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State Auditor

An Audit Report on

The Metropolitan Transit Authority of Harris County

November 2008

Report No. 09-013



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Overall Conclusion

The Metropolitan Transit Authority of Harris County (Transit Authority) presented financial and performance reports for fiscal year 2007 that were internally consistent and supported by the Transit Authority's information systems.

The Transit Authority also complied with established policies and procedures for travel expenditures, General Mobility Program expenditures, and long-term expansion. However, it should establish formal policies and procedures for (1) verifying quarterly departmental budget information and budget changes and (2) procuring legal services.

Auditors also determined that the Transit Authority has adequate processes to manage its planned long-term expansion for light rail. However, the Federal Transit Administration (FTA) noted that the plans for two federally funded light rail corridors call for total borrowing that exceeds the Transit Authority's current debt capacity. The FTA determined that the Transit Authority had demonstrated its technical ability and capacity to develop and manage a third federally funded light rail corridor, but it noted that the schedule for that corridor project was optimistic when compared to the other two corridor projects.

In addition, the Transit Authority consistently implemented recommendations from internal and external audits and reviews.

Background Information

The Transit Authority, which is a political subdivision of the State of Texas, began operations in 1979 to develop, maintain, and operate a public mass transportation system, principally within Harris County.

The Transit Authority is governed by a nine-member board of directors. Five directors are nominated by the mayor of the Houston and confirmed by the Houston City Council. Two directors are nominated by a Harris County judge and confirmed by the Harris County Commissioners Court. The remaining two directors are elected by the mayors of the 14 cities other than Houston that are within the Transit Authority's service area.

In fiscal year 2007, the Transit Authority had 3,288 full-time equivalent employees. Its fiscal year 2007 revenues totaled \$651,199,468, and its fiscal year 2007 expenditures totaled \$570,092,908.

Key Points

The Transit Authority presented financial and performance reports that were internally consistent and supported by its information systems.

The Transit Authority's published financial and performance reports for fiscal year 2007 were consistent with both:

- The financial statements audited by the Transit Authority's external auditor (KPMG, LLP).
- Information in the Transit Authority's accounting and financial reporting systems.

The FTA received a complaint submitted to the U.S. Department of Transportation alleging that the Transit Authority misreported its financial condition for fiscal year 2006. The FTA determined that the complaint was not substantiated, and both the FTA and the U.S. Department of Transportation closed the investigation into this matter.

The Transit Authority adhered to established financial policies and procedures, but it should establish policies and procedures in certain areas.

The Transit Authority adhered to established policies and procedures in the following areas:

- Out-of-town and out-of-state travel.
- General Mobility Program expenditures.
- Long-term expansion.

Additionally, the financial audits that KPMG, LLP conducted for fiscal years 2006 and 2007 did not identify any issues related to the Transit Authority's compliance with policies and procedures for cash management and debt strategies.

However, the Transit Authority should establish and implement policies and procedures for verification of quarterly budget reports, budget changes, and procurement of legal services.

Financial Areas Reviewed

Auditors reviewed the Transit Authority's financial transactions and policies and procedures in the following areas:

- Out-of-town and out-of-state travel reimbursements.
- General Mobility Program expenditures.
- Budgeting.
- Capital projects.
- Purchased services applicable to the procurement, planning, engineering, and construction divisions.

The Transit Authority has adequate planning processes to manage its long-term expansion of light rail, but a number of uncertainties could delay the achievement of that plan.

The Transit Authority has adequate planning and cash flow forecasting processes for its planned light rail expansion, and it has made progress toward its goal of obtaining federal funding for its long-term expansion plan under the hybrid delivery system method approved by the Texas Legislature in 2005.

The FTA has authorized the Transit Authority to enter the preliminary engineering phase for two corridors, but it noted opportunities to improve the initial plans. Updated versions of the plans will be submitted for federal review throughout the duration of the projects.

Federal authorization to enter the final design and construction stage for two of the Transit Authority's three federally funded light rail expansion projects is contingent upon the Transit Authority's completion of negotiations with the proposed facility provider and federal review of the agreement. The Transit Authority's goal is to complete all five of its light rail corridor projects by December 31, 2012. Any additional delays, particularly any delays that affect the already aggressive University Corridor schedule, may impair the Transit Authority's ability to meet this goal.

The Transit Authority implemented corrective action in response to recommendations issued by its internal audit department, recommendations issued as a result of its fiscal year 2004 quadrennial performance audit, and recommendations from FTA reviews in fiscal year 2004 and fiscal year 2006.

Summary of Management's Response

In its response to this report, the Transit Authority describes its perspective on the audit issues and offers additional information for consideration.

Summary of Information Technology Review

Auditors (1) reviewed application and logical access controls over the computer systems that the Transit Authority uses in its budgeting and purchasing processes and (2) followed up on issues noted in recent audits. Controls are in place over these systems, and additional controls are in place to ensure the reliability, validity, and accuracy of budgeting and purchasing data.

The Transit Authority uses Cognos, a third-party system, as its budgeting system. It uses MAPS, a combination of three third-party systems—PRISM-Procurement, SAP, and Oracle Financial—as its purchasing system. Auditors reviewed PRISM-Procurement and Oracle Financial and focused on the purchasing of non-inventory items and services.

The Transit Authority is addressing issues identified in recent audits to improve controls over user access and passwords.

Summary of Objective, Scope, and Methodology

The audit objective was to review selected financial transactions and financial reports to provide information about the Transit Authority's financial condition, cash management strategies, and results of operations.

The scope of this audit included reviews of the annual report, monthly and quarterly board reports, General Mobility Program summaries and reports, quarterly departmental reports, monthly ridership reports, internal audit reports, performance audit reports, reports from the FTA, outstanding lawsuits, and a complaint submitted to the U.S. Department of Transportation.

The audit methodology included collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with the management and staff at the Transit Authority. Auditors analyzed information related to reported financial and performance indicators for fiscal years 1996 through 2007. Auditors also performed reviews and/or tests of procurement policies and procedures, construction projects, professional service contracts, the purchased transportation contract, out-of-state travel reimbursements, General Mobility Program projects, budget policies and procedures, and long-term expansion projects.

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Detailed Results

Chapter 1

The Transit Authority's Financial and Performance Reports Were Internally Consistent and Were Supported by Information in the Transit Authority's Information Systems

Information in the Metropolitan Transit Authority of Harris County's (Transit Authority) financial and performance reports was internally consistent and was supported by the Transit Authority's information systems. Auditors made that conclusion based on reviews of the following reports, which the Transit Authority generates and disseminates to the general public, regulatory agencies, management, and its board on a regular basis:

- **Monthly Board Reports** – Contain ridership, financial, and performance statistics reported on a monthly basis to the Transit Authority's board.
- **Quarterly Board Reports** – Contain quarterly financial information relative to operating budgets, balance sheet accounts, and revenue, as well as quarterly information for the statistics presented in the Monthly Board Reports.
- **Quarterly Preliminary Engineering and Construction Review Reports** – Contain operating budget information and information on actual expenditures compared with budget information for each Transit Authority project.
- **Monthly/Quarterly Ridership Reports** – Contain statistics for passenger trips by mode of transit on a monthly and quarterly basis.
- **General Mobility Program Cash Flow Summaries and Unexpended Cash Carryover Reports** – Contain financial information pertaining to the Transit Authority's General Mobility Program such as expenditures, revenues, and unexpended carryover cash balances. The summaries provide a means for the Transit Authority to monitor its General Mobility Program projects. (The Transit Authority sets aside one-quarter of its one-cent sales tax revenue for the General Mobility Program, which funds mobility projects in Harris County, Houston, and other cities in the Transit Authority's service area.)
- **Comprehensive Annual Financial Report** - Contains the basic financial statements and other required financial information of the Transit Authority. This report was audited by KPMG, LLC, which gave it an

unqualified opinion; this means that the financial statements accurately presented the Transit Authority’s financial position and activities.

The U.S. Department of Transportation has closed a complaint regarding the Transit Authority’s financial information.

During fiscal year 2007, a complaint was submitted to the U.S. Department of Transportation (USDOT) alleging that the Transit Authority violated USDOT regulations and generally accepted accounting principles. The complaint alleged that the Transit Authority provided information to the Federal Transit Administration (FTA) for fiscal year 2006 that did not accurately reflect its financial condition.

USDOT directed the FTA to conduct an inquiry to determine whether the Transit Authority had misstated its financial position. The FTA found that the Transit Authority had not misstated its financial position. USDOT determined that the FTA’s conclusion was reasonable and closed the matter.

The Transit Authority followed guidelines for accruing contingencies related to lawsuits.

From October 2006 through May 2008, the Transit Authority was subject to 15 lawsuits that each had a potential liability of \$50,000 or more. The nature and status of those lawsuits are summarized in Table 1.

Table 1

Summary of Transit Authority Lawsuits With Potential Liabilities of at Least \$50,000 Each October 2006 through May 2008			
Nature of Lawsuit	Total Number of Lawsuits	Number of Lawsuits Pending	Number of Lawsuits Settled or Closed
Injury	8	4	4
Employment	6	3	3
Contractual	1	1	0
Totals	15	8	7

Source: Auditor analysis of lawsuits.

The Transit Authority followed guidelines in Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, by accruing contingencies as soon as they became potential exposures and a reasonable estimate of the liability could be made.

The Transit Authority Complied with Established Policies and Procedures for Travel, the General Mobility Program, and Long-term Expansion, But It Should Establish Policies and Procedures Related to Budgeting and Procuring Legal Services

The Transit Authority complied with established policies and procedures for travel expenditures, General Mobility Program expenditures, and long-term expansion. However, it should establish formal policies and procedures for (1) verifying quarterly departmental budget information and budget changes and (2) procuring legal services.

In addition, the financial audits that KPMG, LLP conducted on the Transit Authority's financial statements for fiscal years 2006 and 2007 did not identify any issues related to the Transit Authority's compliance with policies and procedures for cash management and debt strategies.

Chapter 2-A

The Transit Authority Complied With Its Policies and Procedures for Travel, the General Mobility Program, and Long-term Expansion

The Transit Authority complied with policies and procedures for travel expenditures.

Auditors tested 32 travel expenditures and determined that the Transit Authority complied with its policies and procedures for supervisory approval, supporting documentation, and reconciliation of travel advances with travel reimbursements. Twenty-four of the 32 transactions tested were for out-of-state travel to the destinations listed in Table 2.

Table 2

Twenty-four Out-of-state Travel Expenditures		
Destination	Number of Trips	Amount of Travel Reimbursement
Toronto, Canada	2	\$ 5,769.85
Washington, DC	3	4,663.83
Nashville, TN	3	4,147.57
Crookston, MN	1	2,377.52
San Francisco, CA	1	1,979.32
Los Angeles, CA	2	1,303.66
San Diego, CA	2	1,281.97
Phoenix, AZ	1	1,173.51
Valance, France	1	890.03
Las Vegas, NV	1	830.42
Miami, FL	1	750.00

Twenty-four Out-of-state Travel Expenditures		
Destination	Number of Trips	Amount of Travel Reimbursement
Minneapolis, MN	1	691.33
Reno, NV	1	514.19
San Jose, CA	1	506.00
Norcross, GA	1	269.38
Chicago, IL	1	140.00
Newark, NJ	1	105.00
Totals	24	\$27,393.58

Source: Auditor analysis of a sample of Transit Authority travel expenditures.

The Transit Authority complied with policies and procedures for General Mobility Program expenditures.

Auditors tested fiscal year 2007 expenditures for 15 of 53 projects within the Transit Authority's General Mobility Program and determined that the Transit Authority complied with its policies and procedures for validity, authorization, and cost verification.

General Mobility Program

The Transit Authority sets aside one-quarter of its one-cent sales tax revenue for the General Mobility Program. That program funds mobility projects in Harris County, the City of Houston, and other cities in the Transit Authority's service area.

The expenditures auditors tested totaled \$29 million, which represented 41 percent of the approximately \$70 million in expenditures the Transit Authority made under its General Mobility Program in fiscal year 2007.

The Transit Authority complied with long-term expansion program policies and procedures.

Auditors tested four long-term expansion projects that were in the planning and project development phase and determined that the Transit Authority complied with its policies and procedures for documentation of project need and justification and preparation of federally required program management plans.

As Table 3 shows, in fiscal year 2007, the Transit Authority made a total of \$85 million in expenditures for the four projects tested.

Table 3

Four Long-term Expansion Projects Tested			
Project Tested	Fiscal Year 2007 Actual Expenditures (in thousands, audited)	Fiscal Year 2008 Budget (in thousands, unaudited)	Fiscal Year 2008 Actual Expenditures through June 30, 2008 (in thousands, unaudited)
North Corridor Light Rail Project	\$ 19,202	\$ 24,241	\$ 14,828
East End Corridor Light Rail Project	11,450	12,590	16,494
University Corridor Light Rail Project	17,338	29,936	13,153
Transit Facilities	37,025	15,000	21,877
Total for Long-term Expansion Projects Tested	\$ 85,015	\$ 81,767	\$ 66,352
Total for All Long-term Expansion Projects	\$ 129,890	\$157,460	\$101,334

Source: Information from the Transit Authority.

Chapter 2-B

The Transit Authority Should Establish Formal Policies and Procedures for Verification of Quarterly Budget Reviews, Budget Changes, and the Procurement of Legal Services

The Transit Authority should establish formal policies and procedures for the verification of quarterly budget information and budget changes.

The Transit Authority’s Office of Management and Budget (OMB) verifies information it presents to departments for quarterly departmental reviews; however, it does not have written policies and procedures for its verification process. To prepare this information, OMB staff retrieves budget and staffing data from the budget information system and actual financial data from the accounting system. Establishing formal policies and procedures for validating quarterly departmental budget information would help to ensure that OMB verifies this information thoroughly and in a consistent manner.

For budget changes, OMB requests that a spreadsheet be submitted that documents the time period to which a budget change is applicable. The Transit Authority processed budget changes totaling \$71 million during fiscal year 2007. Auditors tested \$66 million (93 percent) of those changes to

determine whether they were authorized and supported by the spreadsheet that the OMB requests. All of the budget changes tested were authorized, but 8 (53 percent) of the 15 budget changes tested were processed without the spreadsheet that the OMB requests. There are no formal policies and procedures that describe what supporting documentation should be submitted to the OMB for budget changes. Adopting formal policies and procedures for budget change submissions, particularly policies and procedures that specify what documents are required to be submitted with the budget changes, could enhance controls over budget-related transactions.

The Transit Authority should establish policies and procedures for the procurement of legal services.

The Transit Authority's procurement policies and procedures specifically exclude legal services. In fiscal year 2007, the Transit Authority spent approximately \$4 million on legal services it procured for its long-term expansion projects. While the Transit Authority's board is not required to authorize the procurement of legal services, Transit Authority staff asserted that they kept the board apprised of legal activities. In addition, auditors noted that the Transit Authority selected its procurement assistance services consultant using a process that included controls for monitoring the related contract modifications and contract costs.

Legal services are excluded from the Texas Professional Services Procurement Act. However, Federal Transit Administration Circular 4220.1E, which contains requirements for federal grant recipients to follow when awarding third-party contracts, is applicable to the procurement of legal services that are funded with federal funds. Establishing formal policies and procedures for the procurement of legal services would help to ensure that the Transit Authority complies with federal requirements.

Recommendations

The Transit Authority should:

- Establish and implement formal policies and procedures for OMB staff to use when verifying quarterly departmental budget information.
- Establish policies and procedures that describe the supporting documentation that must be submitted with budget change requests.
- Establish and implement formal policies and procedures for procuring legal services.

Management's Response

- 1. Current practices for verifying information that OMB presents to the departments for quarterly departmental reviews have been in place since 2004. The information verification is done by a group of highly experienced and qualified management analysts with an average tenure of over 10 years at METRO in this type of work and over 25 years including their experience elsewhere. This staff has consistently and meticulously followed the practices currently in place and there have been no material errors or short comings in the budget information provided to the departments. However, we agree that written procedures could enhance controls and hence they have now been put in place.*
- 2. For budget changes, OMB does not routinely request a spread sheet for every budget transfer unless it is required to properly identify the time period to which a budget change is applicable. The current budget transfer forms that must be filled in for every budget transfer has served well over the years, as the form requires a justification as well as transfer details. The originators add supplementary material on their own, or as requested by OMB depending on the nature of the transfer. However, we agree that written procedures could enhance controls and hence they have now been put in place.*
- 3. Pursuant to the laws of the State of Texas and the Professional Services Procurement Act, all legal services are excluded from the normal procurement process. Notwithstanding the Federal Administration ("FTA") Circular 4220.1E ("Circular"), which discusses certain requirements for federal grant recipients to follow, the third-party contracting process outlined in the Circular is not applicable to the Metropolitan Transit Authority ("METRO"). Section 5 of the Circular provides that the "FTA's role in grantee procurements is reflective of Executive Order 12612, Federalism. The executive order directs Federal agencies to refrain from substituting their judgment for that of their recipients unless the matter is primarily a Federal concern and to defer, to the maximum extent feasible, to the States to establish standards rather than setting national standards." State law is incorporated in the Circular by reference. Further, the Transportation Equity Act ("TEA-21"), enacted June 9, 1998, as Public Law 105-178, allows grantees to use a Brooks Act type of selection process, which is a qualification-based selection, when awarding contracts for professional services if there are State Statutes allowing a qualifications-based method for such professional service contracts. Texas, under which METRO is enabled, and pursuant to the Professional Services Procurement Act, is one of the states that has State Statutes that provide for the procurement of professional services on a qualification-based method. Additionally, in a response by the FTA to a frequently-asked question, FTA's noted and advised that "TEA-21 (aforementioned) would allow a qualifications-based method (no price negotiations) for those services that are specifically authorized by the State*

Statute, and this would normally encompass professions that are licensed by the State (e.g. lawyers, doctors, architects, etc.)” In sum, regarding legal services for federally-funded projects, METRO is neither bound nor required to adhere to the Circular that was outlined in the State Audit Comment. However, even in light of all the above sources and support outlined, which clearly delineate that the Circular is not applicable to METRO, METRO will, by January 31, 2009, establish its own formal policies and procedures for the procurement of legal services for federally-granted projects as recommended by the audit.

The Transit Authority Has Adequate Planning Processes to Manage Its Expansion for Light Rail, But a Number of Uncertainties Could Delay the Achievement of That Plan

Hybrid Delivery System

Texas Transportation Code, Chapter 451, authorizes certain metropolitan rapid transit authorities to use alternative procurement procedures for certain construction projects. These alternative procedures, known as a "hybrid delivery system," are designed to increase metropolitan rapid transit authorities' ability to deliver transportation projects quickly and cost-effectively by allowing for more flexibility in the management of large construction projects than that allowed under more restrictive competitive bidding requirements.

The Transit Authority has adequate planning and cash flow forecasting processes for light rail expansion. In addition, the Transit Authority has made progress toward its goal of obtaining federal funding for its long-term expansion plan for light rail under the hybrid delivery system method approved by the Legislature in 2005 (see text box for additional details).

The FTA determined that the Transit Authority's long-term expansion plan has the financial capacity to allow two of its three federally funded light rail projects—the North Corridor and Southeast Corridor projects—to re-enter the preliminary engineering phase. However, the Transit Authority needs to achieve certain milestones before the FTA will authorize those two projects to enter the final design and construction phase. Achieving these milestones is contingent upon the completion of the Transit Authority's negotiations with a facility provider. Once the projects are authorized to enter the final design phase, the FTA can execute full funding grant agreements with the Transit Authority.

Additional uncertainties exist for the Transit Authority's third federally funded light rail project, the University Corridor project. That project has not progressed as far as the North Corridor and Southeast Corridor projects. Delays in that project, as well as delays in two locally funded light rail projects, may impair the Transit Authority's ability to meet its current goal of completing all five light rail projects by December 31, 2012.

Chapter 3-A

The Transit Authority Has an Adequate Planning Process for Light Rail Expansion

Auditors reviewed the Transit Authority's fiscal year 2008 business plan and budgeting process and determined that the supporting assumptions were consistent with (1) the Transit Authority's strategic goals for fiscal year 2008 and (2) historical trends.

Auditors also reviewed the Transit Authority's ridership forecasting model and determined that the methodology for forecasting ridership numbers was adequate. In addition, the Transit Authority's underlying assumptions were supported by adequate documentation and research, and the model's output was consistent with the Transit Authority's fiscal year 2008 business plan.

