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Independent Auditor's Report on Applying Agreed-Upon Procedures
Interim Report I

Dear Ms. Joffrion:

The Tennessee Department of Transportation's Office of Internal Audit (OIA) has performed the procedures described in the attached Schedule A. These procedures were agreed to by Management (you) in order to assist you in determining the adequacy of recently implemented controls pertaining to operations at the Division of Multimodal Transportation Resources (DMTR). Due to the nature of the engagement, availability of resources, and the timing of the planned control implementations, all agreed-upon procedures have not been completed to date. Some of the agreed-upon procedures require periodic follow-up evaluations to determine their eventual disposition. Additionally, agreed-upon procedure #8 was not assessed because these activities have not been implemented as of the report date. The Office of Internal Audit will issue additional report(s) as other items in the initial agreed-upon agreement are concluded.

This agreed-upon procedures engagement was performed in accordance with Government Auditing Standards (GAS), December 2011 Revision which incorporates Statements on Standards for Attestation Engagements established by the American Institute of Certified Public Accountants (AICPA). The sufficiency of these procedures is solely the responsibility of the specified users of this report. Consequently, we make no representation regarding the sufficiency of the procedures described in Schedule A for the purpose for which this report has been requested or for any other purpose. Schedule B includes recommendations to enhance current practices. Recommendations are suggestions for process improvements designed to address variances from current to expected conditions. They are intended to provide DMTR management information on how to achieve the desired state but should not be construed as prescriptive requirements. Other measures, not mentioned herein, could be enacted by DMTR management to achieve the desired results.

We were not engaged to and did not perform an audit or an examination, the objective of which would be the expression of an opinion or negative assurance on the specified elements, accounts, items, efficiency and effectiveness of your operations, or government

service delivery. Accordingly, we do not express such an opinion here. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified users of this report and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes. Management is responsible for the Division of Multimodal Transportation Resources risk management and internal control responses.

We appreciate the courtesies and cooperation extended to us.

Kind regards,

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Schedule A
Agreed-Upon Procedures Engagement Procedures and Observations

The following agreed-upon procedures were performed for the Division of Multimodal Transportation Resources. The scope of the work was for the period July 1, 2012 through June 30, 2013. The results of the procedures are detailed below.

Agreed-Upon Procedure #1
Confirm the action plan for the implementation of a checklist for invoice submission/processing through a retroactive application of the checklist to prior invoice submissions beginning July 1, 2012 to the most current reimbursement request.

Procedures and Observations
The "Invoice Checklist" was retroactively applied to a sample of reimbursement claims previously processed by DMTR for subrecipient agencies. The testing was performed to determine if unallowable costs submitted for reimbursement, as detailed in *OMB CIRCULAR A-87: Cost Principles for State, Local, and Indian Tribal Governments*, would be identified and excluded from reimbursement as a result of subrecipient adherence to the guidelines and requirements of the Invoice Checklist. After conducting two retroactive reviews, it became apparent that the checklist, in its current composition, is insufficient to collect the detailed information needed to allow DMTR to specifically identify unallowable costs.

Although DMTR has performed considerable efforts to address this matter, DMTR continues to experience difficulty identifying unallowable costs. This condition is a result of receiving insufficient detail for expenditures claimed for reimbursement in the transit grant programs. Additionally, the Schedule of Expenditures form, as required by the Department of Finance and Administration, provides only sum totals for categories of grant expenditures claimed for reimbursement and does not incorporate additional information needed to determine appropriateness of individual reimbursement request items. In order to evaluate and ascertain whether a particular line item is allowable or not, the DMTR will need additional information that will enable a better assessment of the appropriateness of the request. (See recommendations A, B, C, D, and E.)

Agreed-Upon Procedure #2
Assist in refining the checklist for identifying critical requirements as appropriate, including:

- *Offsetting revenues (correctness and appropriate use)*
- *Unallowable costs and itemization of "Other Costs"*
- *Capital items to be entered into inventory monitoring schedule*
- *Compliance checks*
- *Indirect cost allocation plan*
- *Cost itemization/Allowable costs*
- *Documentation requirements*

- *Accruals versus calculation of liability and the 3-day payment rule*
- *Footing and cross checking against contract and financial system*
- *Additional documentation and other required items*

Procedures and Observations
The elements of the Invoice Checklist were analyzed for compliance with rules and policies as enumerated below:

