEGISLATIVE
AUDIT
COMMISSION

Review of
State Toll Highway Authority
Financial and Compliance Audit
Year Ended December 31, 2007

622 Stratton Office Building
Springfield, Illinois 62706
217/782-7097

REVIEW: 4301
STATE TOLL HIGHWAY AUTHORITY
FINANCIAL AND COMPLIANCE AUDIT
YEAR ENDED DECEMBER 31, 2007

FINDINGS/RECOMMENDATIONS - 11
ACCEPTED - 1
IMPLEMENTED - 10

REPEATED RECOMMENDATIONS - 5

PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 6

This review summarizes the reports of the Illinois State Toll Highway Authority filed with the Legislative Audit Commission August 27, 2008. The auditors performed a financial audit and compliance examination for the year ended December 31, 2007 in accordance with *Government Auditing Standards* and State law. The auditors stated that the financial statements were fairly presented.

The State Toll Highway Authority was established in 1968 to provide the construction, operation, regulation and maintenance of a system of toll highways to accommodate the traveling public through and within the State. The Authority has the power and responsibility to establish and collect tolls sufficient to pay for maintenance, repairs, regulation, and operation of the toll highway system and to meet the principal and interest bond funding requirements. The Authority does not receive any State appropriations. It was awarded a federal grant for value pricing. Under the provisions of State law, no bond issue of the Authority, or any interest thereon, is an obligation of the State.

The Authority's predecessor, the Toll Highway Commission, issued revenue bonds totaling $493 million. Since 1985, the Authority has issued almost $3.8 billion in bonds.

The operations of the Authority are administered by a Board of Directors, which include the Governor and Secretary of the Illinois Department of Transportation. Mr. Brian McPartlin was the Executive Director during the audit period. He resigned in October 2008 and was replaced by Mr. Jeffrey Dailey who served as the Tollway's Chief Engineer from 2004 to 2007. Mr. Dailey remains as Executive Director.

The number of employees during the years indicated was:

	Full Time	Part Time	Temporary	Total
2007	1,623	204	0	1,827
2006	1,587	195	1	1,783

The 2007 data includes 188 State troopers, 378 full-time toll collectors, and 53 plaza supervisors and assistants.

Financial Information

Appendix A provides a summary of toll revenue by class of vehicle and other revenue sources. Average daily transactions represent the average daily number of vehicles passing through toll plazas. Total revenue increased from $606,954,360 in 2006, to $637,524,057 in 2007, an increase of $30,569,697, or 5%. Net receivables were $37.5 million in 2007. However total receivables were $87.6 million with $50 million as allowance for doubtful accounts. The majority of the allowance for doubtful accounts was $42 million for toll evasion.

Appendix B presents the statement of net assets for two years ended December 31, 2007 and 2006. Total assets were $5,613,303,287 as of December 31, 2007 compared to $4,870,910,537 at December 31, 2006. Capital assets comprise the largest portion of the Authority's assets, which included the historical cost of land, roadway, and structures, buildings and related improvements and equipment. Expenses for the maintenance and repairs of the roadway and related improvements are charged to operations when incurred. The largest 2007 liability of the Authority totaled $2,985,030,000 for revenue bonds payable.

Changes in Net Assets

Appendix C is a summary of the revenues, expenditures, and other changes in net assets for the years ended December 31, 2007 and 2006. Operating revenues rose almost 4%, or $23.3 million, in 2007 when compared to 2006, due to increased toll revenue and toll evasion recovery. The Tollway completed its violation system change-over and resumed issuing violation notices. Operating expenses increased by almost 15%, or $60.1 million in 2007 when compared to 2006 primarily due to an increase in depreciation expense of $27 million; and engineering and maintenance of roadway increased $9.5 million due to the increased salt, wages and fuel costs due to early winter snows. The loss on disposal of property was $27 million greater in FY07 than FY06 due to the sale of assets such as trucks and plows through a consignment broker. Net assets increased approximately $76 million from 2006 to 2007.