The revenue forecast that the Transit Authority included in its fiscal year 2008 business plan was based on an adequate methodology for forecasting revenue, and the underlying assumptions for that forecast were supported by adequate documentation.

The methodology the Transit Authority used to create its short-term cash flow forecast was adequate. Forecasts were based on historical trends from actual bank transactions, and the Transit Authority updated its forecast model on a daily basis.

Chapter 3-B

The FTA Has Authorized the Transit Authority's North Corridor and Southeast Corridor Projects to Re-enter the Preliminary Engineering Phase, But There Are Opportunities to Improve the Plans for Those Projects

The FTA has authorized two of the Transit Authority's federally funded light rail projects—the North Corridor project and the Southeast Corridor project—

to re-enter the preliminary engineering phase. Both projects are being developed under the FTA's New Starts program (see text box for additional details on that program).

The FTA concluded that the operating plans for the North and Southeast Corridors were organized and complete. Although both of these projects have been authorized to enter the preliminary engineering phase, a financial assessment of these plans conducted by the FTA in March 2008 determined the following:

- The FTA noted that several assumptions in the plans were optimistic. For example, the FTA noted that farebox revenue, ridership, and sales tax revenue were assumed to grow at rates that were higher than the average historical growth rates. In addition, the FTA noted that assumptions regarding federal funding sources through fiscal year 2030 were higher than historical levels.

- The FTA noted that the plans lacked detail to allow full analysis of revenues and operations and maintenance costs between existing and new service.
- The FTA noted that the plans did not include detailed supporting schedules that projected capital revenues and costs by source and project.
- The FTA noted that Transit Authority's plans call for total borrowing that exceeds its current total debt capacity (voter approval will be required to issue the additional debt after fiscal year 2012). However, the FTA did not perceive this as a severe shortcoming for the projects because the local

The FTA's New Starts Program

The FTA's New Starts program is the federal government's primary financial resource for supporting locally planned, implemented, and operated major transit capital investments.

New Starts projects must undergo evaluation by the FTA throughout the entire project development process. The FTA evaluates projects according to a variety of criteria. Based on these evaluations, the FTA makes decisions about moving projects forward, from preliminary engineering, to final design, to making annual funding recommendations to Congress, and to the execution of a full funding grant agreement.

Source: Federal Transit Administration.

share of these projects is anticipated to be financed by dedicated local sales tax revenue.

During this audit, auditors also reviewed the plans and identified the following:

- The plans lacked historical data necessary for auditors to assess the reasonableness of the projected funding sources.
- The Transit Authority's capital plans and cash flows assumed that funding begins in fiscal year 2009, while the project-specific schedules for the North Corridor and Southeast Corridor projects assumed that funding began in fiscal year 2006.
- The proposed capital plans for the North Corridor and Southeast Corridor for fiscal year 2008 showed transit sales tax funding assumptions that were higher than the total sales tax revenue projected for the entire Transit Authority.

The FTA will require the Transit Authority to present additional comprehensive, detailed versions of the plans for the North Corridor and Southeast Corridor projects before those projects can progress to the final design and construction phase. In addition, the FTA will conduct a full scope financial management system review of the Transit Authority before it will award the Transit Authority full funding grant agreements for those projects.

Recommendations

The Transit Authority should:

- Implement the recommendations in the FTA's financial assessments for the North Corridor and Southeast Corridor projects.
- Conduct a thorough review of the next iteration of its plans for the North Corridor and Southeast Corridor projects and correct any inconsistencies between the schedules included in those plans and the Transit Authority's most current business plan.
- Within its next iteration of the plans for the North Corridor and Southeast Corridor projects, include a more comprehensive discussion of its proposed contingency plans in response to each scenario tested in the sensitivity analysis section.

Management's Response

The FTA New Starts application process is an application procedure to qualify transit projects to receive 5309 New Starts funding. This process usually takes approximately three to six years to reach the point of negotiating a full funding grant agreement with the FTA. The process is interactive with FTA and their supporting consultants. It is dynamic as New Starts guidance evolves over time to address changes to the federal requirements suggested by Congress, FTA staff, applicants, and the economy.

The process is also competitive as many properties seek these funds due to the scarcity of other funding options and the limited availability of local dollars. The process seeks to eliminate projects on the basis of not being cost effective and not having sufficient data to allow FTA and their consultants to evaluate the merits of the projects. As a result, a project does not get rated and does not proceed through the New Starts process without meeting these minimum standards.

Federal dollars are not distributed to an applicant until a full funding grant agreement has been negotiated and signed. At this time, the applicant will begin to receive disbursements from FTA based on an agreed distribution schedule.

The North and the Southeast light rail projects have both received a financial rating of Medium and are successfully progressing through the process.

As part of the New Starts application process, the submitting agency must update all application elements on an annual basis once a project has entered Preliminary Engineering. This includes all financial and ridership documentation. The annual submittal deadline for ridership updates typically occurs in May and all other updates typically occur in August/September. In addition, when the planning and engineering work of the submitting agency has progressed to advance from one stage of project development to another (i.e. Preliminary Engineering, Final Design, Construction), updates are required to all application materials to reflect changes in project scope, costs, land use patterns, and many other factors. Based upon how quickly a project advances through the development phases, more than one update may be made in any given year.

Refined schedules are being reviewed by FTA as part of the facility provider contracts and will become final once the contracts are signed. FTA does not execute Full Funding Grant Agreements (FFGA) until after a project has entered Final Design. In addition, the submitting agency does not have to complete negotiations with a facility provider before entering Final Design. This is an option selected by METRO to participate in FTA's Public Private Partnership Pilot Program (Penta P). Penta P allows FTA to determine that

an acceptable risk sharing arrangement has been established between the submitting agency and their facility provider. Once this is established, FTA grants expedited reviews of their approval milestones.

The initial technology proposed for the North and Southeast corridors was light rail transit. At the time, FTA's guidance required that projects be evaluated based on their performance with the existing system. This procedure did not allow for the inclusion of other proposed projects from METRO's 2030 long range plan. As previously explained, FTA's guidance is dynamic and regularly updated to reflect various changes in philosophy. In mid 2007, FTA's New Starts guidance changed to allow applicants to consider the performance of a candidate project with the agency's regionally adopted long range plan as the supporting network. As a result, both the North and the Southeast projects achieved a cost effectiveness rating of Medium as light rail transit projects and could proceed to qualify for federal funding.

The forecast of farebox revenues, system ridership, and sales tax revenues are based on regional growth assumptions developed by sources independent of the New Starts application process. Specifically, farebox revenues and system ridership growth assumptions are based on population levels, employment levels, and changes in tripmaking levels and patterns developed by the Houston-Galveston Area Council (H-GAC). METRO is required by law to use the assumptions developed by H-GAC. These assumptions are prepared independent of METRO's New Starts application and are used for all regional projects to determine future needs of the region.

Dr. Barton A. Smith is the Director of The Institute for Regional Forecasting, which is responsible for regional and economic forecasting in the Houston area. METRO and The City of Houston utilize the results produced by Dr. Smith and the Institute for Regional Forecasting. Serving for twenty years as professor of economics at the University of Houston, Dr. Smith has gained the reputation as being one of the leading authorities on the City of Houston's economy. His numerous studies and publications have been relied on by a variety of government and business entities that require economic forecasting for their operations. Dr. Smith has conducted numerous studies and research work in education, housing, transportation, and regional economics. He has gained national and local recognition for his studies and analysis of the Houston economy and real estate markets.

METRO uses the Barton Smith sales tax forecast as an independent source in its financing model to determine affordability of long-term capital projects. The Barton Smith sales tax forecast is updated quarterly and there may be periods where sales tax projections may fluctuate between quarters due to changes in economic trends in the Houston MSA. In the Penta P financial model, METRO constrains the sales tax growth level based on certain assumptions to meet minimum debt service coverage requirements. The use of

Dr. Smith's forecasts is a conservative approach and is specifically reflective of the Houston economy.

FTA did note that our assumptions regarding federal funding sources through fiscal year 2030 were higher than historical levels. However, this was not a criticism by FTA, but merely a statement of fact. Of course, the federal funding assumptions through 2030 are higher than METRO's historical levels. This assumption parallels the fact that METRO is planning to build a large transit construction program through 2030 that will require federal participation. METRO's last large federal program was the Regional Bus Plan. The Regional Bus Plan focused on expanding bus service and bus facilities throughout the service area. The METRO Solutions plan seeks to expand light rail, commuter rail, and bus service to the region to address the changing demographics, density patterns, and travel needs. As the fourth largest city in the nation and one of the fastest growing cities in the nation, Houston has historically served as a donor city by not accessing the level of federal funds that are warranted for a city of our size. As a result, we have a transit system that needs to be expanded. METRO is taking the first step to reverse the donation trend and become a recipient of our region's fair share of federal funds to provide the transit services that our residents deserve.

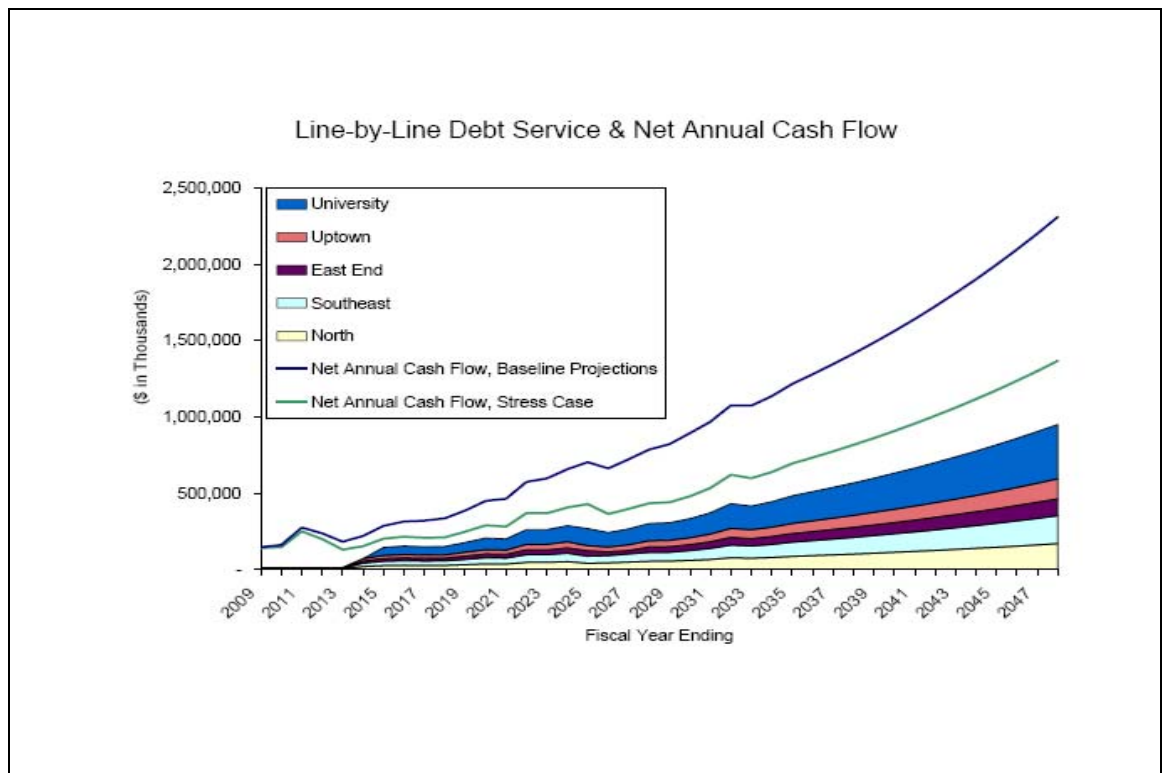
Your report also indicates that "FTA noted that the plans for the two federally funded light rail corridors call for total borrowing that exceeds the Transit Authority's current debt capacity" and suggests that METRO has insufficient debt capacity to complete the projects. SAO failed to provide the proper context for FTA's statement in the audit report. After reviewing METRO's cash projections, FTA actually stated the following:

"METRO submitted a combined cash flow analysis that includes the financial impact of both proposed New Starts projects (Southeast Corridor LRT MOS and North Corridor LRT MOS) as well as all METRO Solutions Phase II projects. Cash reserve balances throughout the 24-year (FY 2008 to FY 2030) cash flow projection are positive.

In all, METRO's projection calls for total borrowing of close to \$4.6 billion, which exceeds current total debt capacity by nearly \$3.0 billion, and it is anticipated that METRO will require voter approval to take on additional debt after FY 2012. The cash flow projection assumes total debt repayments over the 24-year period of \$2.4 billion, indicating an outstanding debt liability at the end of FY 2030 of \$2.2 billion. The ending cash balance in FY 2030 is projected to be \$1.1 billion..."

However, FTA's statement incorrectly assumes that METRO borrows \$4.6 billion. We and our financial advisors met with FTA on September 11, 2008, to correct this error. The \$4.6 billion figure is in fact the total debt service

(principal and interest) over the 30 year life of the bonds—not the principal amount borrowed. As demonstrated in the graphic below, the net annual cash flow available for debt service on the METRO Solutions Phase 2 projects (represented by the purple line) is more than sufficient to cover the debt service obligations in every year through the payoff of the bonds. In fact, the net annual cash flow in the stress case (which assumes significantly reduced sales tax and farebox revenues and is represented by the green line) is still more than sufficient to cover the debt service. In addition, the remaining cash flow available after debt service is sufficient to pay for the remainder of the METRO Solutions program with no additional debt. Including all METRO obligations through 2030 (operating costs, debt service, and METRO Solutions capital), METRO will end up with over \$2.3 billion in cash reserves in 2030.



Further, in your report you suggest that the plans submitted by METRO to FTA “lacked detail to allow full analysis of revenues and operations and maintenance costs between existing and new service.” The statement you have made above is misleading. Full details of all analyses were provided to FTA. In fact, the summary report you reviewed included an extensive discussion of operations and maintenance costs. METRO provided FTA and FTA’s financial consultants documentation and spreadsheets that cover the detail discussed. FTA’s report, however, did recommend that providing additional details could enhance the rating given to future submissions.

You also state in your report that the “FTA noted that the plans did not include detailed supporting schedules that projected capital revenues and costs by source and project.” As previously noted, this is merely a notation of an item that will be needed as the project progresses through the project development process. FTA has always been provided detailed project schedules as appropriate for the current phase of project development. This is a requirement of their ongoing review process. The schedules are reviewed monthly with FTA and its consultants. An assumption of capital expenditures by year based on the project schedule was provided in the financial plans reviewed and in the FTA required New Starts templates. When FTA mentioned supporting schedules in its report, FTA was specifically referring to a level 2 cost loaded schedule. This is required for the next submittal in the project development process. Since METRO is currently pursuing Final Design entry, the appropriate and relevant schedules for this stage of project development have been submitted to FTA and are currently being reviewed by FTA’s consultants.

Several conclusions regarding the New Starts process are attributed in the audit to SAO’s own audit staff:

- *The plans lacked historical data necessary for the auditors to assess the reasonableness of the projected funding sources.*
- *The Transit Authority’s capital plans and cash flows assumed that funding begins in fiscal year 2009, while the project-specific schedules for the North Corridor and Southeast Corridor projects assumed that funding began in fiscal year 2006.*
- *The proposed capital plans for the North Corridor and Southeast Corridor for fiscal year 2008 showed transit sales tax funding assumptions that were higher than the total sales tax revenue projected for the entire Transit Authority.*

We advised SAO’s auditor staff that all historical data was provided in an Appendix and referenced in the financial plans. In addition, full details of sources and uses of funds are provided to FTA in a separate spreadsheet for their review as part of the normal FTA process. The cash flows contained in the project specific schedules recognize the funds expended since 2006. As required by FTA guidance, the capital plan document begins from each current fiscal year (FY 2009 for current submissions). Since METRO has been providing these financial plans since 2004, this is historical information that did not need to be shown in the tables again.

As explained above, the schedules for these projects are dynamic until finalized. METRO has developed draft final schedules with our facility provider and these schedules are currently being reviewed by FTA and FTA’s consultants. The capital plans for the North and Southeast Corridors

contemplate the utilization of sales and use tax revenues. The FTA in their review of funding sources will examine sales tax forecasts for certain periods, which are provided by a third party economist, Dr. Barton A. Smith (see above).

- *METRO uses the independent Barton Smith sales tax forecast in its financing model to determine affordability of long-term capital projects. The Barton Smith sales tax forecast is updated quarterly and there may be periods where sales tax projections may fluctuate between quarters due to changes in economic trends in the Houston MSA.*

The financial plans reviewed relied primarily on existing financing techniques and existing revenue sources. These plans were developed prior to METRO having finalized the public-private partnership financing approach with both the facility provider team and the FTA. METRO began briefing FTA on our specific public-private partnership financing approach in April 2007. The approach was presented from a conceptual basis clearly identifying the potential financing sources and issuances. Since this time, METRO has continued to finalize the approach. Per the New Starts process, it is appropriate to submit this financing plan as part of METRO's application to enter the Final Design project development phase. On September 11, 2008, METRO held a workshop with FTA and their consultants to present the public-private financing plan and the associated financial model. The plan is currently proceeding through FTA's formal review process.

The proposed plan of finance for the North and Southeast Corridors involves the usage of public-private partnership agreements that include design-builder, facility provider, conduit issuer, vehicle supplier, and operator. The financing strategy contemplates a "deferred payment" structure that is an unsecured obligation payable from any lawfully available METRO funds subject to annual appropriation. The financing terms take into account that METRO requires assurances that the Corridors will operate as specified. In order to accomplish this, METRO will enter into a deferred payment agreement whereby METRO will make payments only upon the successful commencement of revenue service.

METRO has worked in concert with FTA since 2004 to develop our New Starts applications for the North and Southeast corridors. As our technical and financial partner in these projects, FTA has employed Program Management Oversight Consultants (PMOC) and Financial Management Oversight Consultants (FMOC) to review our financial submittals on an annual basis to ensure consistency with their current guidance and METRO's historical and current audited financials. As our projects advance through the New Starts process, we will continue to work with FTA and their consultants to address their ongoing comments and meet their standard of approval.

Within the next iteration of the plans for the North Corridor and Southeast Corridor projects, we will address the elements of contingency planning and schedule inconsistencies as appropriate in the FTA process.

Chapter 3-C

FTA Authorization for Federally Funded Light Rail Projects to Enter the Final Design and Construction Phase Is Contingent Upon the Completion of Negotiations with the Facility Provider

The Transit Authority has reached some significant milestones in the implementation of its long-term expansion plan. For example:

- The FTA has determined that the North Corridor and Southeast Corridor projects satisfy requirements of the National Environmental Policy Act, the Clean Air Act, the National Historic Preservation Act, and other legal requirements. Accordingly, the FTA granted a “Record of Decision” to the North and Southeast Corridor projects, which allowed the Transit Authority to resume right-of-way acquisitions for those projects.
- The Transit Authority asserted that it has signed a consent agreement with the City of Houston, removing uncertainties about design variations from City of Houston code and utility relocation.
- In June 2008, the Transit Authority started early construction activities, such as utility work, on its East End Corridor project.
- The Transit Authority asserts that it finalized the negotiations for the facility provider contract on October 6, 2008, and it submitted the contract to the FTA on October 7, 2008.

Four of the five light rail corridor projects—the federally funded North Corridor and Southeast Corridor project and the locally funded East End Corridor and Uptown Corridor projects—are expected to be implemented by the same facility provider. However, in April 2008, the Transit Authority terminated its negotiations for a final design/build contract with the facility provider it originally selected and executed an interim agreement with a new facility provider. The facility provider the Transit Authority originally selected had substantially completed the original contract scope as of March 2008. While an agreement on the price could not be reached with the original facility provider, the Transit Authority indicated that most of the pricing work effort would be re-usable for the proposal with the new facility provider.

The Transit Authority’s draft agreement with the new facility provider covers an eight-month performance period from April 29, 2008, to December 31, 2008, and aims at providing interim program management services until a

final agreement for the final design, build, operate, and maintain phase is reached.

Recommendation

The Transit Authority should continue to work with the FTA to expedite remaining milestones upon completion of negotiations with the new facility provider.

