Internal Audit Report

Public Transportation Grants Indirect and Direct Cost Monitoring

TxDOT Internal Audit Division
Objective
To determine that the indirect and direct cost reimbursement program for rural public transportation grant program (Section 5311) subrecipients includes validation and monitoring processes to help ensure appropriate cost allocation and reporting.

Opinion
Based on the audit scope areas reviewed, control mechanisms require improvement and only partially address risk factors and exposures considered significant relative to impacting operational execution and compliance. The organization's system of internal controls requires improvement in order to provide reasonable assurance that key goals and objectives will be achieved. Improvements are required to minimize existing process variation and control gap corrections that may result in potentially significant negative impacts to the organization including the achievement of the organization's business/control objectives.

Overall Engagement Assessment

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<td>Finding 3</td>
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Management concurs with the above findings and prepared management action plans to address deficiencies.

Control Environment
The Public Transportation Division (PTN) has established various Standard Operating Procedures (SOPs) for the oversight and monitoring of requests for reimbursements (RFRs) submitted monthly by grant subrecipients. An Indirect Cost SOP was also drafted by PTN; however, at the time of the audit, the SOP had not been finalized and distributed to the Public Transportation Coordinators (PTCs), responsible for monitoring and oversight of grant subrecipients.

On a monthly basis, the PTCs are responsible for the review and verification of RFRs prior to approval and submission for reimbursement. Supporting documentation reviewed by the PTCs during this monthly review can include a high level expenditure summary (streamlined documentation) or an in depth supporting documentation review for all amounts included in the RFR (full documentation). Streamlined reviews are PTN's standard monthly review method accounting for 66% of the monthly reviews performed in FY 2016.

As an added control and on a quarterly basis in FY 2016, the PTCs performed a full documentation review of all subrecipients which incorporated at least 30% (reduced to 20% coverage starting in FY 2017) of the total amount of expenditures reimbursed to the sub-recipient during the quarter (Quarterly Financial Monitoring). These PTC performed quarterly reviews may also be sampled and reviewed by a PTC Lead/Supervisor for additional review/verification each quarter. As a result of the quarterly review, additional full documentation reviews may also be performed when the PTCs exercise professional
judgement to determine if increased financial monitoring of the subrecipient when future monthly reimbursement requests are submitted.

As part of the oversight and monitoring for Section 5311 grants, aggregate RFR totals are tracked by PTN using PeopleSoft and leveraged for required federal reporting. Upon request by the Internal Audit Division, PTN was unable to provide a uniform and comprehensive listing of individual RFR payments made to Section 5311 grant program subrecipients for FY 2016. Instead information that was provided for this request included various PTC created grant monitoring documents (e.g., spreadsheets, pdf documents, word documents) with varying degrees of reimbursement and grant balance detail.

**Summary Results**

Audit testing completed resulting in management action plans.

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| 1       | Indirect and Direct Cost Monitoring | Upon review of the support used for a full documentation review (FY16 Q4) by a PTC to validate previously reimbursed sampled line item expenses, $288K did not have adequate support:  
• documentation for line item expenses totaling $252K did not include adequate detail to validate expense  
• documentation for line items expenses totaling $36K were not requested from the subrecipient at the time of the quarterly review to support the required 30% coverage  
A review of four completed FY16 Q4 reviews that were sampled and completed by a PTC Lead/Supervisor identified:  
• three reviews noted unsupported reimbursed cost ($153K)  
• inaccurate indirect cost calculations were not properly identified in the second level review ($22K) |
| 2       | Indirect and Direct Cost Monitoring | For 18 RFRs, validation testing of the indirect cost calculation and indirect cost line item reimbursements was performed resulting in erroneous reimbursements totaling $22K:  
• two RFRs, for one subrecipient, contained unallowable indirect cost line item expenses that resulted in over reimbursements of $1,711  
• three RFRs, for one subrecipient, contained indirect cost line item expenses not utilizing the indirect percentage rate and allocation base defined in the Negotiated Indirect Cost Agreement (NICRA) resulting in over reimbursements of $12,617  
• one RFR, for one subrecipient, had a reimbursement made for $8,291 although not all information needed to verify the indirect cost calculation was found  
Subrecipients noted above were unique and not the same. |
| 3       | Indirect and Direct Cost Monitoring | A review of RFR supporting documentation and hard copy retention for 10 PTCs found:  
• three PTCs stored RFR supporting documentation containing personally identifiable information (PII) in unlocked file cabinets. |
Audit testing completed not resulting in management action plans.