Fixed Assets

Appendix D summarizes the changes in fixed assets for which the Authority was accountable during 2007 and 2006. Infrastructure increased from $4,668 million as of December 31, 2006 to $5,598 million as of December 31, 2007, an increase of 930 million, or 20%. Construction in progress was $660,331,366 as of December 31, 2007.

State Administrative Chargeback

The FY2004 budget included a provision to charge an administrative fee to offset costs borne by the general funds for services provided to agencies or programs financed by special funds. When the Governor's Office of Management and Budget (GOMB) first initiated a transfer of $19 million from the Tollway in FY04, the Attorney General raised concerns about the legality of the transfer and the State Comptroller suspended action on the transfer pending a legal determination from the Attorney General on whether the money belonged to Tollway bondholders. The Tollway's general counsel, an Assistant Attorney General along with bond counsel, a Special Assistant Attorney General, concluded that the Tollway could pay operating expenses of this kind to the State as long as they were reasonable and necessary, and were not in excess of aggregate amounts provided in the Tollway's annual budget.

The Governor's Office of Management and Budget and the Tollway worked cooperatively to determine a methodology to determine a reasonable basis for calculating the value of services provided to the Tollway which were borne by State general funds. The Tollway and GOMB settled on a cost allocation methodology that summed all costs borne by the general funds for types of services provided to the Tollway by numerous State agencies and offices, and then allocated a pro-rata portion to the Tollway.

Collectively, the parties agreed to an allocation based upon the Tollway's portion of State headcount. For FY04, the portion of costs owed by the Tollway was determined to be 2.46% (number of Tollway employees divided by total active SERS employees) of the total cost of identified shared services. Using this methodology, it was agreed the Tollway would remit $10,590,000 for FY07. The Tollway's share of the cost of identified State services was 2.387% for 2007.

Accountants' Findings and Recommendations

Condensed below are the 11 findings and recommendations presented in the audit report. There were five repeated recommendations. The following recommendations are classified on the basis of updated information provided by Patricia Pearn, Fiscal Operations Manager, and received October 28, 2008.

Accepted or Implemented

1. **Strengthen internal controls over financial reporting. Direct individuals preparing account reconciliations to cross-check all amounts to ensure that the supporting work paper (including all detail) is complete and accurate, and agrees to the balance recorded in the general ledger and trial balance. Ensure that an individual other than the preparer reviews all significant trial balance accounts to ensure supporting documentation exists, amounts agree to the trial balance and that all posted adjustments are accurate. Research and**

and properly record all unresolved reconciling items prior to the month-end close. Utilize the automated accounts payable system to track all vendor invoices, including routine bills received such as utilities and other re-occurring expenses. Use journal entries only in circumstances where an invoice is not available such as for recording estimates and retainages related to construction projects. (Repeated-2005)

Finding: The Illinois State Toll Highway Authority does not have sufficient control over the financial reporting process. Several adjustments were deemed immaterial and not corrected on the final financial statements. During a review of the financial documentation the auditors noted the following:

- The Accounts Receivable – Toll Evasion Recovery Account was understated by approximately $340,000 at year-end. Tollway personnel recorded a journal entry crediting the accounts receivable account; however the adjustment should have been recorded as a debit to the accounts receivable account.

- An unidentified variance existed between the supporting information provided for accounts receivable and the balances reported in the trial balance. Supporting documentation received from the Tollway was approximately $103,000 less than the amount recorded on the trial balance.

- The Tollway did not fully amortize debt issuance costs at the end of December 2007. The original cost of the issuance was approximately $964,000 and approximately $481,000 was used as the basis for the calculation. The remainder of the costs were not known until after year-end. As a result, accrued interest payable and interest expense were understated by approximately $483,000.