- *OMB Circular A-87 (Allowable/Unallowable Costs; Indirect Cost Allocation; Documentation)*
- *49 CFR - Section 18 (Offsetting Revenue; Capital Items/Inventory; Compliance; Documentation)*
- *FTA C 9040.1F (Offsetting Revenue, Allowable/Unallowable Costs; Capital Items/Inventory; Compliance; Documentation)*
- *OMB Circular A-133 (Compliance)*
- *FTA C 5010.1D (Offsetting Revenue; Accruals; Allowable/Unallowable Costs; Capital Items/Inventory; Compliance; Documentation)*
- *Department Of Finance and Administration Policy 03 (Offsetting Revenue; Cost Allocation)*
- *DMTR State Management Plan*

OIA also tested prior year reimbursement requests to ascertain the viability of the checklist in identifying critical requirements. Additionally, members of the OIA participated in meetings involving the DMTR and the Human Resource Agencies (HRAs) that receive these grants monies. OIA also conducted onsite visits and individual interviews with personnel from subrecipient agencies.

In evaluating the checklist and identifying critical requirements for offsetting revenues, we observed issues between DMTR and HRAs in computing "Average Farebox Revenue" and in restricting the use of contract revenue (CR) for local match dollars. Contract revenues are income derived from providing human service transportation to other agencies (State or local) or other social service organizations. HRAs were concerned that proposed changes on the use of Contract Revenue would result in the elimination of services and render them unable to provide the required local match dollars. Initiatives to collect additional information are often met with resistance from the HRAs because of additional effort (that may require additional personnel) or already providing the same information in another report, albeit in a different format.

Potential implications of the checklist implementation notwithstanding, the "Invoice Checklist", in its current form, is effective for:
- Collecting ridership data for reporting to the National Transit Database but not for collecting farebox and ridership information necessary for reconciliation and determining the appropriateness and correctness of using offsetting revenues.
- Improving efficiency by serving as a reminder for agencies to check specific information before submitting reimbursements requests but not for requiring all necessary detailed documentation to perform effective claims analysis.

- Encouraging agencies to contract with Disadvantaged Business Enterprises and facilitate compliance with requirements of the Davis-Bacon Act of 1931.
- Serving as a claims submission cover sheet.

Our observations also noted that the invoice checklist is not effective in producing meaningful "Average Fare" figures for internal evaluation purposes, as well as to account for the proper Contract Revenue figures. DMTR does not currently receive all information that is needed not only to remain in compliance but also to conduct meaningful evaluations of program performance and identifying opportunities to improve the effectiveness and efficiency of transit grant programs. Current processes in place indicate that farebox revenue deducted from claims submissions cannot be reconciled to ridership reports because individual fare information is not submitted by the HRAs. Our work in this area indicates that software applications both currently deployed or under consideration could be utilized to provide the necessary information to effectively manage transit operations and collect the necessary information needed for compliance. (See recommendations A, B, C, D, and E.)

Agreed-Upon Procedure #3
Provide the necessary inputs to enable the development and generation of a process for correcting previous errors in payment of invoices.

Procedures and Observations
Applicable federal and state requirements for reimbursements and correcting errors in payment of invoices were researched and reviewed:

- *OMB Circular A-87 (Allowable/Unallowable Costs; Indirect Cost Allocation; Documentation)*
- *DMTR State Management Plan*
- *DMTR Invoice Reimbursement Administration Manual*

In relation to the work conducted on agreed-upon procedures #1 and #2, OIA also conducted process flow assessments of the claims reimbursement procedures, how payment errors are identified, and what options are available to recoup any excess payments. In addition, prior audit findings, uncovered by the State Comptroller's Office, were reviewed to determine the nature and typical dollar amounts of errors in payment of invoices.

The work performed revealed the following:
- HRAs normally deplete the allocated grant funds several months prior to the end of the grant contract period, but continue to provide the public transit services the grants support and incur expenses allowable within the grant for which they are not reimbursed.
- Insufficient details of reimbursement requests make it difficult to correctly identify allowable and unallowable costs. Discrepancies range several hundred to small dollar amounts which could be considered immaterial to the total grant amount but are nonetheless not allowable.

- The State Management Plan delineates a process when repayment of funds is required.

Developing documentation requirements and a claim analysis process will help identify unallowable costs at the time reimbursement is presented. (See recommendations D, E, and I.)

Agreed-Upon Procedure #4
Provide assistance in the development of templates for calculating program allocations.