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<th>Scope Area</th>
<th>Evidence</th>
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<td>Indirect and Direct Cost Monitoring</td>
<td>• Documented Standard Operating Procedures have been established for the oversight and monitoring of reimbursement requests.</td>
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<td>Closeout Process Control Design</td>
<td>• PTN implemented a formalized closeout checklist in January 2017 that will assist the PTCs in the final reconciliation and reporting of expenses for the grant.</td>
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**Audit Scope**

This audit was performed by Judit Alphonse, Alma Alvarez, Lilly Burson, Tristan Masto, and Jennifer Stanush (Engagement Lead). The audit was conducted during the period from January 9, 2017 to March 17, 2017. The engagement focused on indirect and direct cost monitoring and evaluation of the grant closeout process.

Scope Area 1 - Indirect and Direct Cost Monitoring included evaluation of supporting documentation utilized by PTCs for 18 RFRs sampled during their Quarterly Financial Monitoring review (FY 2016 Q4) for 10 Section 5311 subrecipients approved for use of indirect costs; supporting documentation and its retention location for 18 RFRs to ensure the security of any PII; and indirect costs and calculations for 18 RFRs.

Scope Area 2 - Closeout Process Control Design included evaluation of the control design for PTN’s grant closeout process to ensure development of a formalized process and compliance with state and federal criteria.

**Methodology**

The methodology used to complete the objectives of this audit included:

- Interviewed key personnel including PTN Program Services Section Director, PTCs, PTC Supervisor, and PTN Program Services Compliance Section Lead.
- Reviewed the FY16 Q4 Quarterly Financial Monitoring form (PTN-126) for 10 Section 5311 grant program subrecipients approved for use of indirect costs to identify the population of Section 5311 RFRs judgmentally selected and reviewed by the PTC.
- Reviewed Section 5311 RFR supporting documentation obtained by PTCs from the subrecipients during the FY16 Q4 Quarterly Financial Monitoring review for direct and indirect cost general ledger line items judgmentally selected for validation by the PTC.
- Reviewed cognizant agency approved NICRA for the 10 Section 5311 subrecipients approved for use of indirect costs to determine the approved indirect cost percentage rate and indirect cost allocation base.
- Using the indirect cost percentage rate and allocation base found in the NICRA document, verified indirect cost line item calculations within the FY16 Q4 Section 5311 RFRs.
- Reviewed FY16 Q4 Section 5311 RFR supporting documentation for PII and its retention locations.
Through interviews with key personnel and review of state and federal criteria, assessed the control design for PTN’s grant closeout process.

**Background**

This report is prepared for the Texas Transportation Commission and for the Administration and Management of TxDOT. The report presents the results of the Public Transportation Grants Indirect and Direct Cost Monitoring audit which was conducted as part of the Fiscal Year (FY) 2017 Audit Plan.

PTN oversees state and federal grant programs including Federal Transit Administration (FTA) grants. The Rural Public Transportation grant program (49 USC, Section 5311) provides the public, living in rural areas and small cities with populations under 50,000, access to health care, shopping, education, employment, and recreation. During FY 2016, 37 transit providers (“subrecipients”) were awarded $33.7M in federal and state grant funds.

PTN requests applications for specific grant funding sources through calls for projects. As part of the grant application process, subrecipients that plan to submit for reimbursement of indirect costs throughout the grant must submit a cognizant agency approved NICRA. The NICRA is a document developed by the subrecipient that outlines the indirect cost allocation base, which is based upon direct cost line items, and an indirect cost percentage rate used to calculate the indirect costs. The cognizant agency is the agency responsible for reviewing, negotiating, and approving the NICRA.

Grant subrecipients submit monthly RFRs as grant related expenses are incurred. PTCs are responsible for reviewing RFRs for accuracy, completeness, and ensure appropriate supporting documentation is obtained prior to payment of the RFR. PTN categorizes supporting documentation required to be submitted by the subrecipient as 1) streamlined documentation (e.g., a general ledger (G/L) expenditure summary containing line item account codes, descriptions, date and expenditure amounts) or 2) full documentation (e.g., accounting summaries, check registers, and other detailed support documents such as invoices, time sheets, and proof of payment).