- Auditors noted two vouchers totaling $112,000 (dated March 2006), were inappropriately recorded as liabilities as of December 31, 2007 (Comptroller Reimbursement Account). Upon further inquiry, these two vouchers were noted as paid by the Comptroller on March 15, 2006, but were not reversed out of the liability account by the Tollway at year-end.

- During an examination of year-end accruals, the auditors discovered that a majority of the December 31, 2007 liability for accounts payable and other accrued liabilities was recorded using adjusting journal entries. These adjustments, totaling approximately $25 million, were recorded manually by adjusting journal entries to the general ledger account entitled “Accrued Expenses – Other”, as opposed to using an automated accounts payable system. The Tollway’s present automated system only records vouchers that have been submitted to the State Comptroller’s office for payment as of December 31 (“pay order liabilities”) and does not support other liabilities for which vendor invoices were received after December 31 pertaining to the prior fiscal year (2007). The software system utilized by the Tollway does not allow invoices to be entered into the system after year-end.

Accepted or Implemented – continued

- Various accounts payable invoices totaling approximately $2.2 million were not properly accrued at year-end.

- A manual entry to accrued liabilities was erroneously recorded twice at year-end causing an overstatement of accrued liabilities of approximately $228,000.

- Various construction accruals totaling approximately $477,000 were not properly accrued at year-end.

- Accrued payroll at year-end was understated by approximately $272,000. There were four Tollway departments missing accruals for the last two days of the fiscal year resulting in the understatement.

- The amount of pension benefit assets held in excess of the pension benefit obligation was recorded by the Tollway as both restricted net assets and deferred revenue. The required deferred revenue reversal of approximately $364,000 was communicated to management and has been corrected in the final financial statements. Although the amount of the adjustment was immaterial it was recorded to enhance the comparability of the deferred revenue detailed footnote in the Notes to the Financial Statements.

Tollway personnel stated that in the absence of a standard, fully-integrated general ledger system, the Tollway prepares GAAP statements by accumulating accounting information from a large number of financial databases maintained by various departments within the Tollway. General Accounting personnel must determine which accounting information is verified and should be recorded in the financial system. Then these entries are manually prepared and entered. The complexity of the process to prepare statements leaves open the possibility of human error.

Response: Accepted. We agree that internal controls over financial reporting should continue to be strengthened and we continually make the effort to improve our financial reporting processes and their integrity. We will enhance our processes to the fullest extent possible and continue to pursue the acquisition of a standard, fully integrated general ledger system, which would include an automated accounts payable subsidiary ledger which would track all open invoices and allow a proper accrual at the end of each accounting period.

2. **Capitalize and depreciate all assets in accordance with the written capitalization policy. Where appropriate, update policy to reflect current practice for areas such as useful lives and address depreciation conventions to be used. In addition, account for lease terminations in accordance with GAAP. (Repeated-2005)**

REVIEW: 4301

Finding: The Tollway's practices and procedures for recording and maintaining capital asset records need improvement. Several adjustments were deemed immaterial and not corrected on the final financial statements. The following were noted during the audit of capital asset records:

- The Tollway did not appropriately account for a capital lease termination. As a result, beginning net assets were understated by approximately $1.9 million, revenue was overstated by approximately $1.4 million, expenses were understated by approximately $2.5 million and capital assets were overstated by approximately $2.1 million.

- Two machinery and equipment capital asset additions totaling approximately $3 million were expensed as opposed to being capitalized in 2007.

- During 2007, the Tollway entered its pooled infrastructure capital assets into its capital asset software. Previously these assets were depreciated in pools using Excel. The capital asset software utilized by the Tollway prorated depreciation expense on most of the pooled assets for depreciation not recorded in prior years. In recalculating depreciation expense the auditors noted that depreciation on one of these assets was not prorated; instead the entire amount of approximately $2.5 million was recorded in 2007 as depreciation expense. Depreciation is not being consistently calculated on pooled assets.