Management's Response

We will continue to work with the FTA as appropriate in the FTA New Starts application process.

Chapter 3-D

Delays May Impair the Transit Authority's Ability to Implement Its Long-term Expansion Plans for Light Rail

Additional uncertainties exist for the federally funded University Corridor light rail project. The FTA has not yet determined whether that project satisfies the requirements of the National Environmental Policy Act of 1969, and commencement of implementation activities by the selected design/build contractor is not scheduled to start until June 2009.

The FTA has determined that the Transit Authority has demonstrated its technical capability and capacity to develop and manage the University Corridor light rail project, but it noted that the project's schedule is optimistic as compared to other project schedules that allow more time for development from preliminary engineering to revenue service. One area of FTA concern is the Transit Authority's schedule for acquisition of the University Corridor design-build contract in light of the delays observed with the facility provider contract for the Transit Authority's other four corridor projects.

Recommendation

The Transit Authority should develop a detailed schedule for the University Corridor light rail project during the preliminary engineering phase to allow for further analysis and quantification of risks related to project uncertainties.

Management's Response

Part of the normal project development process includes the constant refinement of a project's schedule. A project's schedule can not be defined as incurring delay until it has been finalized through a contractual agreement. It is inappropriate for the State Auditor's Office to declare that delays will occur due to uncertainties in a project at a given moment in time. Delays are not a definite result. Alternative approaches and additional resources are available to address potential schedule modifications.

We will continue to work with the FTA as appropriate in the FTA New Starts application process.

The Transit Authority Consistently Implemented Recommendations from Internal and External Audits and Reviews

The Transit Authority has consistently implemented recommendations from internal audits, a performance audit required by the Texas Transportation Code, a review of its compliance with FTA procurement requirements, and a review of its federal Urbanized Area Formula Grant activities.

Internal Audits

From October 1, 2004, through September 30, 2007, the Transit Authority's Audit Department conducted the 28 internal audits listed in Table 4. As a result of these audits, the Audit Department issued 51 recommendations for improving Transit Authority operations. During this audit, auditors tested 38 of those recommendations and determined that the Transit Authority had implemented all 38 recommendations.

Table 4

Audits Conducted by the Transit Authority's Audit Department October 1, 2004, through September 30, 2007	
Description of Audit	Audit Report Release Date
Annual Audit of Police Special Funds for Fiscal Year 2004	November 30, 2004
Special Project - Observation of Disaster Recovery Testing	December 16, 2004
Compliance Review - Audit of Contract and Temporary Labor	February 15, 2005
Fare Box Revenue - Investigation of Revenue Agent Activities	March 11, 2005
Annual Audit of Police Special Funds for Fiscal Year 2005	December 13, 2005
Audit of Quality Assurance and Quality Control Programs	January 25, 2006
Inquiries Regarding Texas Medical Center Transit Center Mixed Use Development	March 8, 2006
Audit of Retirement Benefits Administration	June 30, 2006
Review of Fannin South Park and Ride Revenue	June 30, 2006
Audit of Maintenance Parts Physical Inventory	June 30, 2006
Observation of Disaster Recovery Testing - 2005	August 8, 2006
Audit of Telephone and Pager Services	August 17, 2006
Special Project - SEMA Get Well Plan	September 15, 2006
Observation of Transit Police Rail Platform Activity	November 20, 2006
Compliance Review - Audit of Accounts Payable	December 28, 2006
Audit of Asset Disposal Procedures and Controls	December 28, 2006
Audit of Tax Revenue Distributions	December 29, 2006
Audit of Maintenance Parts Physical Inventory at September 20, 2006	January 26, 2007
Annual Audit of Police Special Funds Fiscal Year 2006	January 26, 2007
Review of Metro Lift Practices and Procedures for Addressing a Missing Person Incident	March 9, 2007
Compliance Review - Fixed Assets	March 30, 2007

Audits Conducted by the Transit Authority's Audit Department October 1, 2004, through September 30, 2007	
Description of Audit	Audit Report Release Date
Observation of Disaster Recovery Testing - 2006	March 30, 2007
Audit of Ride Stores	June 29, 2007
Audit of Payroll	June 29, 2007
Audit of Compliance - Performance Measure	June 29, 2007
Audit of Purchase Card Activities and Procedures	September 27, 2007
Audit of Facility Management	September 28, 2007
Audit of Network Management	September 28, 2007

Source: Compiled by auditors from review of audit reports.

Performance Audit Required by the Texas Transportation Code

Texas Transportation Code, Section 451.454(a), requires that:

The board of an authority in which the principal municipality has a population of more than 1.2 million or less than 750,000 shall contract at least once every four years for a performance audit of the authority to be conducted by a firm that has experience in reviewing the performance of transit agencies.

The Transit Authority's last performance audit was conducted for the four-year period ending September 30, 2004. The resulting report contained 19 recommendations for improving cost controls, strategic planning, service quality, manpower planning, operator performance, safety, data verification, and performance indicators. During this audit, auditors tested five of those recommendations and determined that the Transit Authority had implemented all five recommendations.

Review of Compliance with FTA Procurement Requirements

Under a contract with the FTA, Business Management Research Associates, Inc. (BMRA) conducted a procurement system review at the Transit Authority. BMRA reviewed 56 elements related to FTA requirements regarding procurement processes. The results of the review indicated that the Transit Authority was deficient in five areas, and BMRA issued recommendations for the Transit Authority to address these deficiencies. The deficiencies were related to procurement policies and procedures, price quotations, evaluation of options, cost and price analysis, and purchase order clauses. During this audit, auditors tested all five deficiencies and determined that the Transit Authority had implemented corrective action to address all of them.

Review of Federal Urbanized Area Formula Grant Activities

Title 49, United States Code, Section 5307(i), requires the FTA to perform reviews and evaluations of recipients of federal Urbanized Area Formula Grants every three years. These reviews focus on compliance in 23 areas. The FTA conducted this review at the Transit Authority during fiscal year 2006 and identified eight deficiencies in areas such as continuing control, maintenance, half fares, and compliance with the Americans with Disabilities Act. During this audit, auditors tested all eight deficiencies and determined that the Transit Authority had implemented corrective action to address all of them.

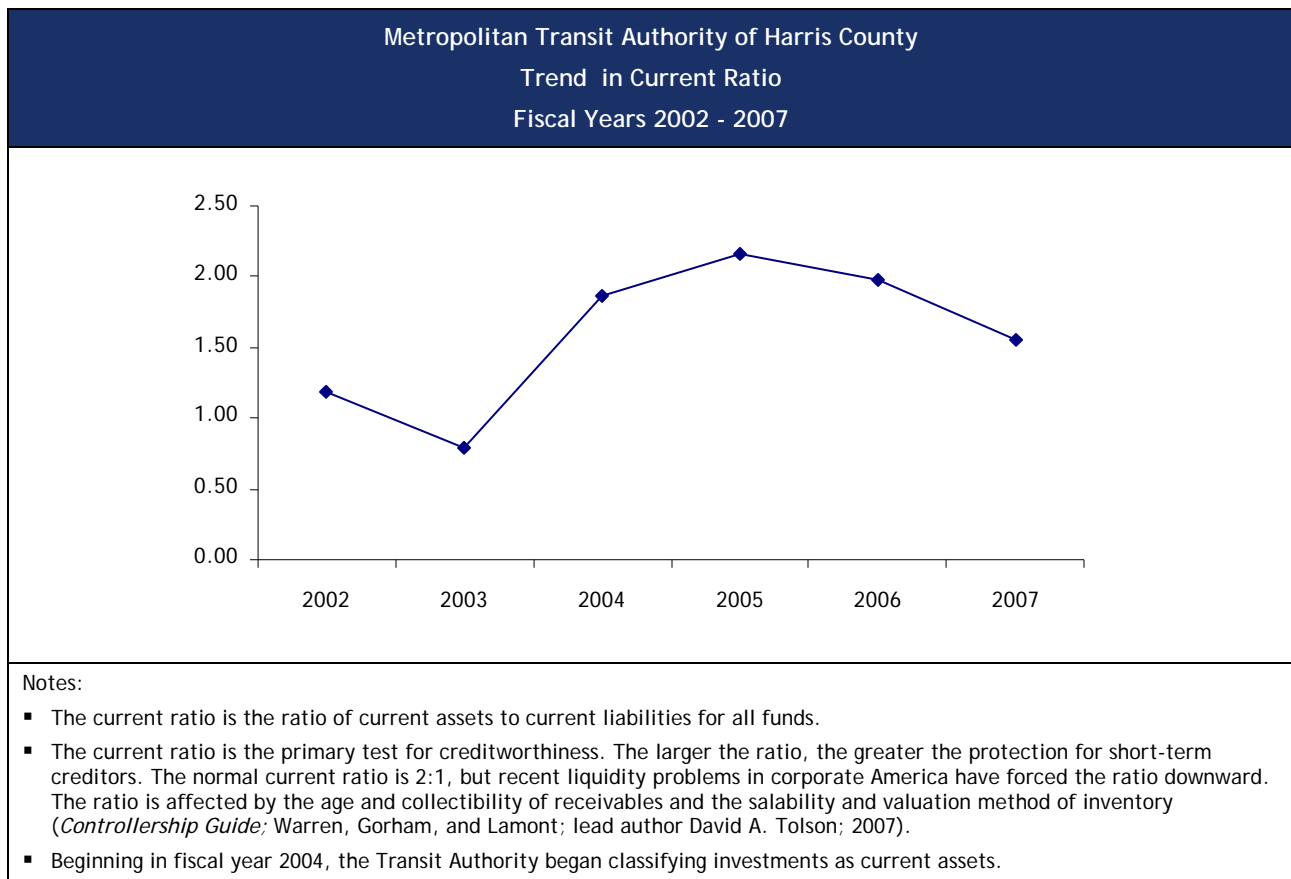
Selected Transit Authority Financial and Performance Information

This chapter presents selected Transit Authority financial and performance information. Additional financial and performance information is presented in Appendices 2 through 6.

Liquidity ratios measure an entity's capacity to meet its short-term liabilities by using cash or converting non-cash assets into cash. Creditors and other lenders favor liquidity ratios, which tend to reveal financial weakness. One key liquidity ratio is the current ratio, which is the ratio of current assets to current liabilities for all funds. A current ratio exceeding 1:1 indicates that an entity can satisfy its liabilities that will be due within the next year with available liquid resources.

Figure 1 shows the six-year trend in the Transit Authority's current ratio. During the past six years, the Transit Authority has generally maintained sufficient liquid resources to satisfy liabilities that will be due in the coming year. While its current ratio dropped below 1:1 in 2003, a reclassification of investments to current assets caused the ratio to increase.

Figure 1

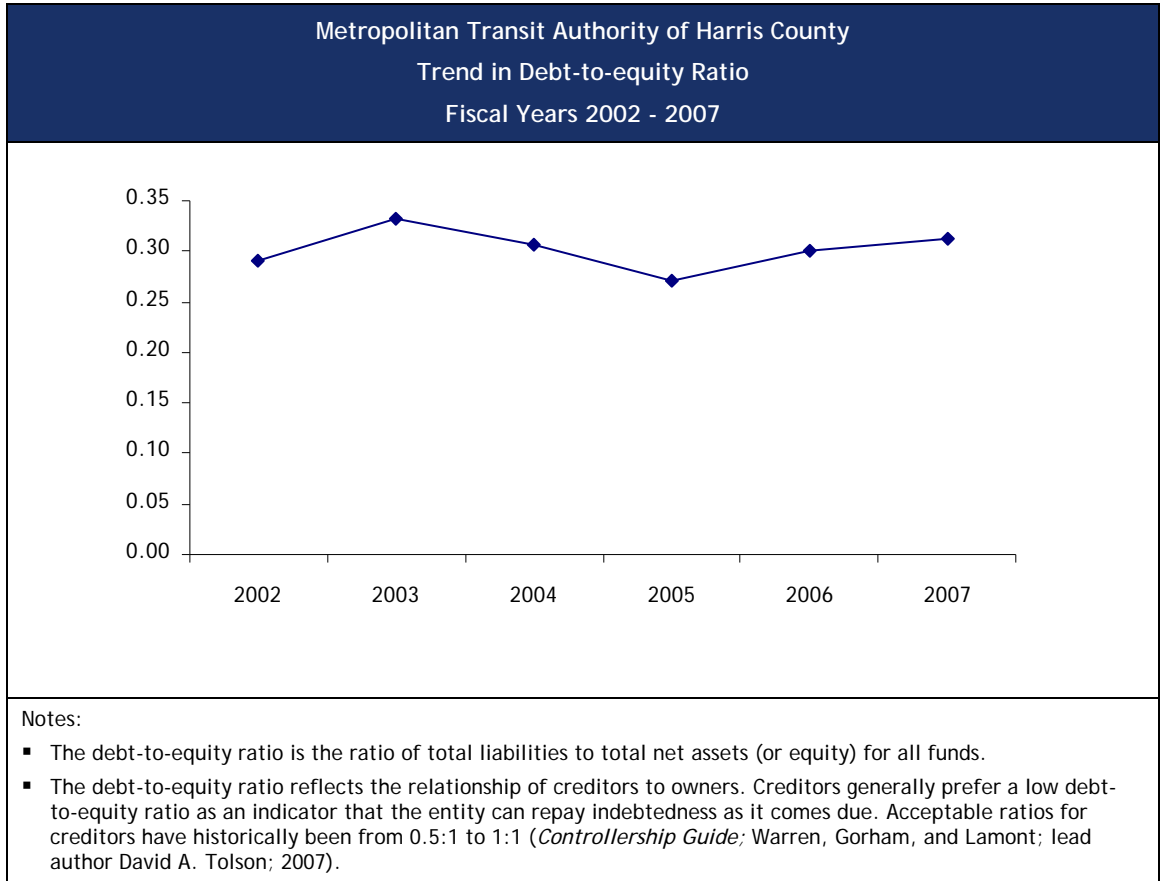


Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 2 shows the six-year trend in another leverage ratio, the Transit Authority's debt-to-equity ratio, which is the ratio of total liabilities to total net assets (or equity). This ratio measures an entity's financial leverage.

A high debt-to-equity ratio can indicate that an entity has issued debt to expand or operate. Generally, the Transit Authority's debt-to-equity ratio has been approximately 0.3:1. This indicates that, when compared to its net assets, the Transit Authority's level of debt is relatively low.

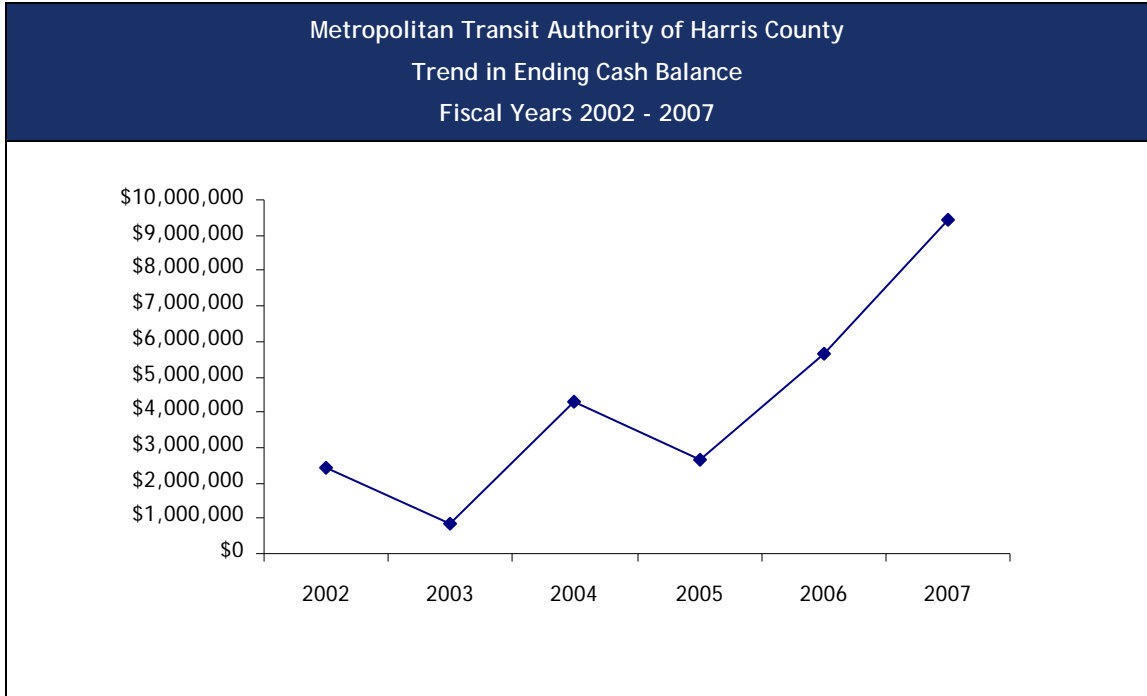
Figure 2



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 3 shows the six-year trend in the Transit Authority's ending cash balance for all funds. These amounts reflect the cash balance as of September 30 of each fiscal year and have fluctuated from a low of \$830,000 on September 30, 2003, to a high of \$9.4 million on September 30, 2007.

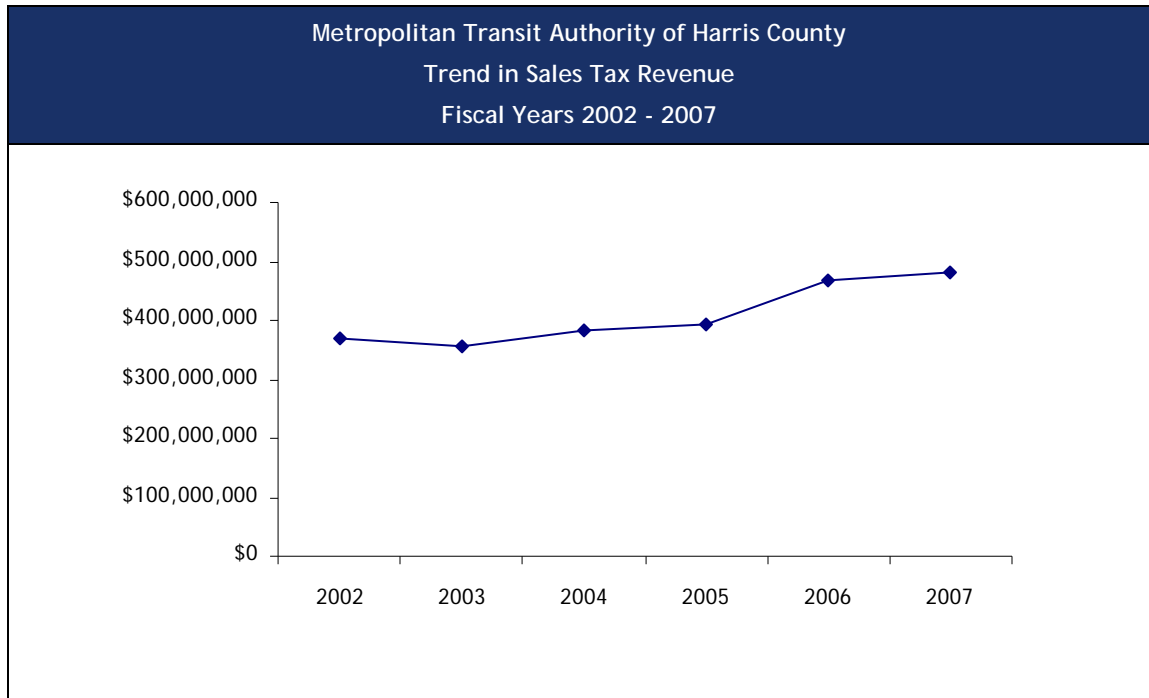
Figure 3



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 4 shows the six-year trend in the Transit Authority's sales tax revenue for all funds. The Transit Authority's primary operating and capital resources are derived from a 1 percent sales tax levied in the Transit Authority's service area. The amounts in Figure 4 represent the taxes collected throughout the year and demonstrate a generally positive trend. Cash collections for the fiscal year ended September 30, 2007, were \$482 million.