In addition to monthly RFR reviews, once a quarter, PTCs perform a financial monitoring review for all transit providers having RFRs paid within the quarter. During this quarterly process, the PTC performs a full documentation review of judgmentally selected line items totaling 30% of the total amount reimbursed to the subrecipient for the quarter. The quarterly monitoring review is performed to verify previously reimbursed costs by reviewing detailed supporting documentation to obtain assurance for the subrecipients’ G/L system financial reports.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the International Standards for the Professional Practice of Internal Auditing. 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. Recommendations to mitigate risks identified were provided to management during the engagement to assist in the formulation of the management action plans included in this report. The Internal Audit Division uses the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework version 2013.
A defined set of control objectives was utilized to focus on operational and compliance goals for the identified scope areas. Our audit opinion is an assessment of the health of the overall control environment based on (1) the effectiveness of the enterprise risk management activities throughout the audit period and (2) the degree to which the defined control objectives were being met. Our audit opinion is not a guarantee against operational sub-optimization or non-compliance, particularly in areas not included in the scope of this audit.
Detailed Findings and Management Action Plans (MAP)

Finding No. 1: Quarterly Financial Monitoring

Condition
Public Transportation Division’s Quarterly Financial Monitoring process can be improved to ensure that issues with reimbursements are identified and remediated. While risk-based monitoring is occurring, the performance of these monitoring activities could be improved to drive increased subrecipient performance/compliance and provide increased assurance.

Effect/Potential Impact
Payment to grant subrecipients for expenditures which have not been validated could result in TxDOT reimbursing for unallowable expenses. Subsequently, if unallowable expenditures were found to be reimbursed to the subrecipient, TxDOT would not be reimbursed by the Federal Transit Administration (FTA).

Line item expenses totaling $288K did not include adequate detail to support the previously reimbursed amount.

Criteria
U.S. Department of Transportation Federal Transportation Administration Circular - FTA C 5010.1E requires that TxDOT monitor federally assisted projects to ensure compliance with federal grant requirements and provide assurance that effective internal controls are in place for subrecipient grant activities. TxDOT must ensure all resources are used in accordance to grant specifications and used solely for authorized purposes.

Texas Administrative Code, Title 43, Part 1, Chapter 31, Subchapter D, Rule §31.48 requires TxDOT to conduct quarterly on-site monitoring to review agency financial records that support requests for payment and, at least quarterly, to discuss with the subrecipient problems encountered and technical assistance needs.

The Quarterly Financial Monitoring standard operating procedures state that quarterly at least 30% of the total amount reimbursed for that quarter to the grant subrecipient must be reviewed and documented. For each request for reimbursement (RFR) selected for review, the PTC will verify costs by tracing line item supporting documentation (e.g., receipt, invoice, cancelled check, timesheets, pay statements, etc.) to determine whether the documentation matches grant subrecipient’s accounting summary report and RFR form amount.

Cause
PTCs did not obtain the required documentation needed to support the validation of reimbursed costs, and when exceptions were noted, PTCs did not consistently obtain additional, required documentation from the subrecipient. In addition, the second level review performed by the PTC Lead/Supervisor of the Quarterly Financial Monitoring review did not consistently identify further documentation needs to support the validation of reimbursed costs.

Evidence
Fifty-eight RFR line item expenses were sampled (24% of total lines) from 10 PTCs Quarterly Financial Monitoring reviews in FY16 Q4. Test work was conducted to confirm that the documentation obtained and reviewed by the PTC supported the reimbursed line item expenses totaling $515K.
PTN Grants Indirect and Direct Cost Monitoring  TxDOT Internal Audit Division – Limited Scope

Quarterly Financial Monitoring Review – PTC
A review of the supporting documentation utilized by the PTCs to validate line item expenses, identified exceptions with 24 of 58 (41%) line items.

- Documentation for 21 of the line item expenses with exceptions ($252K*) did not include adequate detail to support the reimbursed amount as follows:
  - 8 line items were missing invoice and proof of payment
  - 7 line items were missing proof of payment
  - 5 line items were missing timesheets and proof of payment
  - 1 line item was missing an invoice

- Documentation for 3 of the line item expenses with exceptions ($36K*) was not requested from the subrecipient at the time of the review for verification of reimbursed amounts

Quarterly Financial Monitoring Review – Lead/Supervisor Review
PTN’s monitoring process for the Quarterly Financial Monitoring review includes a second level review of judgmentally selected quarterly reviews by the PTC Lead/Supervisor. Four Quarterly Financial Monitoring reviews in FY16 Q4 were sampled and reviewed by the PTC Lead/Supervisor, the following was noted:

- 3 of 4 (75%) Quarterly Financial Monitoring reviews had exceptions noted including unsupported reimbursed costs ($153K) and inaccurate indirect cost calculations ($22K) not identified by the PTC Lead/Supervisor second level review.