Procedures and Observations
The allocation templates designed by the Assistant Director of DMTR were reviewed and determined to be sufficient to correct the previous Significant Deficiency cited in the 2012-2013 Federal Transit Administration (FTA) review. The templates were submitted to the FTA and subsequently approved. Any audit issues associated with this matter was resolved.

Allocation methodologies utilized by DMTR were compared to those of other DOTs across the country. The comparative analysis revealed some prevalent practices not currently used by DMTR, which includes requiring a competitive application process to allocate Rural Transit Grants and consideration of program performance measures in grant allocations. (See recommendations B, C, and F.)

Agreed-Upon Procedure #5
Confirm the adequacy of the inventory monitoring plan by:
- *Determining all required data points are covered.*
- *Verifying the definition or qualifying criteria for assets to be tracked.*
- *Providing assurance on the accuracy and completeness of inventory data.*

Procedures and Observations
To address this part of the engagement, the applicable federal and state rules for maintaining continued control of assets purchased with grant funds were reviewed to ascertain the elements required for compliance. The relevant criteria included:
- *49 CFR - Section 18*
- *OMB Circular A-133 Compliance Supplement*
- *FTA C 5010.1D*
- *DMTR State Management Plan, Chapter 12*

The documents enumerated above provided guidance for purchasing, disposal, use, and record-keeping of grant funded assets and inventory. To remain in compliance, DMTR is required to maintain asset information in the rolling stock inventory records, such as:
- Property Description
- Vehicle Identification Number
- Funding Source
- Acquisition Date

- Acquisition Cost
- Location
- Use and Condition
- Useful Life
- Disposal Date
- Disposal Proceeds

Additionally, DMTR is required to maintain a perpetual inventory system and perform a physical inventory assessment every two years. The results of the physical inventory must be reconciled with the perpetual inventory to establish existence, accuracy, and completeness of the records.

OIA's procedure included evaluating DMTR's "Perpetual Vehicle Inventory for Rural Agencies" and "List of Disposed Vehicle Info for Transit" for compliance with the requirements and to determine if the current process satisfies the inventory record requirements. In addition, OIA selected a random sample of agency vehicles from the vehicle inventory list, performed onsite visits, and tested DMTR's records. The physical inspection verified the existence of the vehicles and the accuracy of the records. With the exception of one record where the tag number is transposed and another with an incorrect digit in the tag number, the inventory records for the sample vehicles were correct. The comparison revealed that DMTR is collecting and maintaining all of the required categories of information.

Our work indicated that DMTR's "Policies and Procedures for Maintaining Satisfactory Continuing Control of Federally Funded Assets" provides an excellent framework for collecting and maintaining inventory records. It details processes and required documentation when a vehicle is purchased and placed into service, periodic inventory reporting requirements, and disposal of vehicles. However, currently outlined processes in the manual appear inconsistent with the State Management Plan. This is especially true when defining how to handle proceeds of disposed assets exceeding $5,000. Refining current procedures, providing definitive language within the policies and procedures manual, as well as instituting new practices can help ensure the effectiveness of the inventory monitoring plan. (See recommendations B, C, G, and I.)

Agreed-Upon Procedure #6
Assist in the development and implementation of a substantive risk assessment.

Procedures and Observations
OIA researched Policy 22 of Tennessee's Department of Finance and Administration and the Tennessee Subrecipient Contract Monitoring Manual for subrecipient risk assessments requirements. In addition, comparative analyses of risk assessment tools and methods used by other Departments of Transportation were examined. The result of the process is the development of a risk assessment questionnaire that addresses the requirements. The resulting Risk Assessment process was recommended for use and was subsequently sent out to the various HRAs to request their input and responses.

Upon receiving the results of the self-assessments, OIA noted that agency risk scores ranged from 27 to 43 with an average of 33.15 and mean of 30. Responses to individual questions and agency total scores appear to indicate that some agencies were more forthcoming with their responses and used the process as an opportunity to factually evaluate prevalent risks within their agency. Additional procedures need to be implemented along with the risk assessment to optimize the benefits associated with identifying risks. (See recommendations H and I.)

Agreed-Upon Procedure #7
Recommend strategies to develop a suitable program for internal subrecipient monitoring as they pertain to core program requirements; determination of appropriate monitoring responsibilities, funding options, logistics, and coordination with other audits.