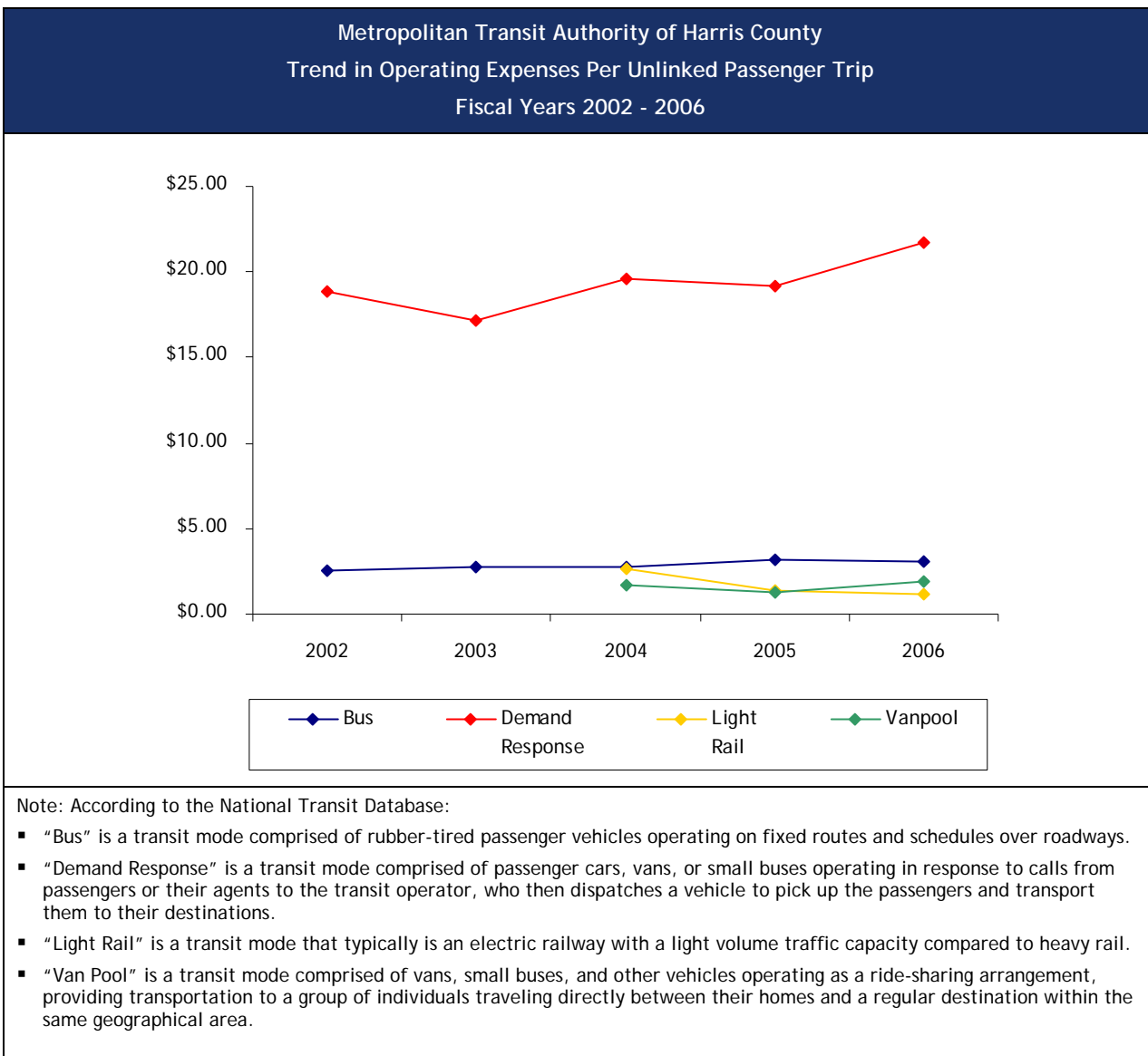
Figure 4



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 5 shows the five-year trend in the Transit Authority’s operating expenses per unlinked passenger trip. An unlinked passenger trip is defined as the number of times passengers board public transportation. Passengers are counted each time they board a vehicle, regardless of the number or types of vehicles boarded, from their origins to their destinations. Operating expenses are the expenses associated with the operation of a transit entity. This ratio compares total operating expenses per form of transportation, and thus provides a measure of the cost of a passenger’s travel each time the passenger boards transportation, depending on the mode of transportation the passenger chooses.

Figure 5



Source: *Annual Transit Profiles for the Metropolitan Transit Authority of Harris County, Texas*; National Transit Database, reporting years 2002-2006 (see <http://www.ntdprogram.gov/ntdprogram/index.htm>).

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The audit objective was to review selected financial transactions and financial reports to provide information about the Harris County Metropolitan Transit Authority's (Transit Authority) financial condition, cash management strategies, and results of operations.

Scope

The scope of this audit covered:

- A review of the annual report, monthly and quarterly board reports, General Mobility Program summaries and reports, quarterly departmental review reports, and monthly ridership reports for fiscal year 2007.
- A review of internal audit reports for fiscal years 2005 through 2007, performance audit reports for fiscal years 2001 through 2004, the fiscal year 2006 triennial review, and the fiscal year 2004 procurement review reports of the FTA.
- A review of outstanding lawsuits from October 2006 through May 2008 and of the status of a complaint regarding the Transit Authority that was submitted to the U.S. Department of Transportation during fiscal year 2008.
- An analysis of information regarding reported financial and performance indicators for fiscal years 2002 through 2007.
- Reviews and/or tests of procurement policies and procedures, construction projects, professional service contracts, the purchased transportation contract, out-of-state travel reimbursements, General Mobility Program projects, and budget policies and procedures for fiscal year 2007. In addition, auditors reviewed long-term expansion project activity from fiscal year 2007 through July 2008 and the fiscal year 2008 business plan.

Methodology

The audit methodology included collecting information and documentation; performing selected tests and other procedures; analyzing and evaluating the results of the tests; and conducting interviews with the management and staff at the Transit Authority.

Information collected and reviewed included the following:

- Monthly and quarterly board reports.
- Annual financial reports.
- Year-end adjustments.
- Ridership reports.
- General Mobility Program cash flow summaries.
- General Mobility Program unexpended cash carryover spreadsheets.
- Preliminary engineering and construction quarterly reviews.
- Budget analyses.
- Accounting system reports.
- Internal audit, triennial review, procurement system review, and performance audit reports.
- Reserves for contingent liabilities.
- Complaints filed with regulatory agencies.
- National Transit Database profiles.
- Long-term expansion contracts and contract procurement files.
- Fiscal year 2008 business plan and budget.
- New Starts program financial plan.

Procedures and tests conducted included the following:

- Comparisons of various board reports, the Transit Authority's accounting system, and the audited annual financial report for consistency.
- Analyses of internal audits, regulatory agency reviews, and follow-ups on the status of resulting recommendations.
- Reviews of the status of contingent liabilities and complaints filed with regulatory agencies.
- Calculation of key financial ratios.
- Analysis of state-required performance indicators.

- Comparisons of the Transit Authority’s National Transit Database profile with the profiles of other transit entities.
- Tests of construction, professional service, and purchased transportation contracts for (1) adequacy of planning, procurement, and project/contract management processes and (2) verification that those contracts complied with procurement policies and procedures, project management policies and procedures, and applicable laws and regulations.
- Tests of travel reimbursements to determine whether they were reasonable, justified, accurately reported, and in compliance with policies and procedures.
- Reviews of the General Mobility Program for compliance with policies and procedures.
- Tests of budget change transactions for compliance with the Transit Authority’s policies and procedures.
- Review of the adequacy of short-term cash flow forecasting.
- Review of the long-term financial plan assumptions for reasonableness and consistency with other planning documents and compliance with New Starts program requirements.

Criteria used included the following:

- Policies and procedures of the Transit Authority.
- Texas Transportation Code.
- Statement of Financial Accounting Standards No. 5, Accounting for Contingencies.
- Federal Transit Administration *Best Practices Procurement Manual*.
- Federal Transit Administration Circular 4220.1E, *Third Party Contracting Requirements*.
- Federal Transit Administration, *Guidance for Transit Financial Plans June 2000*.

Project Information

Audit fieldwork was conducted from February 2008 through July 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit

objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

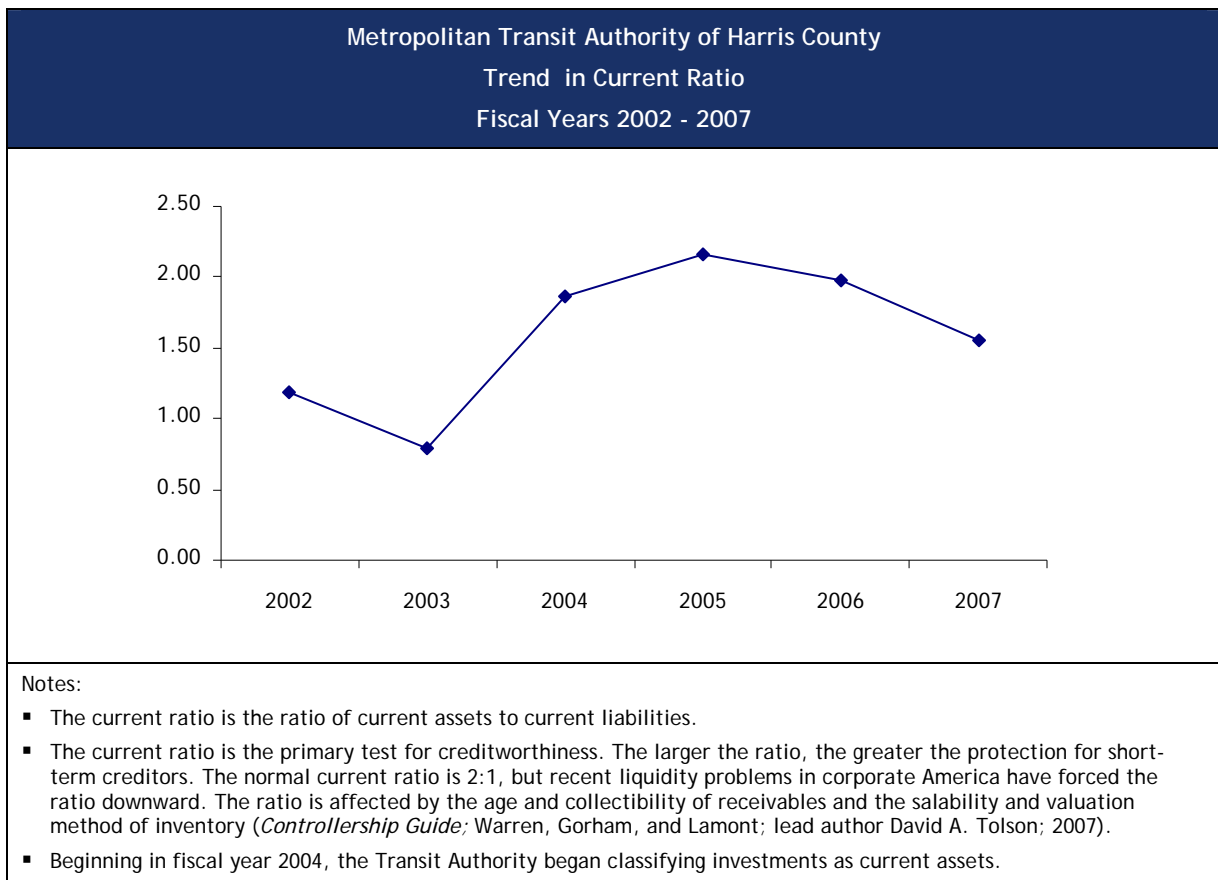
- James Michael Yerich, CPA, CGFM (Project Manager)
- Fabienne Robin, MBA (Assistant Project Manager)
- Isaac Barajas
- Nick Frey
- Arby Gonzales, CFE
- Gary Leach, MBA, CISA, CQA (Information Systems Audit Team)
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Michael C. Apperley, CPA (Assistant State Auditor)

Trends in the Transit Authority's Liquidity Ratios

Liquidity ratios measure an entity's capacity to meet its short-term liabilities by using cash or converting non-cash assets into cash. Creditors and other lenders favor liquidity ratios, which tend to reveal financial weakness. This appendix provides information on selected liquidity ratios for the Metropolitan Transit Authority of Harris County (Transit Authority).

Figure 6 shows the six-year trend in the Transit Authority's current ratio, which is the ratio of current assets to current liabilities.

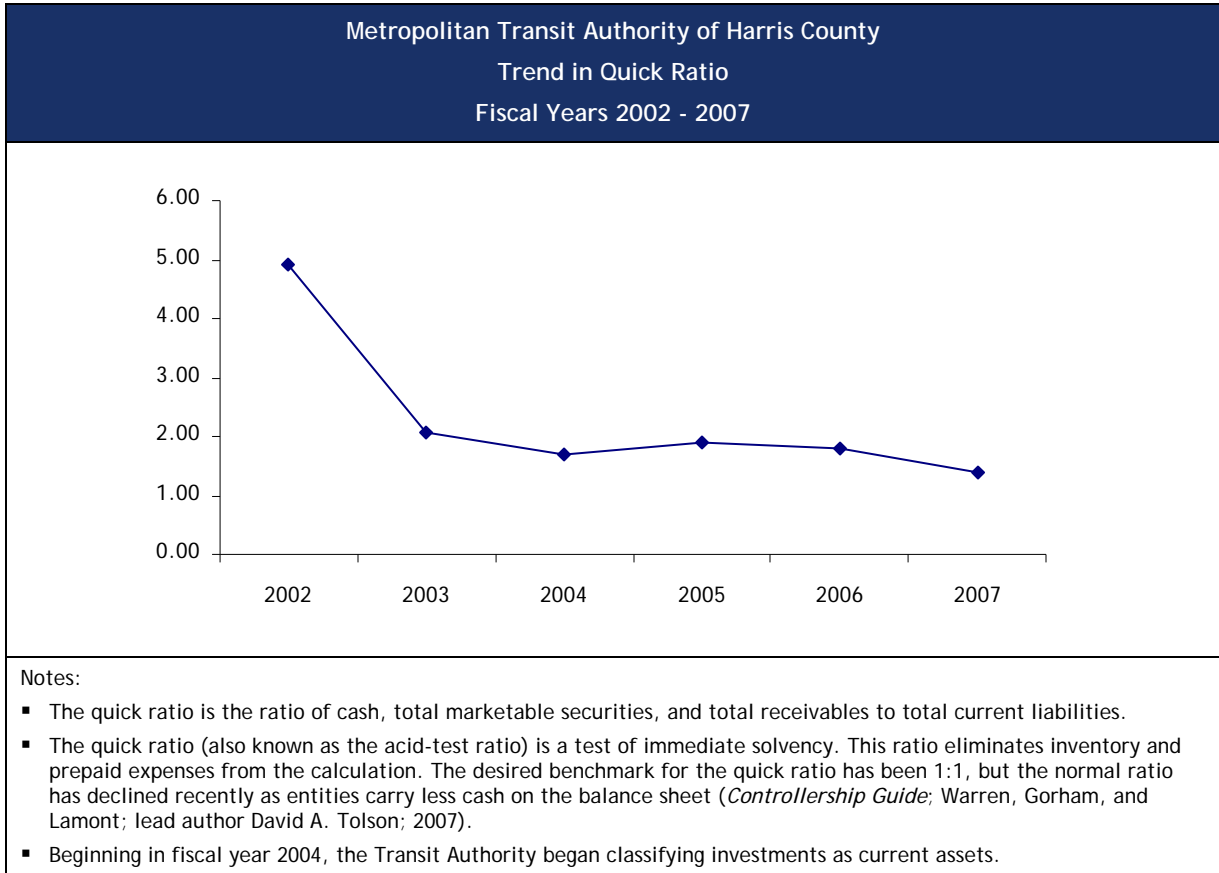
Figure 6



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 7 shows the six-year trend in the Transit Authority's quick ratio, which is the ratio of cash, total marketable securities, and total receivables to total current liabilities.

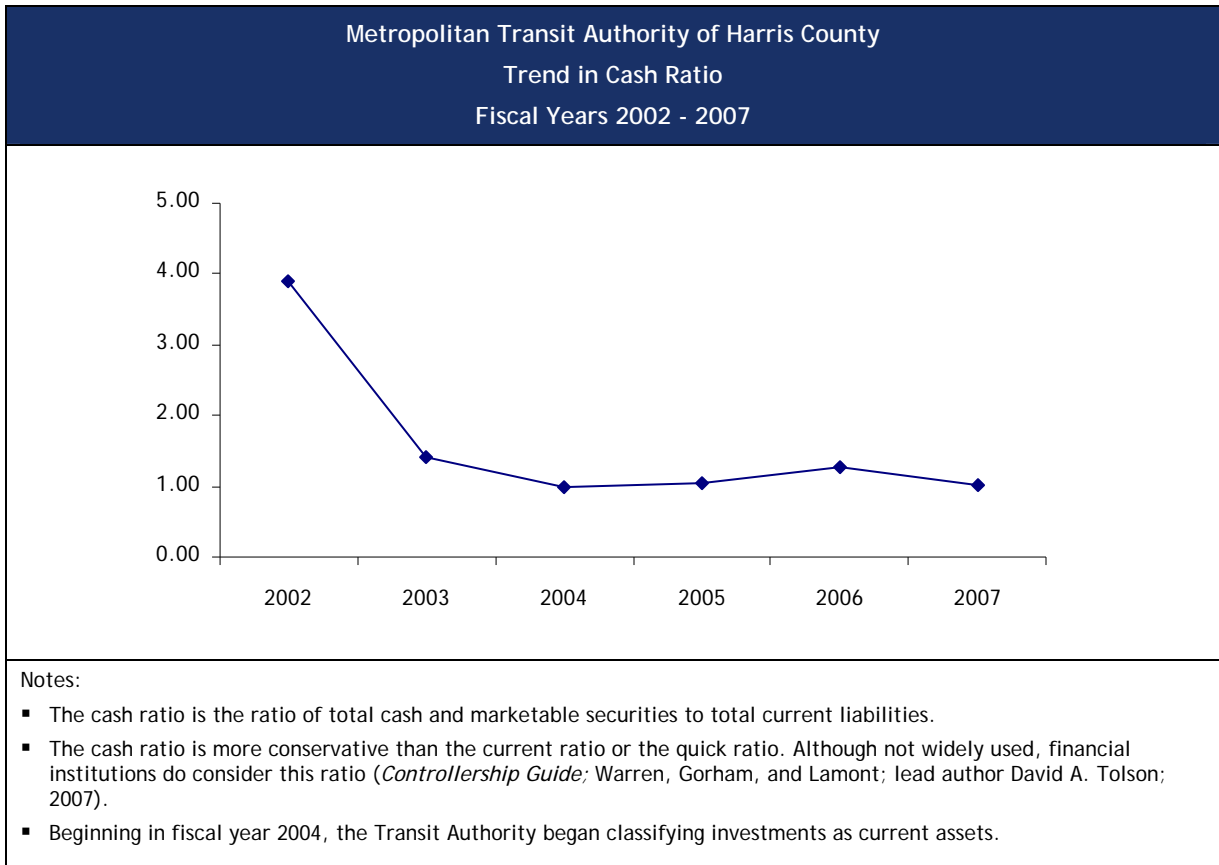
Figure 7



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 8 shows the six-year trend in the Transit Authority's cash ratio, which is the ratio of total cash and marketable securities to total current liabilities.