*Please note these items have been forwarded to the Compliance Division for further review to determine if reimbursement from subrecipient is required.

Management Action Plan (MAP):

MAP Owner:
Donna Roberts, Program Services Section Director, Public Transportation Division (PTN)

MAP 1.1:
Public Transportation Division (PTN) headquarters staff discussed the results of the audit with the Public Transportation Coordinators (PTCs) during the April 2017 PTC Workshop. The discussion emphasized the three types of detail support documentation common to the exceptions, with instructions to the PTCs to exercise diligence in obtaining those documents as part of their quarterly monitoring process. PTN will update the Standard Operating Procedure (SOP) and the Lead Review Checklist to provide additional clarification when reviewing salaries, fringe, and rent payments. PTN will conduct additional training at the July 2017 PTC Workshop.

Completion Date:  August 15, 2017
Finding No. 2: Validation of Indirect Cost Calculation

Condition
Indirect cost line item amounts submitted for reimbursement by the subrecipients were not consistently substantiated by the Public Transportation Coordinators (PTCs) using the indirect cost percentage rate and indirect cost allocation base documented in the Negotiated Indirect Cost Agreement (NICRA).

Effect/Potential Impact
Payment to grant subrecipients for expenditures which have not been validated could result in TxDOT reimbursing for unallowable expenses. Unallowable expenditures reimbursed to the subrecipient, are not eligible for reimbursement by Federal Transit Administration (FTA).

Two grant subrecipients were over reimbursed for $14,329 in indirect cost expenses.

Criteria
U.S. Department of Transportation Federal Transportation Administration Circular - FTA C 5010.1E requires that TxDOT monitor federally assisted projects to ensure compliance with federal grant requirements and provide assurance that effective internal controls are in place for subrecipient grant activities. TxDOT must ensure all resources are used in accordance to grant specifications, and used solely for authorized purposes.

Texas Administrative Code, Title 43, Part 1, Chapter 31, Subchapter D, Rule §31.48 requires TxDOT to conduct quarterly on-site monitoring to review agency financial records that support requests for payment and, at least quarterly, to discuss with the subrecipient problems encountered and technical assistance needs.

Cause
NICRA documentation is not reviewed during the application process to ensure information needed to validate indirect cost by the PTCs is obtained. Additionally, some PTCs did not have a complete understanding of how to validate indirect costs based on discussions during the audit. Lastly, PTN drafted an Indirect Cost Standard Operating Procedure (SOP); however, the SOP had not yet been finalized and implemented at the time of our audit fieldwork.

Evidence
Indirect cost line items were selected for testing within 18 requests for reimbursements (RFRs) that were sampled by 10 Public Transportation Coordinators (PTCs) during their Quarterly Financial Monitoring review (FY16 Q4). Audit testing included the verification of the indirect cost calculation against the approved NICRA for reimbursed indirect cost line item expenses totaling $179K.

A review of the indirect cost line item expense with the use of the NICRA (upon which the indirect cost line item is calculated) identified exceptions with 6 of 18 (33%) RFRs:

- 2 RFRs, for 1 subrecipient, contained indirect cost line item expenses calculated by the subrecipient using unallowable costs (i.e., not verified by the PTC against the NICRA) resulting in an over reimbursement of $1,711
- 3 RFRs, for 1 subrecipient, contained indirect cost line item expenses not calculated by the subrecipient using the indirect percentage rate and allocation base within the NICRA (i.e., not verified by the PTC against the NICRA) resulting in an over reimbursement of $12,617*
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• 1 RFR, for 1 subrecipient, had a NICRA that did not define the indirect cost allocation base resulting in reimbursement of indirect cost of $8,291 that could not be verified

*Please note: PTN contacted this subrecipient in September 2016 regarding the incorrect indirect cost calculation methodology being used and initiated recovery efforts for the $12,617 during the time of the audit.