- During 2006, approximately $7 million in transponder purchases were improperly capitalized. As a result of this error, beginning net assets are overstated by approximately $7 million, and 2007 depreciation expense is overstated by approximately $1.5 million.

- Depreciation on the new southern extension of I-355 (part of the 2007 infrastructure acquisitions) is being calculated at the full month convention whereas in prior years depreciation has consistently been calculated using a half year convention resulting in an inconsistent method of depreciation. This inconsistency has resulted in depreciation being approximately $6.3 million less compared to what depreciation would have been if calculated utilizing a half year convention. The Tollway's written capitalization policy does not specify depreciation conventions to be used.

- Certain infrastructure assets are being depreciated over 5 years. Although this is consistent with past practice, this useful life has not been included in the Tollway's written capitalization policy.

- The useful life of one building asset, a leasehold improvement, was changed from 20 years in 2006, to 7 years (the remaining term of the lease) in 2007. Useful lives for buildings per the revised written capitalization policy are 20 years which is unchanged from the prior year policy. The change in life for this individual asset has resulted in depreciation expense being overstated by approximately $36,000.

Accepted or Implemented - continued

- One item out of 20 in the property and equipment inventory, totaling approximately $6,000, could not be located.

- One item out of 10, in the property and equipment inventory, was recorded at an incorrect value in that freight charges of approximately $1,800 were not included in the asset value.

The Tollway should capitalize and depreciate its capital assets in accordance with its formal written capitalization policy, and in accordance with the SAMS manual. SAMS requires that applicable freight be included in the capitalized cost of the capital asset. In addition, accounting principles generally accepted in the United States of America (GAAP) requires that capital assets be capitalized and uniformly depreciated over their estimated useful lives using a systematic approach.

According to Tollway personnel, their entire capital asset recording was done in order to accurately portray asset values and useful lives and they were not able to timely reflect these modifications in their written capital asset policy. For the capital item which excluded freight, Tollway management stated that the Property Control System uses the SUN system to record fixed assets. This system is based on purchase orders and does not reflect freight charges.

Response: The Tollway will update our written capitalization policy to conform to the exceptional depreciation conventions and useful lives employed in 2007. Additionally, we will strive to improve the review process for new capital assets placed in service, to ensure proper conformity with our written capitalization policy.

Updated Response: Implemented.

3. Bill all toll violators in accordance with the law and in a timely fashion. (Repeated-2006)

Finding: The Tollway has not timely exercised its right to pursue collection of toll violations.

Currently the Tollway has not been able to bill toll violators on a timely basis. In August 2007, the Tollway implemented a new violation system and resumed issuing notices to violators; however, there were approximately 1.5 million potential notices that had not been issued as of December 31, 2007.

Tollway management stated that a vendor was selected to implement the RITE solution that consists of a toll collection and violation processing system. The toll collection system was given priority over the violation system, resulting in delays in the development and implementation of the violation system.

Response: As of June, 2008, the backlog has been reduced to 890,000 potential notices and will be fully eliminated by year end.

Updated Response: Implemented.

4. Review the entire vendor master listing to ensure that vendors have not been issued more than one vendor number. In cases where it may be necessary to have multiple vendor numbers for different addresses, determine which vendor number should be associated with the vendor and place all other numbers in an inactive file.

Finding: The Tollway has vendors with multiple vendor numbers within its master vendor file. During an examination of the Master Vendor Listing, the auditors noted that 62 vendors appeared multiple times, with the same contact information but the vendor had multiple vendor numbers.

Tollway management stated that this occurred due to an oversight.

Response: The Tollway will implement a process to review the master vendor list on a regular basis.

Updated Response: Implemented.