Procedures and Observations
To obtain a better understanding of the various requirements applicable federal and state requirements for subrecipient monitoring were researched and reviewed, which included:
- *OMB Circular A-133, Audits of States, Local Governments and Non-Profit Organizations*
- *Finance & Administration Policy 22*
- *Tennessee Subrecipient Contract Monitoring Manual, June 2004*

OIA also reviewed the *Compliance Monitoring Program (CMP) Field Guide*, (developed for DMTR by RLS & Associates and TranSystems Corporation). For benchmarking purposes, monitoring programs used by other state DOTs were reviewed. Additionally, the *Monitoring Manual Policies and Procedures* developed by the Governor's Highway Safety Office (GHSO) were also evaluated for best practices. Finally, process flow interviews with personnel from TDOT Finance Division's External Audit group were conducted to document their role, and extent of responsibility, in subrecipient monitoring.

The procedures performed indicated that the External Audit function conducts subrecipient monitoring on a sample of all grants administered by TDOT. These monitoring activities are designed to meet the requirements of the Department of Finance and Administration's Policy 22, which primarily focus on financial and operational compliance. The sample is selected at the agency level and does not ensure monitoring of any particular division's subrecipients. Operational efficiency and effectiveness are not a part of the compliance monitoring.

In developing DMTRs subrecipient monitoring capability, OIA noted several elements that are essential to ensure compliance with existing policies. Separation of incompatible duties should be promoted, thereby separating program administration from all monitoring functions. This would allow program evaluations and monitoring to be performed with utmost objectivity and independence. Benchmarking with current best practices from other grant funding agencies or TDOT divisions should be conducted to streamline processes and promote effective implementation. (See recommendations H and I.)

Agreed-Upon Procedure #8
Assist the Division of Multimodal Transportation Resources (DMTR) management in conducting an educational grant administration workshop for DMTR staff and subrecipients as they pertain to:

1. *Financial Management Processes*
    i. *Budget preparation*
    ii. *Effective chart of accounts*
    iii. *Day to day accounting*
    iv. *Indirect Cost Allocation Plan creation, approval, use on reimbursements (Accruals versus cost allocations)*
    v. *Best practice process for agency to prepare accounting calculations and documentation*
        a. *Alignment with F&A Policy 3*
        b. *Alignment with reconciliation requirements of TEAM/Contract*
        c. *Alignment with Federal Circulars*
        d. *Alignment with State Management Plan*
2. *Grant Administration*
    i. *Invoice documentation and submission*
3. *Compliance Requirements*
    i. *Annual/Other submission requirements*
    ii. *Monitoring issues*

Procedures and Observations

As of the report date, grant administration educational workshops have not been conducted. However, preliminary work has been performed to compile information integral for the development of educational programs for subrecipients, DMTR staff, and as revealing specific areas of need concerning education and training.

Schedule B
Agreed-Upon Procedures Engagement Recommendations

A – Require HRAs and other Grant Recipients to Provide Itemized Reimbursement Requests.

The DMTR should require subrecipients to submit an itemized report of claimed expenditures which are included in the category totals in the "Schedule of Expenditures". Additional detail for recommendations for the checklist and its use can be found under "Agreed-Upon Procedure #2".

B – Optimize RouteMatch Software Capabilities.

DMTR should take control of maximizing RouteMatch capabilities and lead the development of custom reports. Custom reports are designed to provide the exact information DMTR needs for proper grant administration and performance evaluation. Reports should include items such as:

- Ridership data with individual fare and miles traveled information
- Inventory and maintenance records
- Contract revenue accrued
- Cost allocations
- Vehicle utilization
- Performance measure tracking and business analytics

Additionally, DMTR should utilize the unused portion of the report construction which was included in the initial acquisition of RouteMatch. If possible, grant funds retained for State Administration should be used to fund the building and installation of reports in the transit agencies' RouteMatch systems. The benefits of controlling and funding RouteMatch report creation include:

- Consistency in data reporting methodologies across agencies.
- Report information available on demand in real time.
- Enables DMTR to control of exchange of pertinent data.
- Alleviates some of the labor intensive reporting tasks from agencies.
- Increases the reliability of information.
- Increases effectiveness of the data by eliminating redundancies.

C – Implement Grant Management Software.

Grant administration software, such as Intelligrant or Black Cat, should be utilized by DMTR to automate processes involving contracts, allocations, claims submission, claims analysis, reimbursement, monitoring, and inventory record keeping. Grant management software would also provide a platform for subrecipients to upload information or documentation and provide a medium for DMTR to send or initiate information requests to subrecipients. With the appropriate algorithm factored in, the application could be developed to include automated controls designed to prevent reimbursement of unallowable costs and acceptance of incomplete documentation. The opportunity for this application to interface directly with RouteMatch should be considered in the evaluation of grant administration software.