Management Action Plan (MAP):

MAP Owner:
Donna Roberts, Program Services Section Director, Public Transportation Division (PTN)

MAP 2.1:
The Public Transportation Division (PTN) will continue to strengthen its process for the management of indirect costs. PTN created draft Standard Operating Procedures (SOPs) in September 2016 to provide guidance on the administration of indirect costs to include:

• Program managers obtaining subrecipient Negotiated Indirect Cost Agreement (NICRA) information during the grant application process includes indirect cost rate type, percentage rate, and allocation base
• Public Transportation Coordinators (PTCs) reviewing subrecipient NICRA to understand indirect cost rate and allocation base to be used in reimbursements
• PTCs reviewing reimbursements to ensure indirect costs charged are supported by required documentation for the review method used (streamline or full documentation)
• PTCs verifying indirect costs have been properly charged

In addition, PTN staff received training in October 2016 on the monitoring of indirect costs, and refresher training in April 2017. The draft SOPs will be finalized, formally adopted, and distributed to the PTCs.

Completion Date:  May 15, 2017
Finding No. 3: Unsecured Personally Identifiable Information (PII) in Request for Reimbursement (RFR) Supporting Documentation

Condition
RFR supporting documentation containing PII was stored in unlocked filing cabinets. The types of PII included:

- Pay check records containing grant subrecipient employee names and social security numbers
- Transit service trip register containing customer names, pick up location (which can include home addresses) and birth dates

Effect/Potential Impact
Unsecured documentation containing PII can lead to unauthorized disclosure and misuse of subrecipient employee and/or customer information.

Criteria
Title 5, United States Code, §552a(e)(10) states that agencies that maintain a system of records shall establish appropriate administrative and physical safeguards to ensure the security and confidentiality of records in order to protect against threats which could result in substantial harm, embarrassment, inconvenience, or unfairness to the individuals for which the information is maintained.

U.S. Department of Commerce’s National Institute of Standards and Technology (NIST) Guide to Protecting the Confidentiality of PII gives guidance on the identification and protection of PII.

- Chapter 2, section 2.1 Identifying PII - PII is classified as “any information about an individual maintained by an agency, including (1) any information that can be used to distinguish or trace an individual’s identity, such as name, social security number, date and place of birth, mother’s maiden name, or biometric records; and (2) any other information that is linked or linkable to an individual, such as medical, educational, financial, and employment information.”
- Chapter 2, section 2.3 PII and Fair Information Practices – “Personal data should be protected by reasonable security safeguards against such risks as loss or unauthorized access, destruction, use, modification or disclosure of data.”

TxDOT Records Management Manual states that each district and division is responsible for implementing the Records Management program internally which includes ensuring records containing PII are maintained securely throughout their lifetime, and identifying vital records and taking measures to protect them.

Cause
Public Transportation Coordinators (PTCs) did not lock file cabinets where supporting documentation was stored or were unaware of the PII contained within the supporting documentation.

Evidence
Testing to determine if PII was included in supporting documentation retained for 18 RFRs sampled by 10 Public Transportation Coordinators (PTCs) during the Quarterly Financial Monitoring review (FY16 Q4) was performed and noted the following:
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- 2 PTCs stored supporting documentation containing grant subrecipient employee names and social security numbers in unlocked filing cabinets.
- 1 PTC stored supporting documentation containing grant subrecipient customer name, birth date, and pick up locations (i.e. sometimes inclusive of home addresses) in unlocked filing cabinets

Management Action Plan (MAP):

**MAP Owner:**
Donna Roberts, Program Services Section Director, Public Transportation Division (PTN)

**MAP 3.1:**
The need to ensure all Personal Identifiable Information (PII) is kept under lock and key was discussed with the Public Transportation Coordinator (PTCs) at the April 2017 PTC Workshop. Public Transportation Division has drafted a Standard Operating Procedure (SOP) to address this issue, and will distribute the finalized SOP to the PTCs. Direction given included that PTCs should remind subrecipients to redact PII prior to submitting documents to PTN, documents that include PII not be left in plain view, and all physical files containing PII should reside within a locked file cabinet or room when not being actively viewed.

**Completion Date:** May 15, 2017
### Summary Results Based on Enterprise Risk Management Framework

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### Closing Comments
The results of this audit were discussed with the Public Transportation Division Director on June 22, 2017. The Internal Audit Division appreciates the cooperation and assistance received from the Public Transportation Coordinators contacted during this audit.