5. Follow established procedures to ensure all bank accounts are reconciled and approved in a timely manner. Ensure that the preparer and reviewer sign off on the bank reconciliations. (Repeated-2003)

Finding: The Tollway did not approve bank reconciliations in a timely manner. In addition, several reconciliations were not completed in a timely manner and did not include a preparer and/or approval signature. During a review of 66 bank reconciliations, the auditors noted the following:

- 30 out of 66 bank reconciliations (45%) did not include an approval signature;
- 2 out of 66 bank reconciliations did not include a preparer or approval signature; and
- 2 out of 66 bank reconciliations were not completed timely.

Tollway personnel stated that the December 2007 bank reconciliation for the general account was delayed while they awaited information from the State Comptroller's office to reconcile outstanding warrants; when this finally became available, extra time was spent to perform this reconciliation of our largest account balance. Prior to December 2007, the Tollway had no information to reconcile outstanding warrants to the Comptroller's records.

Accepted or Implemented – continued

Tollway personnel also indicated that the missing approvals occurred because the Chief Accountant - M&O position was vacant until July 1, resulting in increased workloads for other staff.

Response: The Authority will apply extra effort toward ensuring timeliness in the preparation of bank reconciliations and proper review and/or approval, as indicated by the initials of the reviewer or approver.

Updated Response: Implemented.

6. Process and approve all contracts in writing before the beginning of the contract period.

Finding: The Tollway did not ensure that all contracts were executed on a timely basis. During a review of 12 contracts, the auditors noted that nine contracts (75%), totaling approximately $282 million, were signed between three and 77 days after issuance of the Notice to Proceed. The Notice to Proceed is the Tollway's written communication to the contractor notifying them that they are authorized to proceed with work outlined in the contract.

Tollway management indicated that the construction contracts were signed by the contractor when brought to the Board for approval. In some cases the formal contract signing was delayed for various reasons. Notices to proceed were provided to the contractor in order not to delay the start of the projects. In no case were any payments made to contractors without signed contracts.

Response: Implemented. The Authority currently requires all contract signatures to be obtained before a notice to proceed is issued.

7. Follow the procurement process without bypassing the policies in place.

Finding: The Tollway user departments and procurement department are not following the established procurement procedures. During a review of the procurement process the auditors noted the following:

- Nine out of 25 purchase orders were placed in the Stock Utilization and Needs (SUN) system after the invoice and goods were received;
- Eleven out of 25 purchase orders did not obtain a multi-quote for purchases made. These instances negated the opportunity for the purchase request to solicit quotes or identify whether a contract should be created for the vendor.

The Tollway internal purchasing procedures indicate the following:

- Purchases and contracts are processed through the SUN system. Using Department's request for inventory or non-inventory goods are initiated by completing the appropriate Need Request Form which requires the appropriate delegated approvals prior to submission to the Procurement Services Unit. With appropriate approvals, specified employees enter the Need into the SUN system and after required approvals are obtained, the Need is routed to the Procurement Services Division where the need is assigned to a buy to be procured if the item is not in inventory stock; and
- Purchases between $1,000 and $31,299 are to be multi-quoted to CMS certified Small Business Vendors, except when the goods/services are only available from a documented sole-source.

Tollway management stated that the systems are not capable of preventing user departments from placing orders independently before entry into SUN. Users placing orders for recurring items in this manner make it difficult for Procurement to coordinate efforts with users to analyze and track recurring spending.

The SUN system drives the procurement process as user departments negate this process it allows for departments to purchase items without the approval of procurement. Bypassing the policies in place also leaves the Tollway exposed to doing business with non-state approved vendors, violating State statutes, and also possible forfeiture of possible discounts/obtaining the lowest price.

<u>**Response:**</u> The procurement rules will be reiterated to all Tollway departments.

<u>**Updated Response:**</u> Implemented.

8. Complete all required internal audits on a timely basis. In addition, the chief internal auditor should report directly to the Tollway's Director. (Repeated-2005)

<u>**Finding:**</u> The Tollway did not complete required audits of all the major systems and the chief internal auditor does not report directly to the Tollway's chief executive officer as required under State statute. Six out of nine planned major systems internal audits were not completed during the 2006-2007 fiscal year cycle. In addition, the chief internal auditor reports directly to the inspector general instead of the chief executive officer.