D– Continually Improve the Invoice Checklist.

DMTR should continue using the "Invoice Checklist" as a tool for claims submissions. DMTR should eliminate the "Average Fare" calculation but develop other elements necessary for agencies to disclose "Contract Revenue". Contract revenue disclosure should reflect the amounts earned and how those funds will be or were used. DMTR should work with RouteMatch to create the tools for obtaining the detailed fare information by rider necessary for farebox revenue reconciliations.

E– Require Additional Documentation to Facilitate Accurate Claims Analysis and Identify Unallowable Costs.

DMTR should develop documentation requirements and defined claims analysis process to identify unallowable costs at the time reimbursement is corrected (see procedures #1 and #2 for detail). Additionally, DMTR should require subrecipient agencies to continue regular submission of the "Schedule of Expenditures" for the duration of the contract period even if all grant funds have been expended prior to the end of the contract period. These submissions will be used to document expenditures for allowable costs that were not reimbursed which may be used to offset any required repayment of previously reimbursed unallowable costs. When errors in payment of invoices cannot be offset with documented allowable costs not reimbursed, DMTR should adhere to the procedures for correcting payment errors as delineated in the DMTR State Management Plan.

F– Refine Allocation Templates by Incorporating Performance Measures.

DMTR should continue to review and refine as necessary the current allocation templates by designing and incorporating performance measures. Incorporating performance measures ensure that the effective and efficient use of grant funds is factored into future allocations. Examples of performance measures to consider include:
- Rider miles per grant dollars expended
- Riders per capita
- Program revenue as a percentage of grant funds expended
- Percent of state ridership

G– Clarify Directives within the Policies and Procedures Manual.

The "Policies and Procedures for Maintaining Satisfactory Continuing Control of Federally Funded Assets" should be revised to include:
- Guidelines for reporting and use of vehicle disposal proceeds which match the language in the State Management Plan for each disposal condition.
- A procedure to verify the disposal proceeds are reported as program income and deducted from reimbursement claims.
- A documented process for comparing appraisal amounts with eventual sale amounts including instructions for reconciling sales amounts significantly less than appraisal amounts.

DMTR should develop and document a process for performing a physical inventory of subrecipient agency equipment at least once every two years for reconciliation with the Perpetual Inventory records. This process should be incorporated into a formal subrecipient monitoring program. DMTR should continue to improve its methods for collecting inventory information to minimize opportunities for data entry or transfer errors. It is recommended

that DMTR pursue the development of RouteMatch reports that will enable inventory information to be directly uploaded from each agency's RouteMatch system.

H– Include Risk Mitigation Requirements in the Risk Assessment Process.
DMTR should enhance and optimize the valued derived from the newly implemented risk management system by:
- Establishing risk assessments as a core function within the proposed Subrecipient Monitoring Program.
- Reviewing and follow-up of self-assessment responses with individually agencies.
- Improving the current process to include other objective scoring factors (along with the subjective responses) such as size, dollar value of the grants received, organizational changes, geographical coverage, etc.
- Requiring explanations and/or risk mitigation plan for evaluations indicating high risk or increased exposure.
- Developing and implementing special oversight conditions for agencies whose overall scores indicate high risk.

I– DMTR Should Benchmark Existing Best Practices when Developing Grant Monitoring Capabilities.
DMTR should create a monitoring team comprised of personnel distinct from those responsible for program administration to ensure independence and objectivity. Additionally, GHSO's current procedures should be evaluated as a potential model for the development of the monitoring program. The key activities performed by the monitoring function should include:
- Promoting compliance by subrecipients through education and oversight.
- Addressing specific instances of claims for questionable or unallowable costs prior to approval.
- Developing positive relationships between DMTR and subrecipients.
- Developing and evaluating performance measures for subrecipient transit programs
- Performing physical inventory reviews of assets purchased with grant funds.
- Verifying of proper use of assets purchased with grant funds (i.e. contract and charter service).
- Identifying and sharing best practices of other transit agencies in the performance of grant activities.
- Acting as a liaison between the subrecipients and representatives of RouteMatch Software to develop automated reports.
- Developing quarterly program progress reports submitted by agencies to address actual financial and ridership performance compared to budget.
- Scheduling an annual on-site visit for most subrecipients; agencies receiving relatively minor grant amounts may be visited a minimum of every two years
- Performing desk reviews performed at regular intervals.