Figure 8



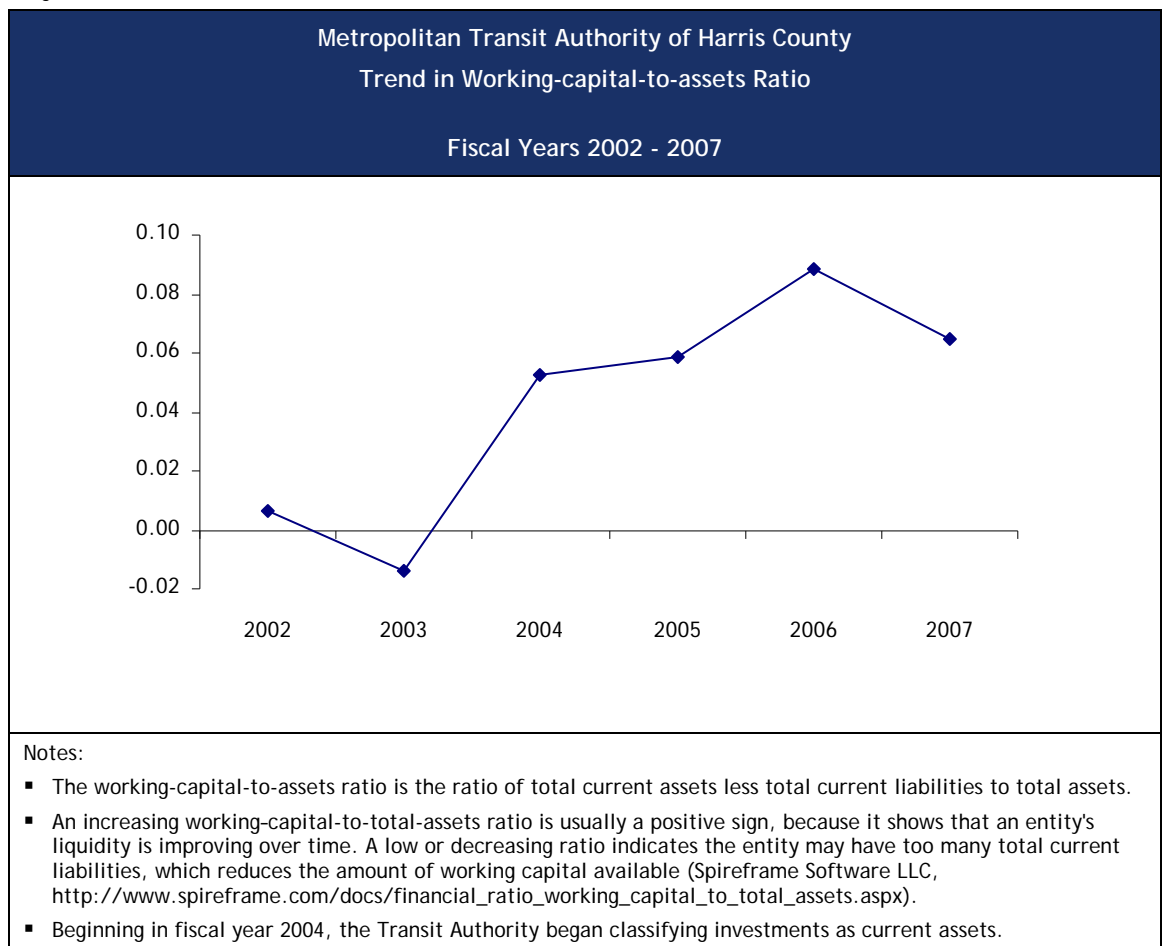
Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Trends in the Transit Authority's Leverage Ratios

Leverage ratios measure the extent to which an entity has been financed by debt. Lenders of long-term funds and equity investors have an interest in leverage ratios. This appendix provides information on selected liquidity ratios for the Metropolitan Transit Authority of Harris County (Transit Authority).

Figure 9 shows the six-year trend in the Transit Authority's working-capital-to-assets ratio, which is the ratio of total current assets less total current liabilities to total assets.

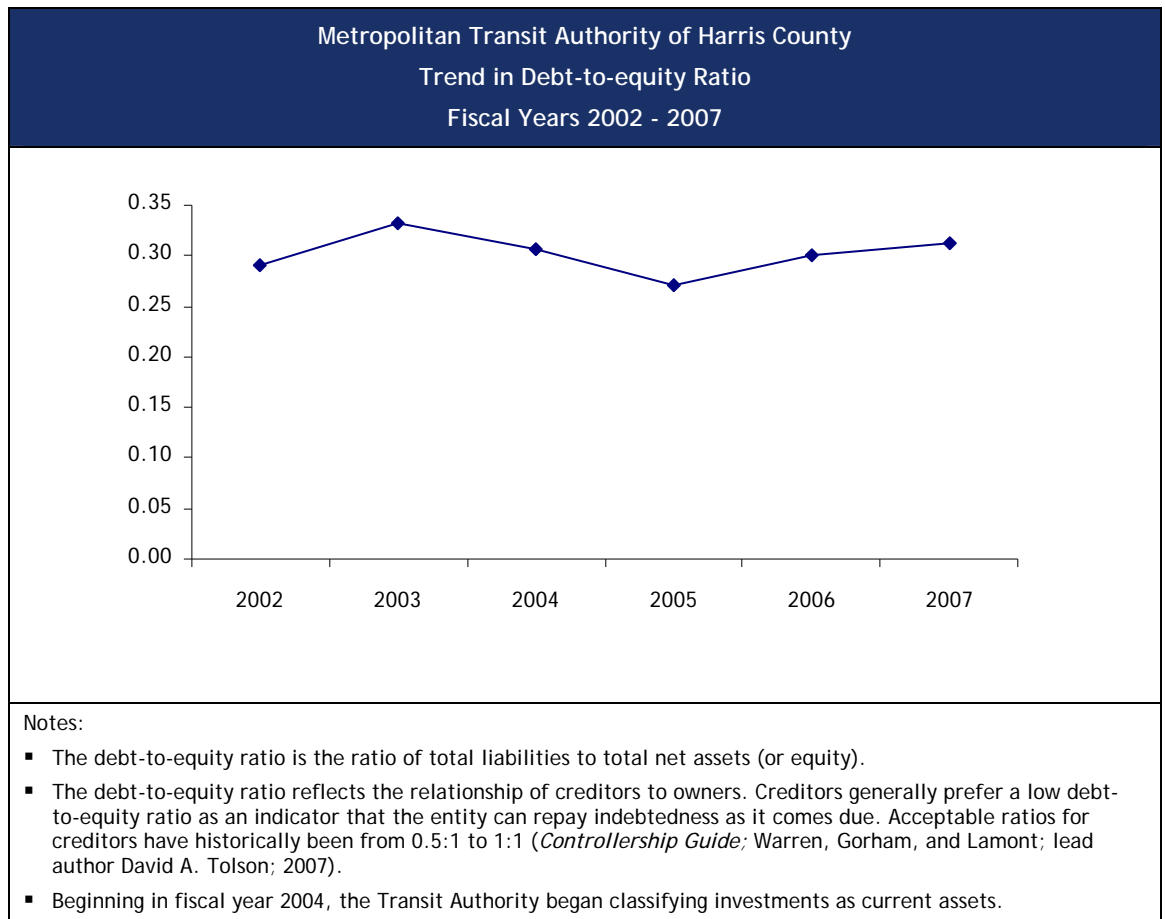
Figure 9



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 10 shows the six-year trend in the Transit Authority's debt-to-equity ratio, which is the ratio of total liabilities to total net assets (or equity).

Figure 10



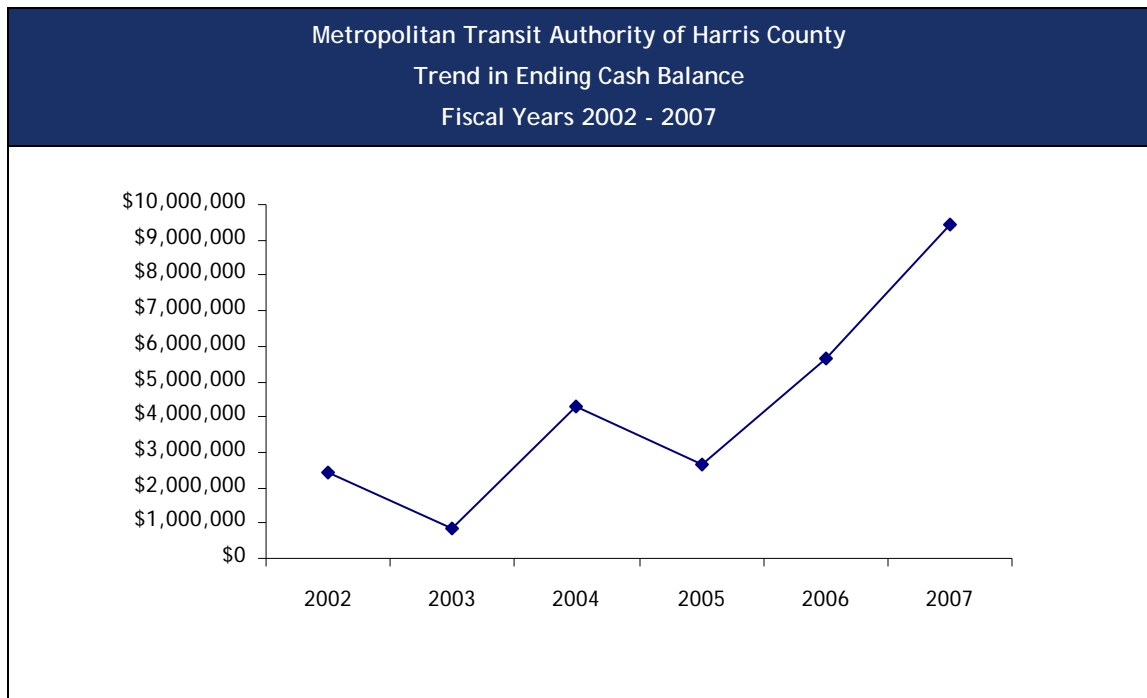
Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Trends in the Transit Authority's Financial Information

This appendix provides information on trends in selected financial information for the Metropolitan Transit Authority of Harris County (Transit Authority).

Figure 11 shows the six-year trend in the Transit Authority's ending cash balance. The reported amounts reflect the cash balance at September 30 of each year.

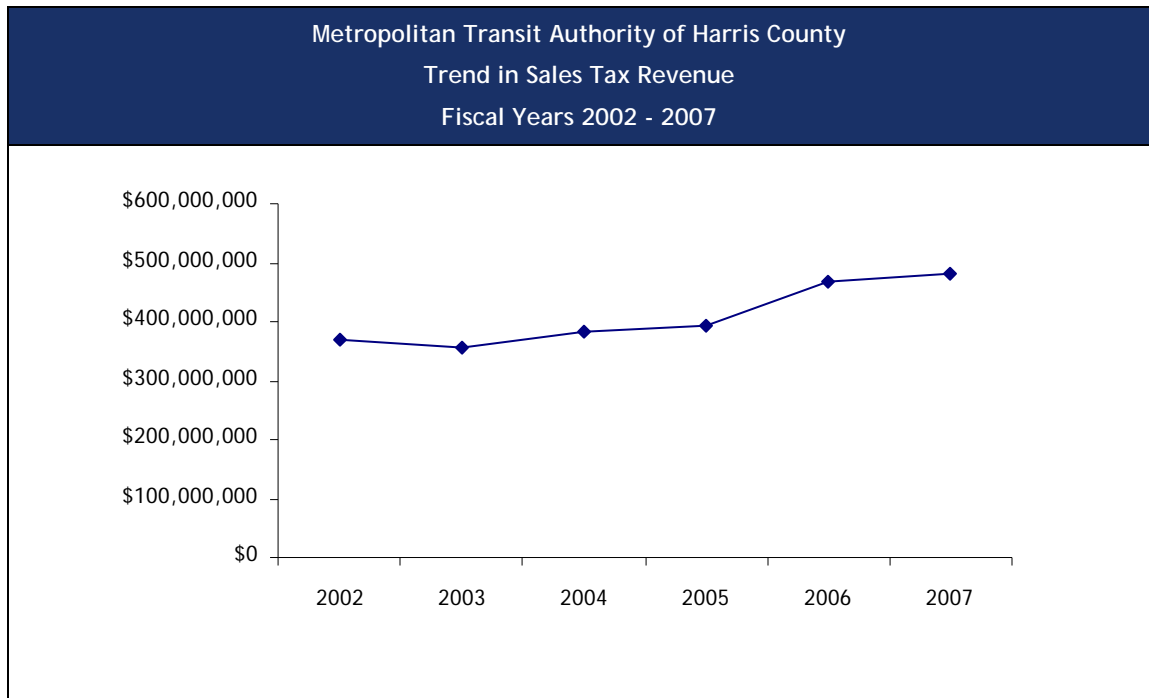
Figure 11



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 12 shows the six-year trend in the Transit Authority's sales tax revenue. The Transit Authority's primary operating and capital resources are derived from a 1 percent sales tax levied in the Transit Authority's service area. The reported amounts represent the taxes collected throughout each fiscal year.

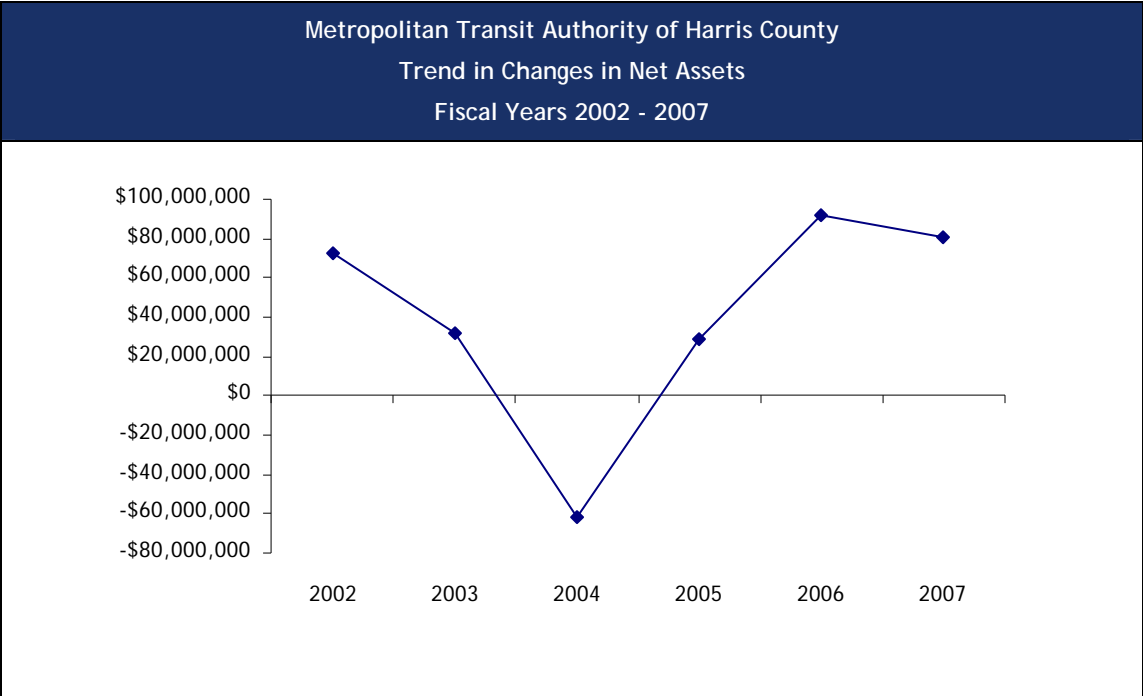
Figure 12



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 13 shows the six-year trend in the Transit Authority's changes in net assets for each fiscal year.

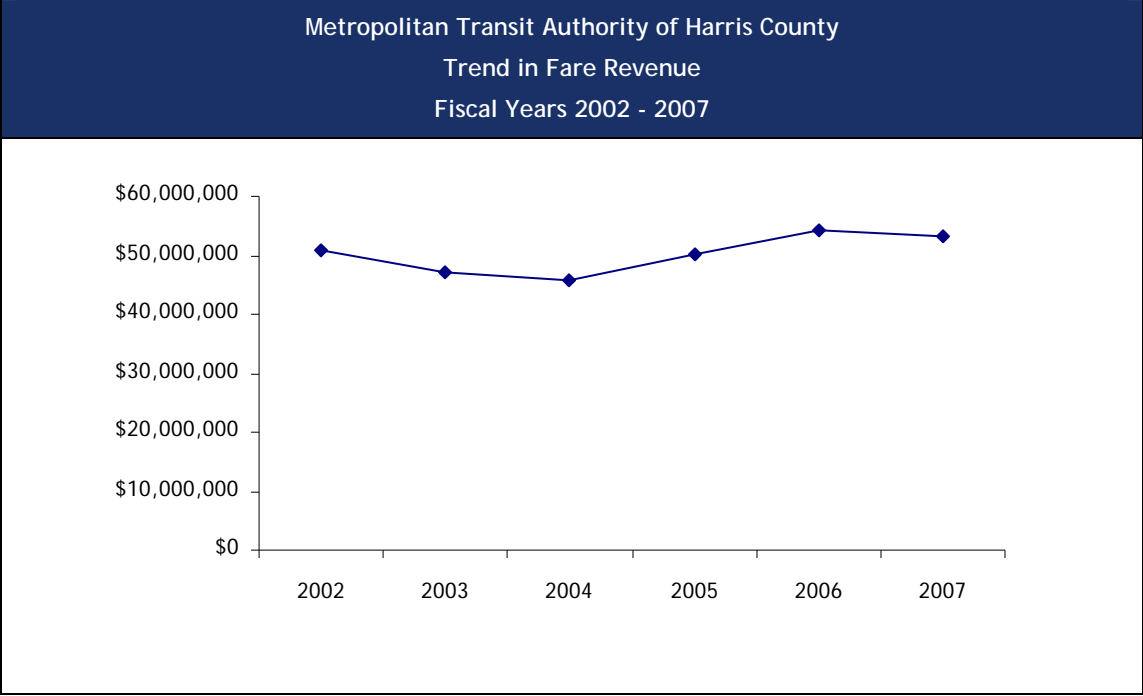
Figure 13



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

Figure 14 shows the six-year trend in the Transit Authority's fare revenue collected throughout each fiscal year.

Figure 14



Source: Transit Authority audited annual financial reports for fiscal years 2002 through 2007.

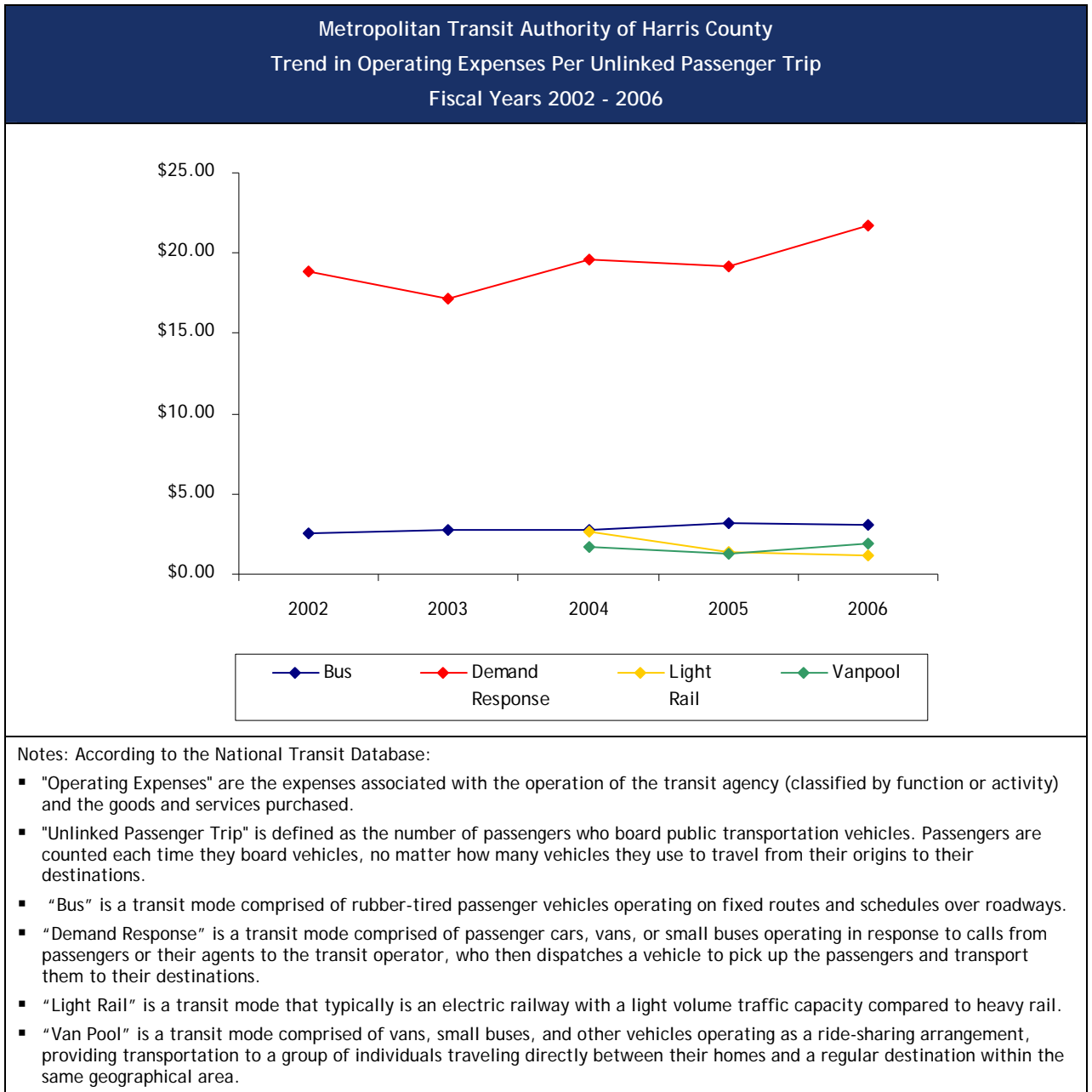
Trends in the Transit Authority's Performance Information

This appendix provides information on trends in performance information for the Metropolitan Transit Authority of Harris County (Transit Authority) based on information self-reported to the National Transit Database (NTDB) of the Federal Transit Administration (FTA).