Tollway management stated that Executive Order #10 required most State agencies to transfer the internal audit function to the Illinois Office of Internal Audit (IOIA), a division of the Department of Central Management Services. The nature of the Tollway's governance created uncertainty as to whether the Tollway was required to comply. However, the Tollway entered into negotiations with the IOIA to perform this service but could not reach agreement on a reasonable fee and scope of service.

Accepted or Implemented - concluded

The transfer of the internal audit function was abandoned upon breakdown of negotiations. The Tollway's Internal Audit Department was re-established. During 2007, three of the required audits were completed, with a fourth one in progress.

Response: We concur and anticipate completion of all required audits in 2008.

Updated Response: Implemented.

9. Implement policies to measure the performance of a vendor as specified under the terms of the contract.

Finding: The Tollway does not maintain a report to determine whether its lane maintenance vendor is performing at the contracted requirements.

The vendor is responsible for lane maintenance to the Tollway's toll system. During testing the auditors noted the Tollway has not developed a reconciliation process to monitor the vendor's performance relating to lane availability using the standards agreed upon within the contract. The contract (valued at approximately $38 million) specifies penalties that can be applied in the event that minimum performance standards are not achieved. A reporting system is currently being developed to monitor the specific metrics relating to lane availability.

Tollway personnel stated that the HEAT (Helpdesk Expert Automation Tool) system [referred to in the contract], which will allow them to monitor performance, is still under development. In the absence of being able to use this system, the Tollway devised an alternate method to track performance.

Response: The Authority will work to implement a system to routinely monitor lane maintenance performance.

Updated Response: Implemented.

10. Review policies and procedures to ensure that required forms are accurately filed with final adjusted balances.

Finding: The Tollway did not accurately report all information on three of their quarterly C-17 (Report of Locally Held Funds) reports to the Comptroller.

The amounts reported on the fourth quarter C-17 were not indicative of the final balances reflected in the December 2007 financial statements. Three locally held fund accounts were excluded from the fourth quarter report. In addition, one C-17 was filed with an investment balance at quarter-end which was subsequently removed from the general ledger and had a zero balance. The inaccurate fourth quarter C-17 reports had not been resubmitted with the actual numbers as of May 2008.

Tollway management stated that this was due to an oversight and that revised forms have been prepared, but not submitted to the Comptroller.

Response: Implemented. A corrected C-17 for the fourth quarter has since been submitted to the Comptroller.

11. Review and approve all reconciliations in a timely manner.

Finding: The Tollway management did not review and approve the revenue reconciliations reports (SB04) for the first quarter of the fiscal year.

The Office of the Comptroller provides each agency which has had activity during the month with certain reconciliation reports which are intended to allow the agency to compare its internal records with those of the Comptroller's. During a review of the SB04 reconciliations for January, February and March 2007 the auditors noted these reports were not reviewed and approved by management.

Tollway management stated that this occurred due to an oversight.

Response: Implemented.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1) states, "The principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts…" The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage to State property and to prevent or minimize serious disruption in State services or to insure the integrity of State records, or to avoid lapsing or loss of federal or donated funds. The Chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make 'quick purchases', including but not limited to items available at a discount for a limited period of time."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the

the purchases and to comment on abuses of the exemption.
During calendar 2007, the Authority filed nine affidavits for emergency purchases totaling $1,560,002.01 as follows:

- $1,131,233.00 for various repairs;
- $332,769.01 for signage; and
- $97,000 for kiosks.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each State agency is required to file reports of all its officers and employees for whom official headquarters have been designated at any location other than that at which official duties require them to spend the largest part of their working time. In June 2007, the State Toll Highway Authority reported it had no employees assigned to locations other than official headquarters.