The United States Congress established the NTDB as the nation's primary source for information and statistics on transit systems. Recipients or beneficiaries of grants from the FTA under the Urbanized Area Formula Program or Other than Urbanized Area (Rural) Formula Program are statutorily required to submit data to the NTDB. More than 660 transit providers in urbanized areas report to the NTDB. Each year, NTDB performance data is used to apportion more than \$5 billion in FTA funds to transit agencies in urbanized areas. The data in the following charts is presented for informational purposes only and was not subjected to audit procedures.

Figure 15 shows the five-year trend in the Transit Authority's operating expenses per unlinked passenger trip.

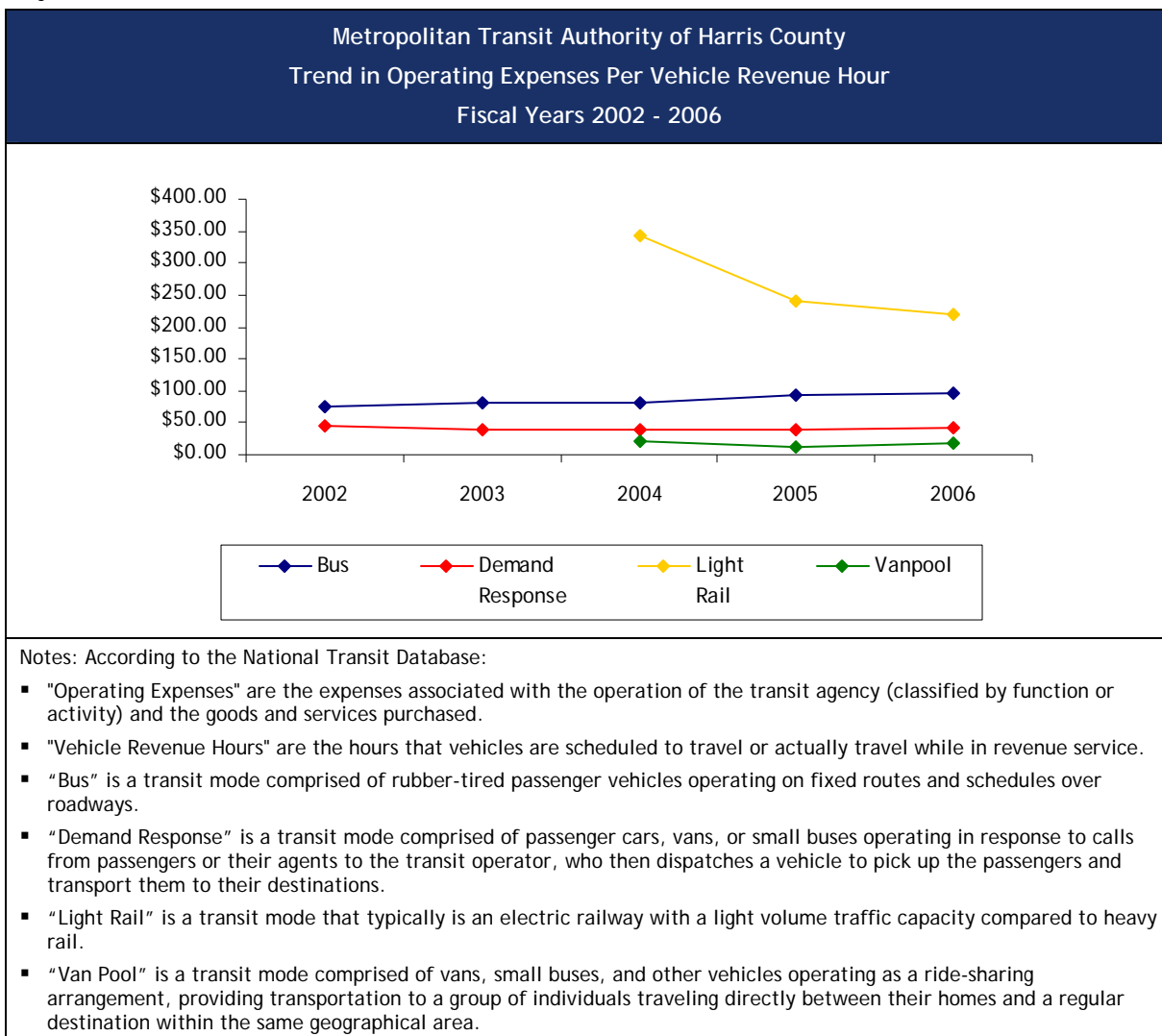
Figure 15



Source: *Annual Transit Profiles for the Metropolitan Transit Authority of Harris County, Texas*; National Transit Database, reporting years 2002-2006 (see <http://www.ntdprogram.gov/ntdprogram/index.htm>).

Figure 16 shows the five-year trend in the Transit Authority's operating expenses per vehicle revenue hour.

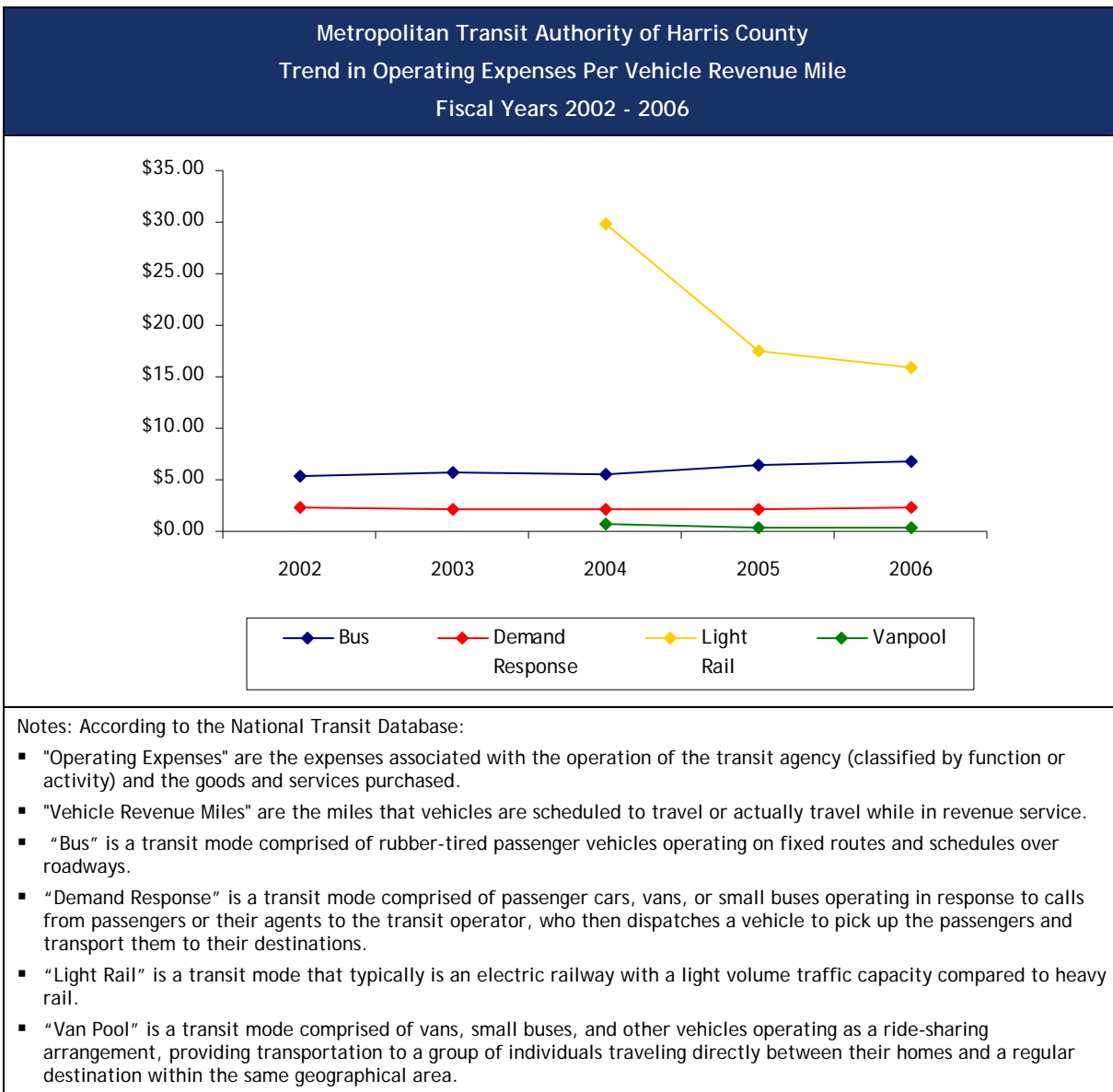
Figure 16



Source: *Annual Transit Profiles for the Metropolitan Transit Authority of Harris County, Texas*; National Transit Database, reporting years 2002-2006 (see <http://www.ntdprogram.gov/ntdprogram/index.htm>).

Figure 17 shows the five-year trend in the Transit Authority's operating expenses per vehicle revenue mile.

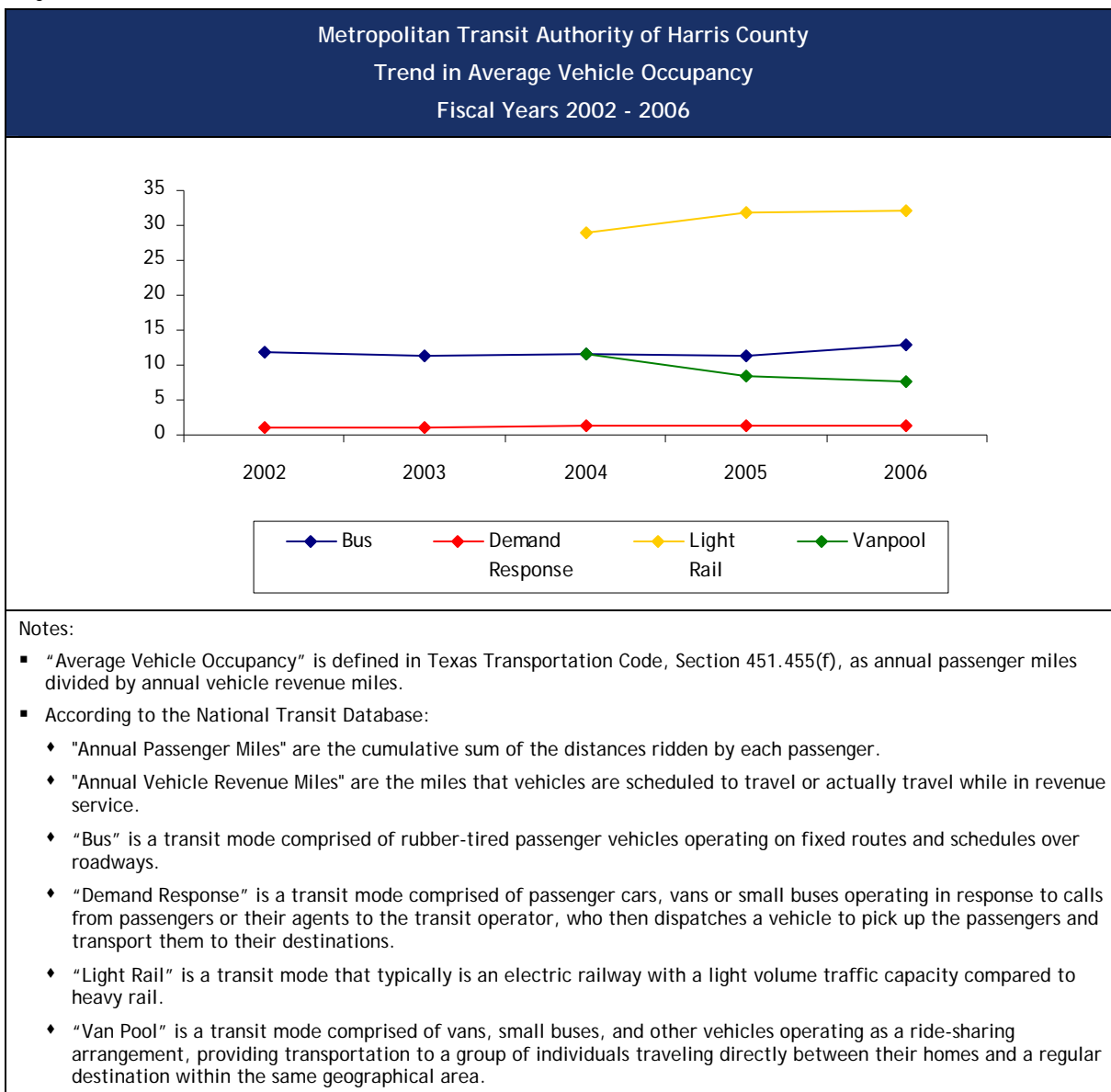
Figure 17



Source: *Annual Transit Profiles for the Metropolitan Transit Authority of Harris County, Texas*; National Transit Database, reporting years 2002-2006 (see <http://www.ntdprogram.gov/ntdprogram/index.htm>).

Figure 18 shows the five-year trend in the Transit Authority's average vehicle occupancy.

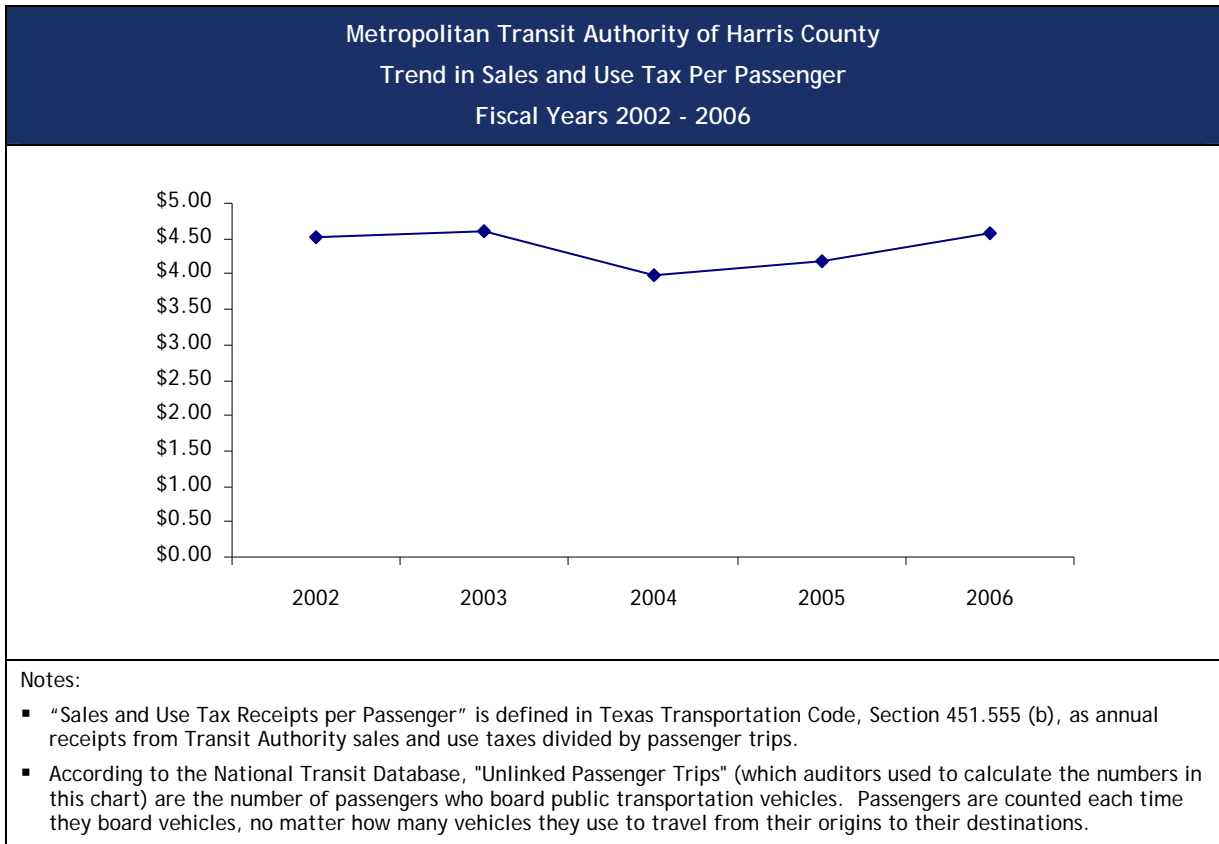
Figure 18



Sources: Texas Transportation Code and *Annual Transit Profiles for the Metropolitan Transit Authority of Harris County, Texas*; National Transit Database, reporting years 2002-2006 (see <http://www.ntdprogram.gov/ntdprogram/index.htm>).

Figure 19 shows the five-year trend in the Transit Authority's sales and use tax per passenger.

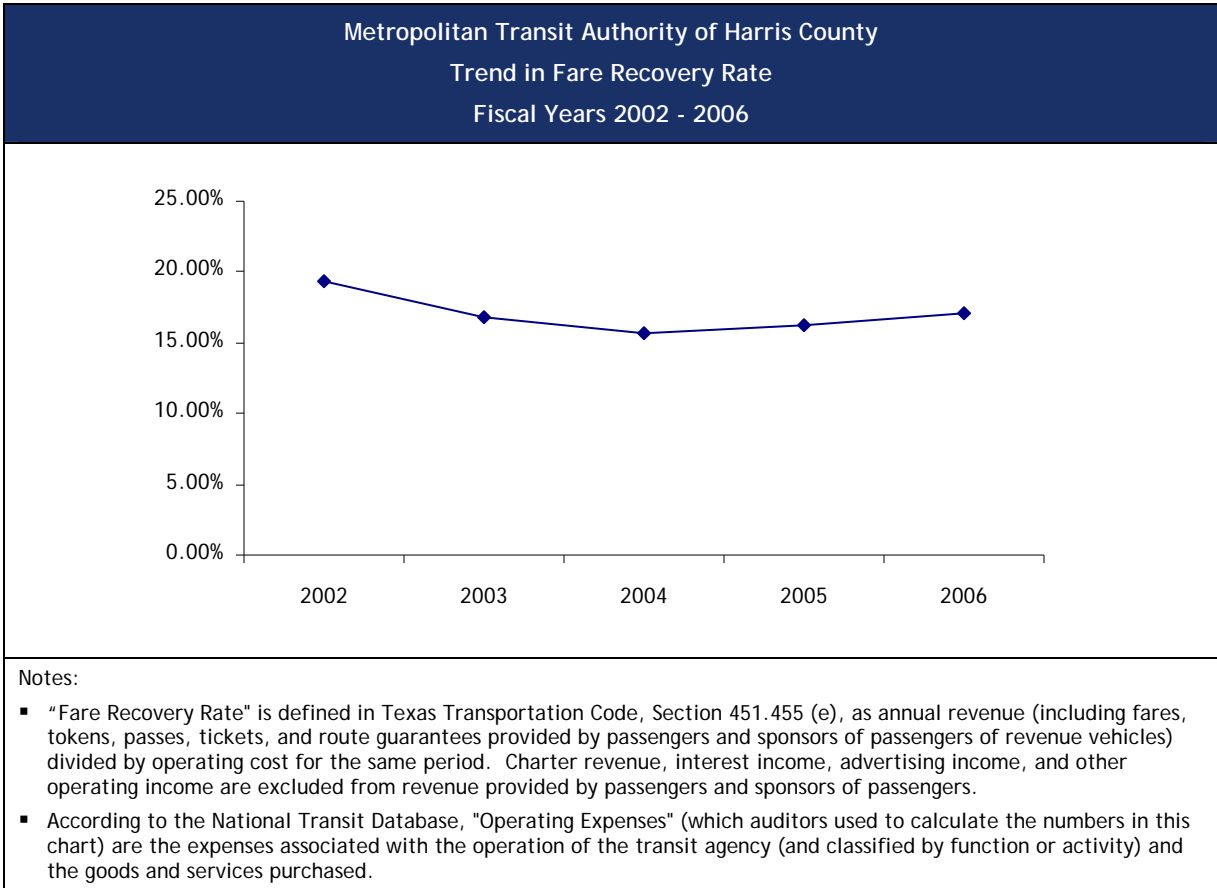
Figure 19



Source: *Annual Transit Profiles for the Metropolitan Transit Authority of Harris County, Texas*; National Transit Database, reporting years 2002-2006 (see <http://www.ntdprogram.gov/ntdprogram/index.htm>).

Figure 20 shows the five-year trend in the Transit Authority's fare recovery rate.

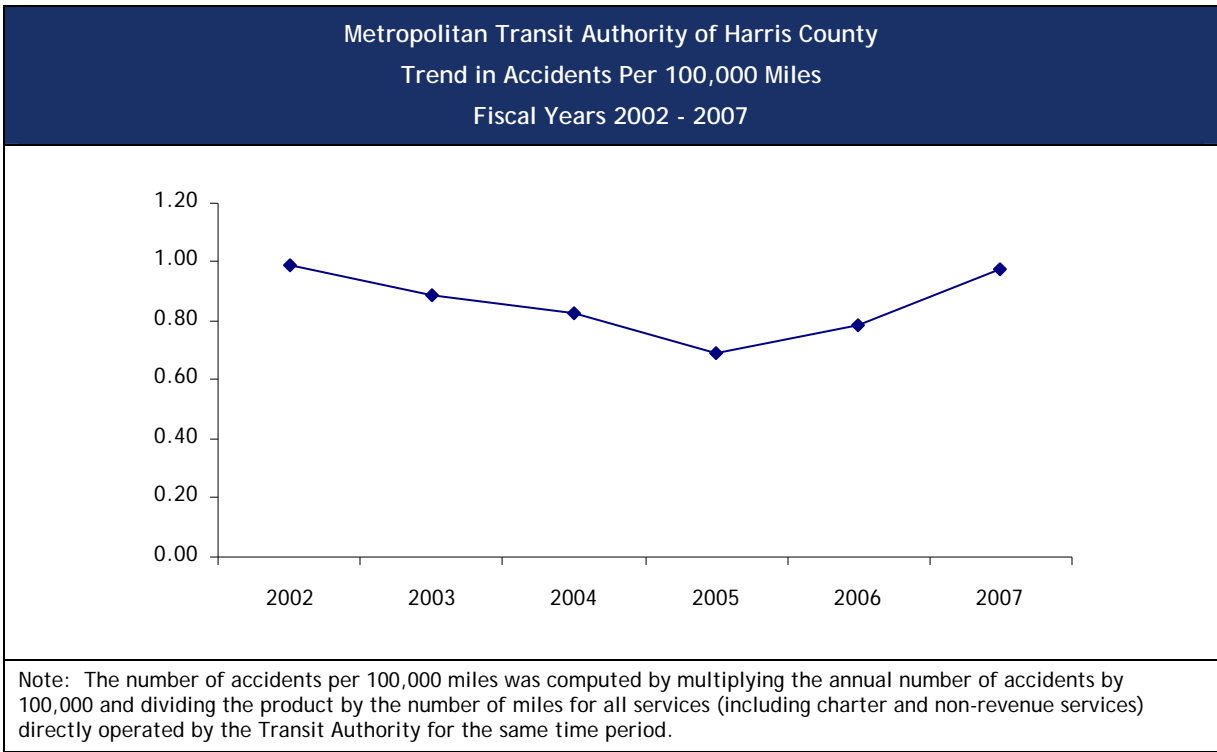
Figure 20



Source: *Annual Transit Profiles for the Metropolitan Transit Authority of Harris County, Texas*; National Transit Database, reporting years 2002-2006 (see <http://www.ntdprogram.gov/ntdprogram/index.htm>).

Figure 21 shows the six-year trend in the Transit Authority's accidents per 100,000 miles.

Figure 21



Source: Information from the Transit Authority.

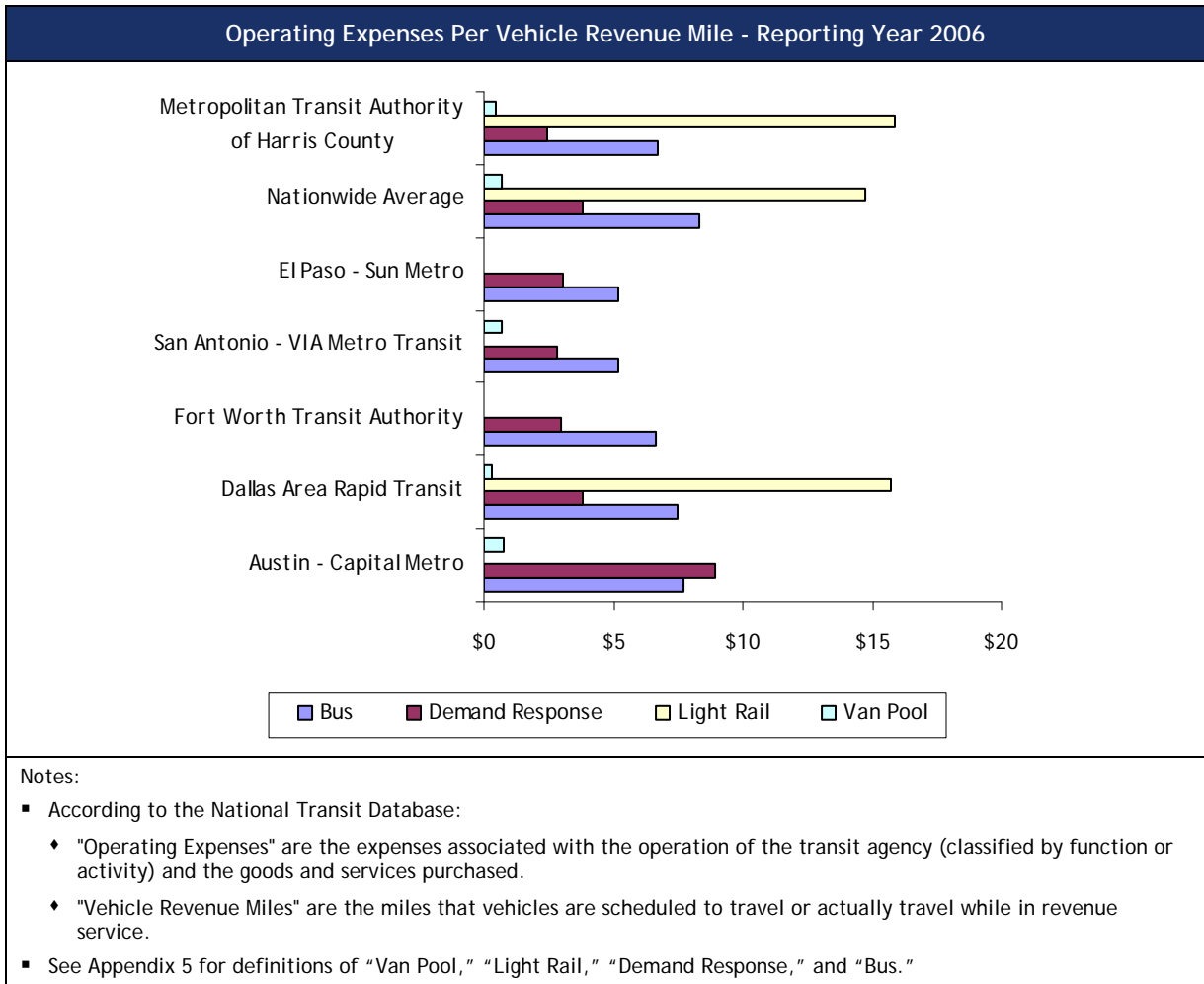
Transit Profile Comparisons for Reporting Year 2006

This appendix presents comparative information for the Metropolitan Transit Authority of Harris County (Transit Authority), transit authorities nationwide, and other transit authorities in Texas. Reporting year 2006 is presented because it was the most recent information available.

The data in this appendix is based on information self-reported to the National Transit Database (NTDB) of the Federal Transit Administration (FTA). The United States Congress established the NTDB as the nation's primary source for information and statistics on transit systems. Recipients or beneficiaries of grants from the FTA under the Urbanized Area Formula Program or Other than Urbanized Area (Rural) Formula Program are statutorily required to submit data to the NTDB. More than 660 transit providers in urbanized areas report to the NTDB. Each year, NTDB performance data is used to apportion more than \$5 billion in FTA funds to transit agencies in urbanized areas. The data in the following charts is presented for informational purposes only and was not subjected to auditing procedures.

Figure 22 compares information on operating expenses per vehicle revenue mile.

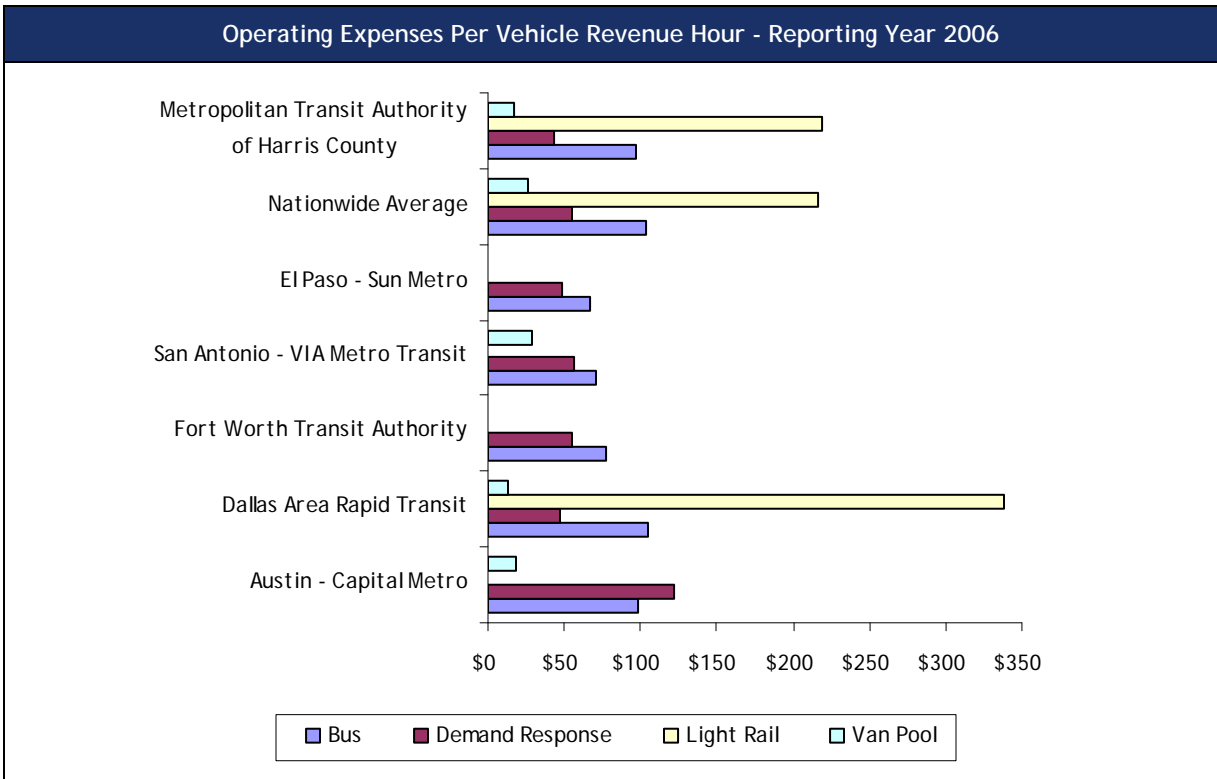
Figure 22



Source: National Transit Database - Reporting Year 2006.

Figure 23 compares information on operating expenses per vehicle revenue hour.

Figure 23



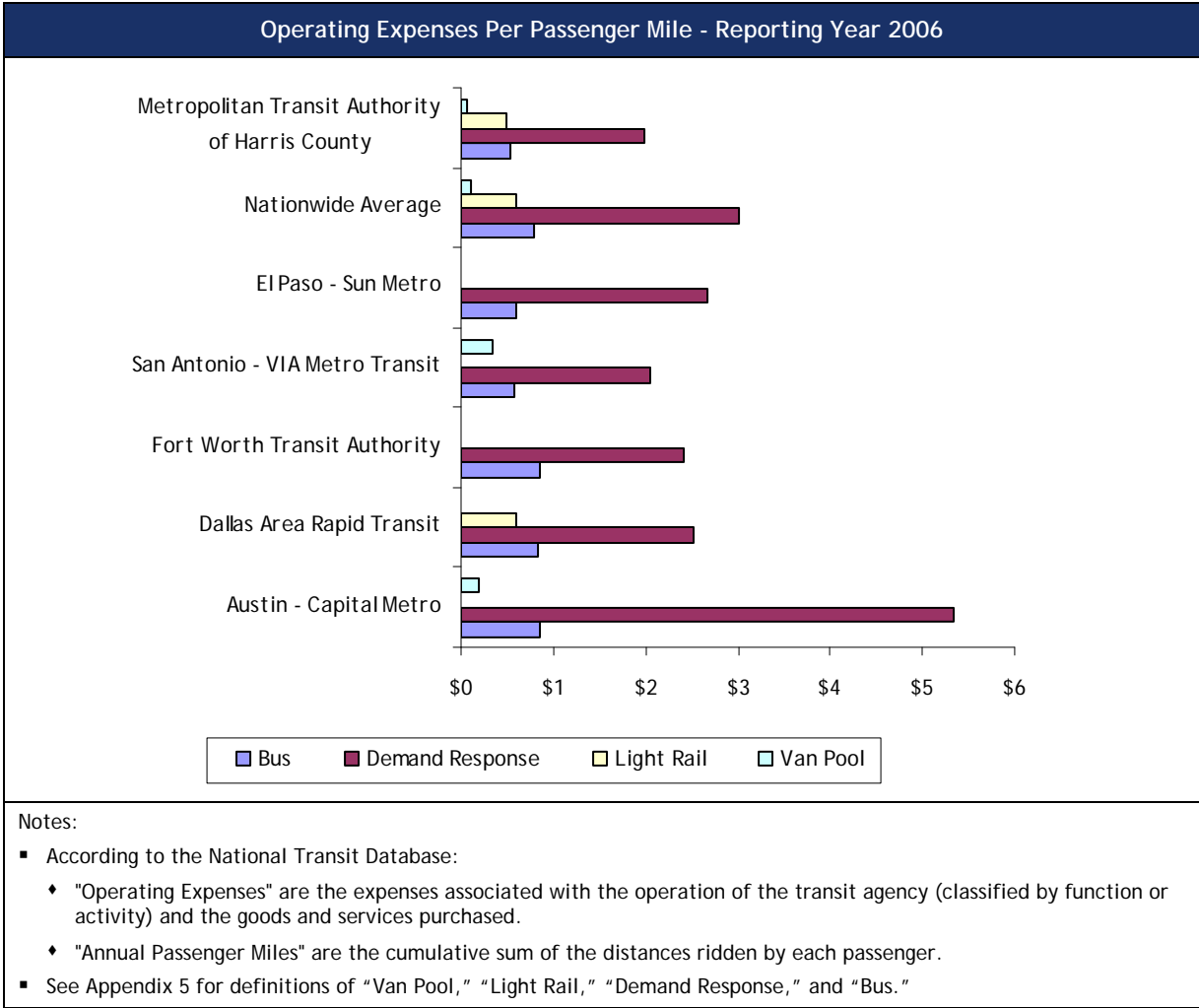
Notes:

- According to the National Transit Database:
 - ♦ "Operating Expenses" are the expenses associated with the operation of the transit agency (classified by function or activity) and the goods and services purchased.
 - ♦ "Vehicle Revenue Hours" are the hours that vehicles are scheduled to travel or actually travel while in revenue service.
- See Appendix 5 for definitions of "Van Pool," "Light Rail," "Demand Response," and "Bus."

Source: National Transit Database - Reporting Year 2006.

Figure 24 compares information on operating expenses per passenger mile.

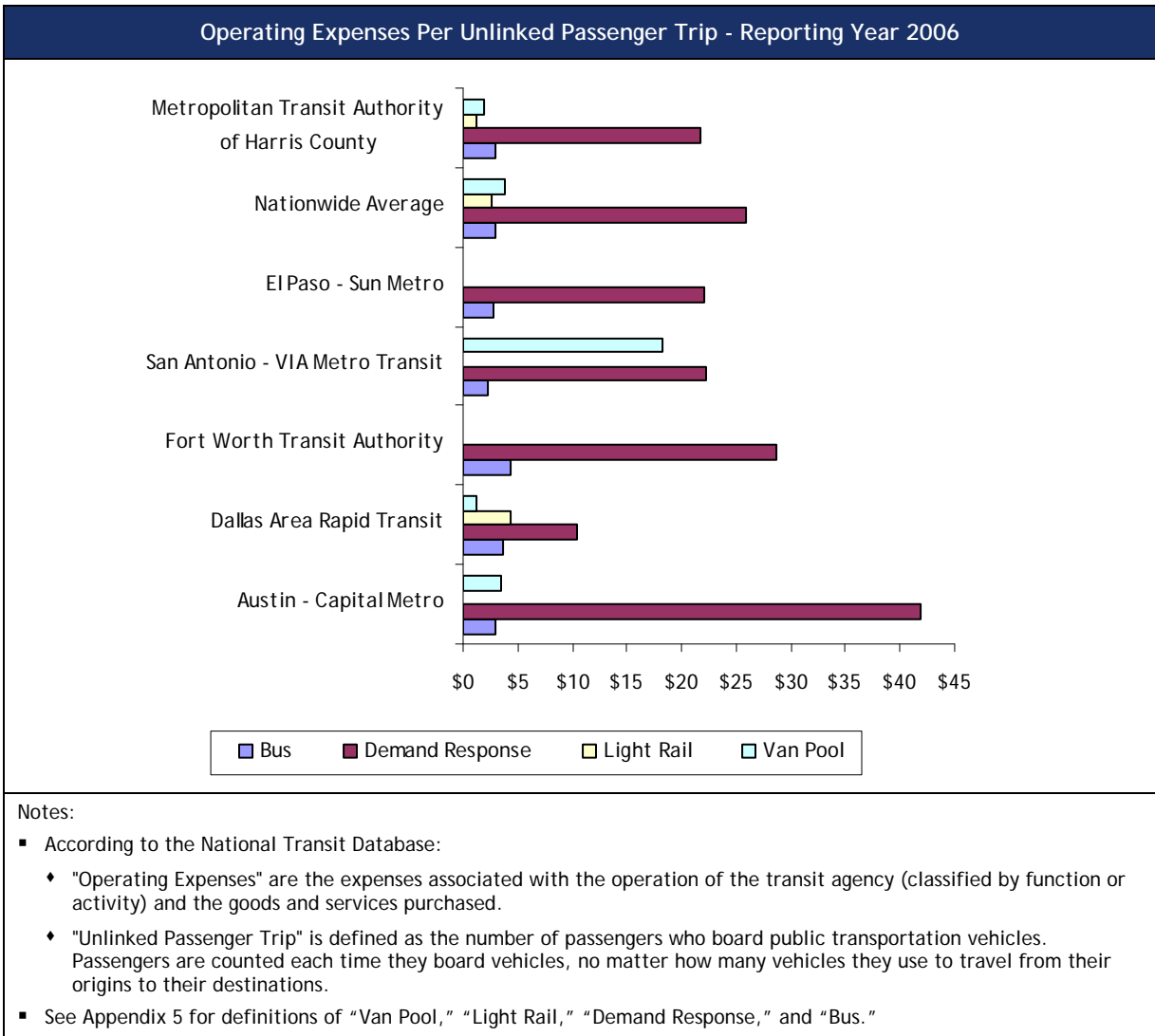
Figure 24



Source: National Transit Database - Reporting Year 2006.

Figure 25 compares information on operating expenses per unlinked passenger trip.

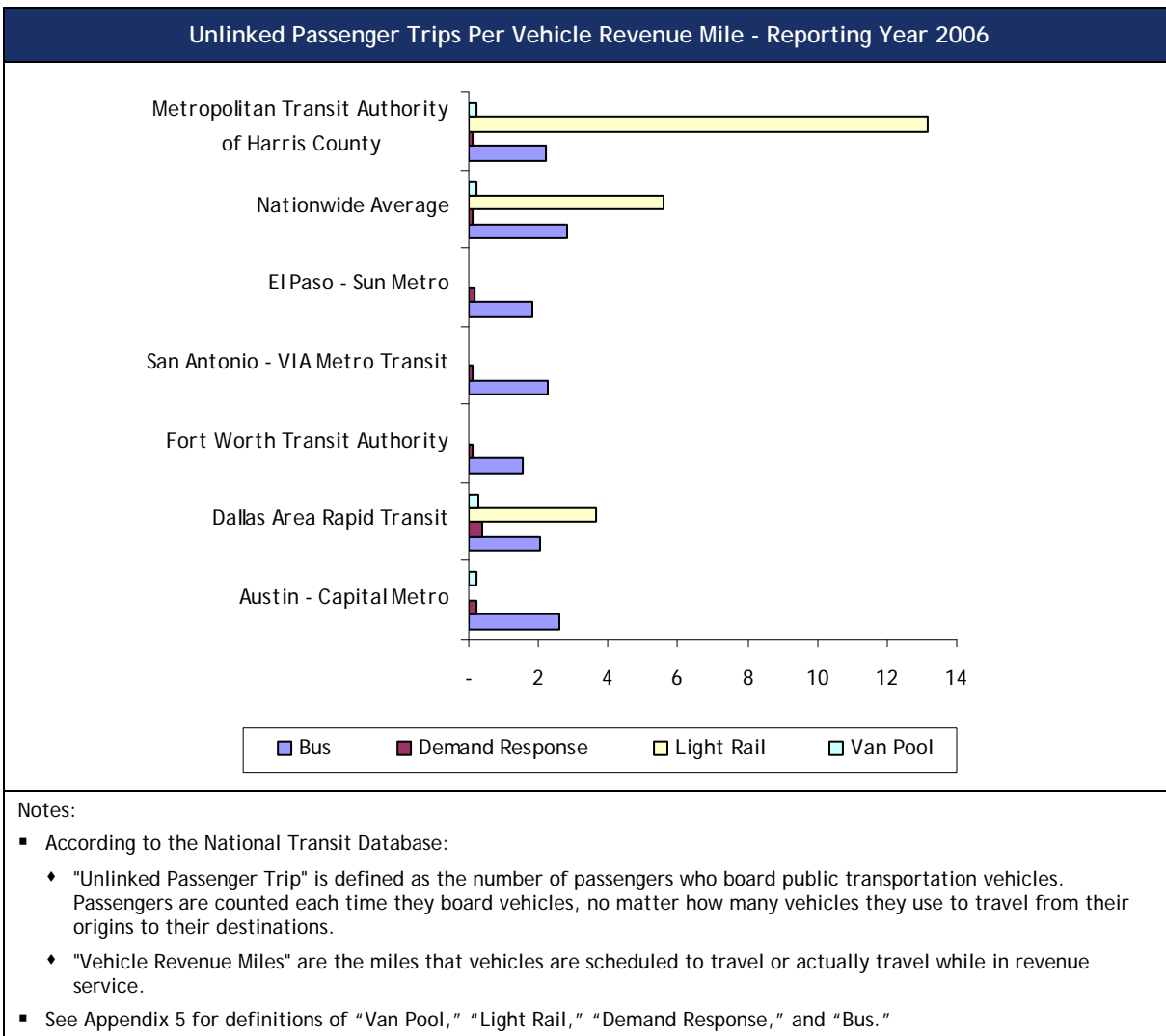
Figure 25



Source: National Transit Database - Reporting Year 2006.

Figure 26 compares information on unlinked passenger trips per vehicle revenue mile.

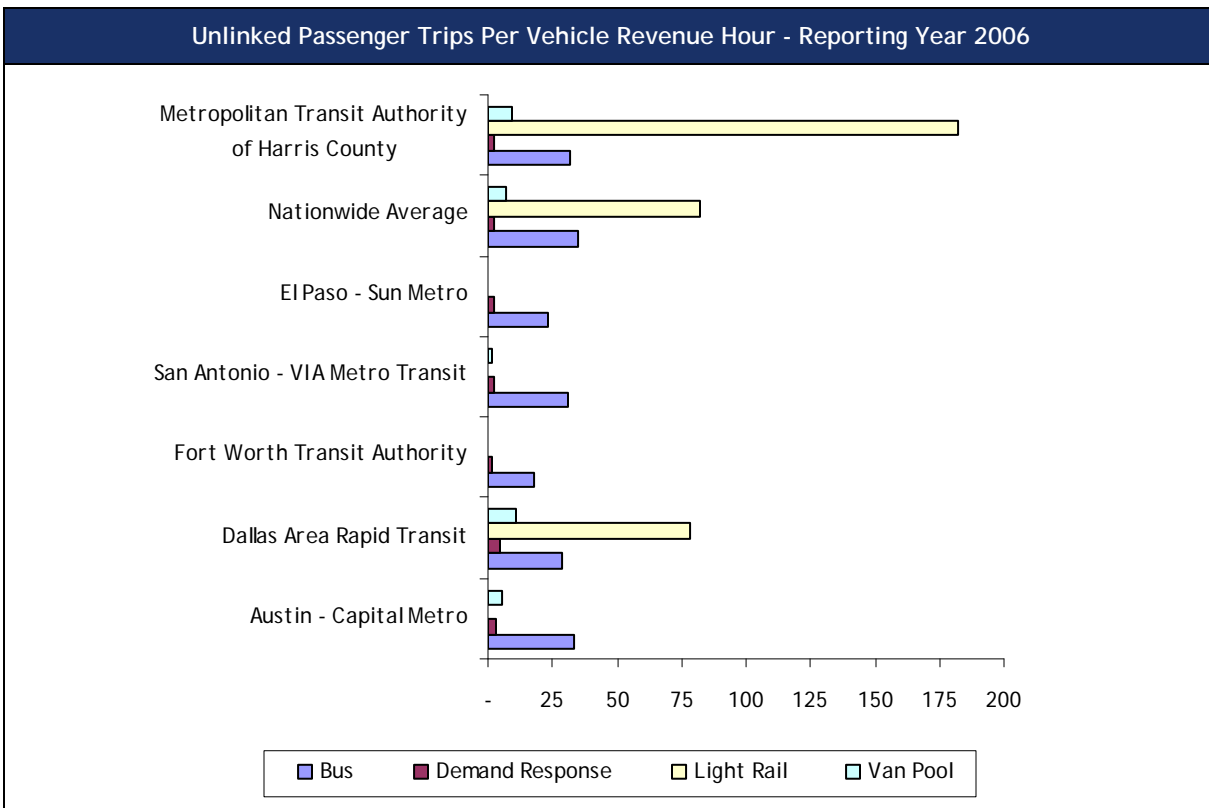
Figure 26



Source: National Transit Database - Reporting Year 2006.

Figure 27 compares information on unlinked passenger trips per vehicle revenue hour.

Figure 27



Notes:

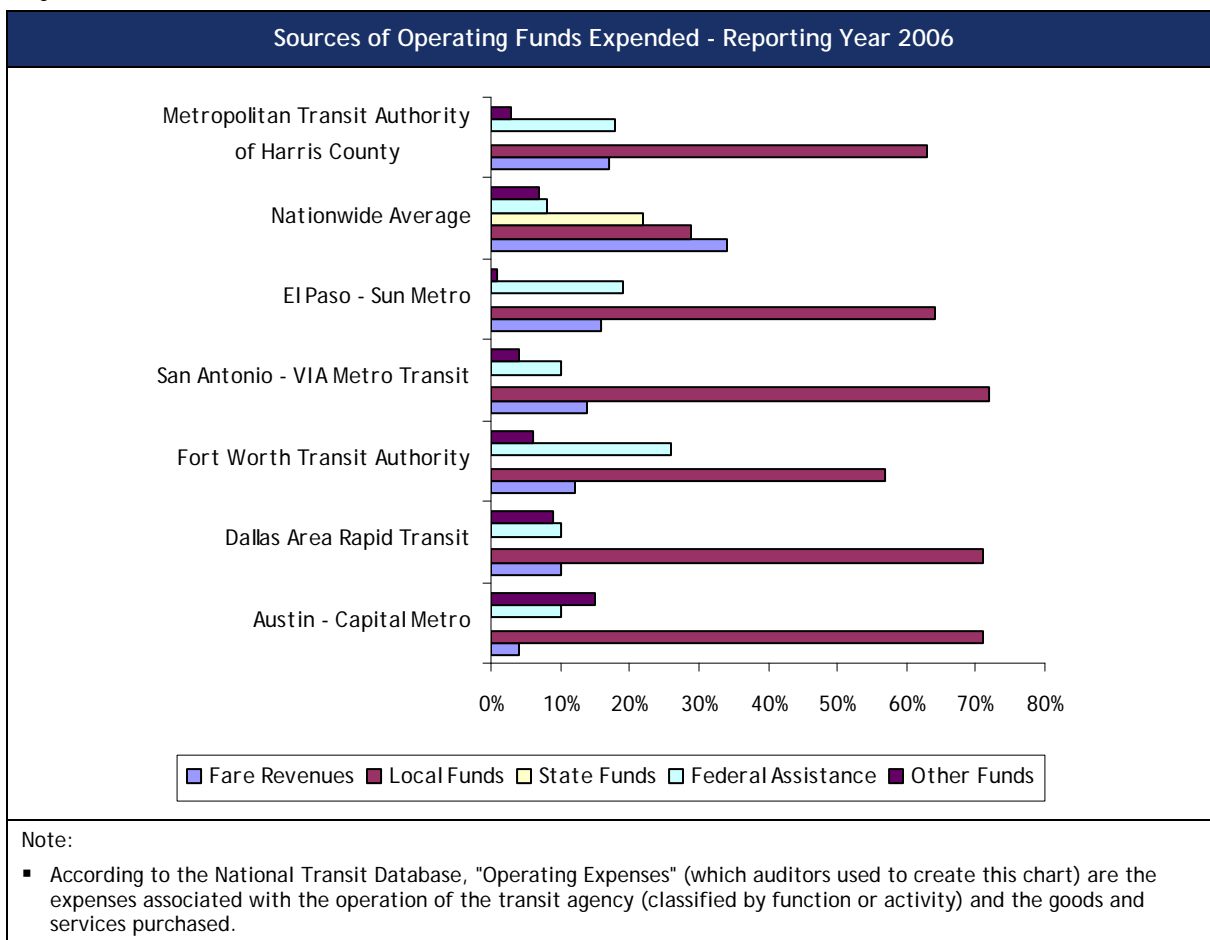
- According to the National Transit Database:
 - ♦ "Unlinked Passenger Trip" is defined as the number of passengers who board public transportation vehicles. Passengers are counted each time they board vehicles, no matter how many vehicles they use to travel from their origins to their destinations.
 - ♦ "Vehicle Revenue Hours" are the hours that vehicles are scheduled to travel or actually travel while in revenue service.
- See Appendix 5 for definitions of "Van Pool," "Light Rail," "Demand Response," and "Bus."

Source: National Transit Database - Reporting Year 2006.

Figure 28 compares information on sources of operating funds expended. Sources of operating funds include:

- Fare Revenues: Revenues received directly from passengers.
- Local Funds: Revenues from local entities that support the operation of the transit system. These funds can include, but are not limited to, tax levies, transfers from local governments, donations unrelated to specific passengers or trips, and advertising.
- State Funds: Financial assistance from a state agency that supports the operation of the transit system. These funds can include tax levies, transfers from state governments, or special contributions from the State.
- Federal Assistance: Financial assistance from the FTA to assist in paying the operating costs of providing transit service.
- Other Funds: Any other funding received.

Figure 28

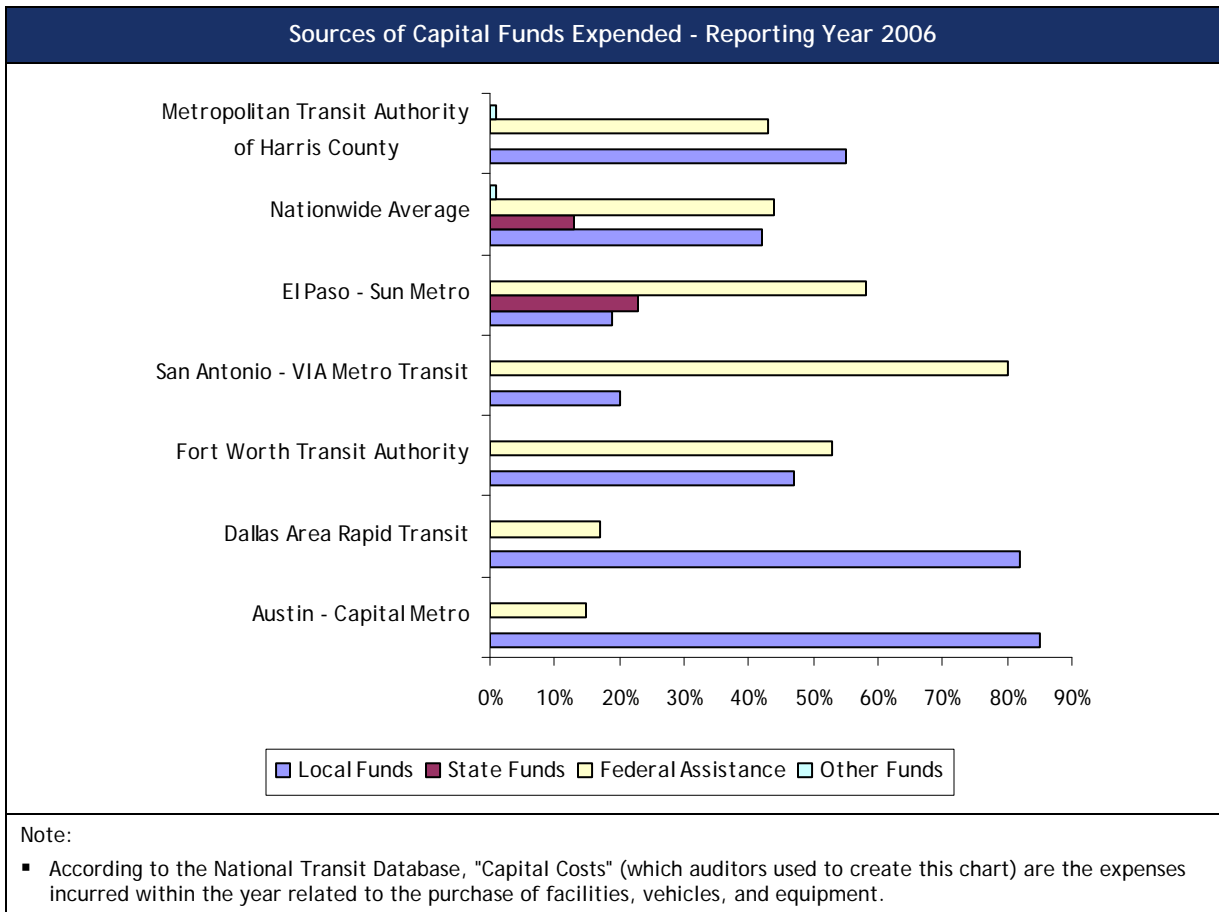


Source: National Transit Database - Reporting Year 2006.

Figure 29 compares information on sources of capital funds expended. Sources of capital funds include:

- **Local Funds:** Financial assistance from local entities to assist in paying capital costs. These funds can include tax levies, transfers from local governments, donations to help cover capital costs, and contributions to cover capital costs.
- **State Funds:** Financial assistance from a state agency to assist in paying capital costs.
- **Federal Assistance:** Financial assistance from the FTA to assist in paying the capital costs of providing transit service.
- **Other Funds:** Any other funding received for capital costs.

Figure 29

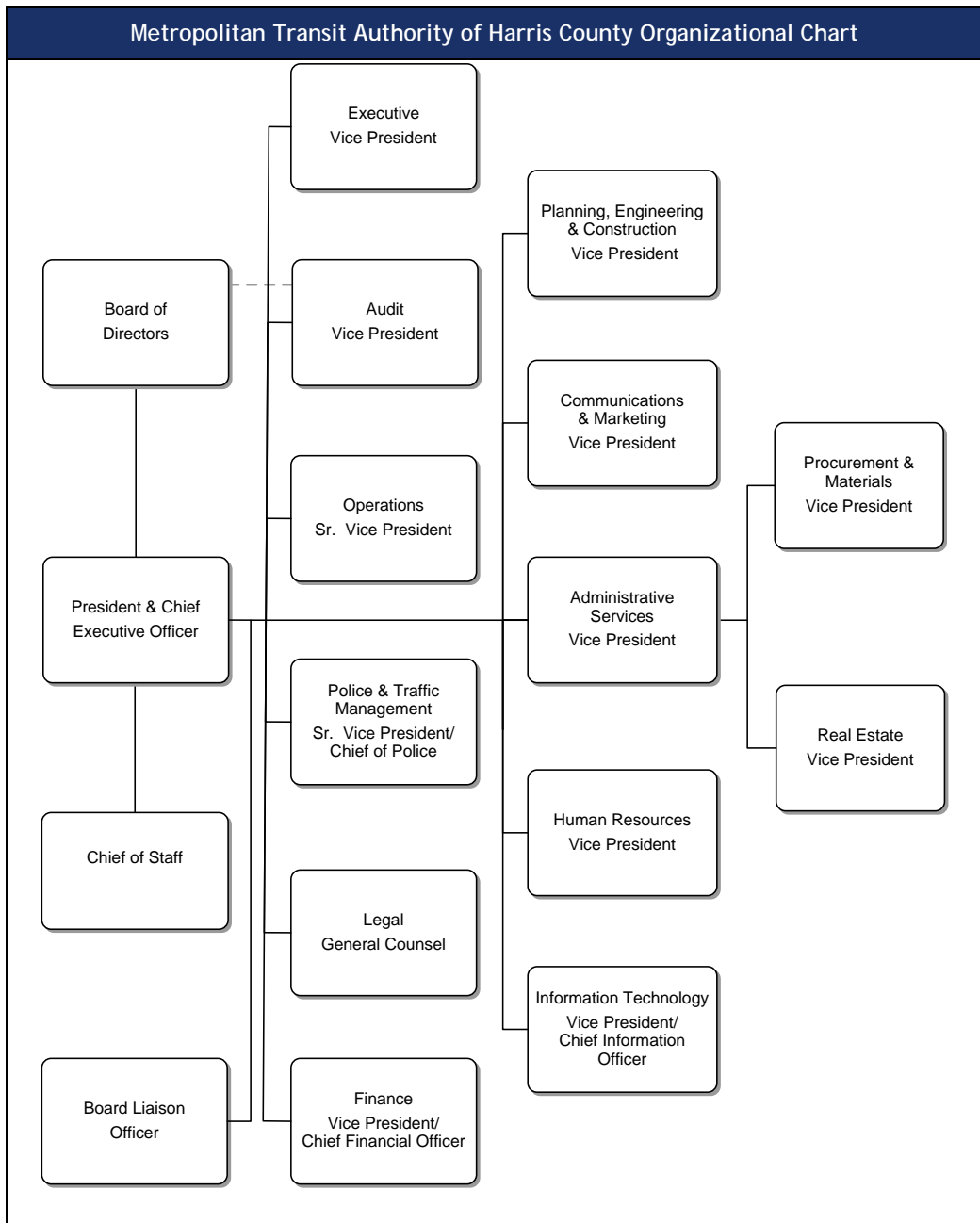


Source: National Transit Database - Reporting Year 2006.

Transit Authority Organizational Chart

Figure 30 is the organizational chart for the Metropolitan Transit Authority of Harris County.

Figure 30



Source: Metropolitan Transit Authority of Harris County audited annual financial report for fiscal year 2007.

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