



STATE OF MICHIGAN
DEPARTMENT OF TRANSPORTATION
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

KIRK T. STEUDLE
DIRECTOR

August 17, 2009

Mr. Robert Emerson
State Budget Director
Department of Management and Budget
111 South Capitol, 6th Floor
Lansing, Michigan 48909

Dear Mr. Emerson:

In accordance with the State of Michigan, Financial Management Guide, Part VII, Chapter 4, Section 100, enclosed is a summary table identifying our responses and corrective action plan to address the recommendations the Office of the Auditor General's Performance Audit of the Bureau of Passenger Transportation (BPT), covering the period of October 1, 2004 through June 30, 2007. The Office of Financial Management approved distribution of the plan.

Questions regarding the summary table or corrective action plan should be directed to Sharon Edgar, Bureau of Passenger Transportation, at 517-373-0471, or Jerry J. Jones, Commission Auditor, at 517-373-2384.

Sincerely,

Signature Redacted

Kirk T. Steudle
Director

Enclosure

cc: The Hon. Jennifer Granholm, Executive Office
The Hon. George Cushingberry, Jr., House Appropriations Committee
The Hon. Ron Jelinek, Senate Appropriations Committee
The Hon. Pam Byrnes, House Transportation Committee
The Hon. Jud Gilbert, Senate Transportation Committee
Mr. Thomas McTavish, Auditor General
Mr. Mitchell Bean, House Fiscal Agency
Mr. Gary Olson, Senate Fiscal Agency
Ms. Lisa Webb Sharp, Director, DMB

Performance Audit of the Bureau of Passenger Transportation
Michigan Department of Transportation
Summary of Agency Responses to Recommendations
Audit Period: October 1, 2004 to June 30, 2007

SUMMARY TABLE

1. **Audit Recommendations the agency has complied with:**

FINDING

3. **Cost Allocation Plans (CAPs)**

RECOMMENDATION

We recommend that BPT develop a process to verify that public transportation providers allocate expenditures in accordance with an approved CAP.

AGENCY RESPONSE

As discussed in detail below, BPT implemented a process to verify that public transportation providers allocate expenditures in accordance with their approved CAPs in July 2007. The five instances of noncompliance cited in the audit finding were in audits performed prior to July 1, 2007.

On July 1, 2007, in coordination with efforts of the BPT, the Michigan Department of Treasury promulgated a revised Audit Guide for Transportation Authorities in Michigan. Page 13 of the revised Audit Guide provides guidance that requires: (1) all BPT approved CAPs used in the preparation of the financial statements be identified by name, and (2) inclusion of a statement that the approved CAPs listed were used in the preparation of the annual audit.

The BPT received all the 2007 annual audits that were required to be performed in accordance with the revised audit guide. With regard to noncompliance of the CAP requirements for the 2007 annual audits (the first year for the new requirements), a noncompliance letter was written to transit agency managers, and their auditors, requesting full compliance by a specified date. The BPT will follow Internal Division Instruction, IDI 70206, *Identification, Review, and Follow up of Audit Findings* to ensure compliance of the CAP requirements for future years.

Corrective action has been fully implemented.

FINDING

4. Continuous Quality Improvement (CQI)

RECOMMENDATION

We recommend that BPT improve its CQI processes by establishing performance indicators to measure the outputs and outcomes related to its goals and objectives.

AGENCY RESPONSE

The annual "Goals and Objectives" document reviewed by the auditors did not include performance indicators. The BPT's annual Goals and Objectives document has served several purposes. Its primary purpose was to establish an issue agenda for BPT management and staff that identified key activities and issues the BPT would focus on in the coming year. If a specific BPT program area did not have an activity or issue that was of special or unique focus for the coming year, it was not covered in the document. In addition, the annual goals and objectives were organized according to the vision statements in the MDOT Strategic Plan. As such, the document reinforced the MDOT vision statements.

The BPT's "2008 Goals and Objectives" document covers all of BPT's ongoing program areas and the BPT has established one or more annual goal statements for each ongoing program area. With this change, the document is now more comprehensive. For each annual goal statement the BPT identified performance indicators and specified the monitoring levels for each indicator. Supervisors also helped each person understand his or her individual role in meeting and monitoring the performance indicators that are relevant to their job. This new format will be used each year, to ensure performance indicators are established for each annual goal statement and are then reflected in individual performance plans.

Corrective action has been fully implemented.

2. Audit Recommendations the agency agrees with and will comply:

FINDING

1. Monitoring of Budgeted and Actual Expenditures

RECOMMENDATION

We recommend that BPT improve its budget review process and its monitoring of actual expenditures made by public transportation providers so that unspent funds can be returned and redistributed by BPT on a timely basis.

AGENCY RESPONSE

BPT concurs there are opportunities to strengthen our budget review process and monitoring of actual expenditures made by public transportation providers under the state operating assistance program that may result in unspent funds being returned and redistributed by the

Bureau in shorter time frames. However, BPT does not fully agree with all of the auditor's conclusions or with the impression of the magnitude of the problem a report reader may be left with upon reading this finding, as discussed in more detail below.

BPT believes it is important for the report reader to understand the overall context of the process being evaluated. The state operating assistance program as defined in Act 51 of the Public Acts of 1951 requires MDOT to provide financial assistance to local public transportation providers as a percentage of each provider's eligible operating expenses for the fiscal year. Funds are paid out on a provisional basis in the same fiscal year that expenses are being incurred. The provisional payments are based on an estimated budget submitted prior to the start of the fiscal year. BPT's processes are aimed at ensuring each provider receives the correct amount, however, since the provisional payments are based on budget estimates, provisional payments to some providers will be greater than their actual eligible operating expenses during the fiscal year; while the provisional payments to other providers will be less than their actual eligible expenditures during the fiscal year. Reconciliation and redistribution of funds is inevitable. State operating assistance is a critical component of each provider's annual operating budget and cash flow. These funds support essential transit services. Provisional payments to a provider that are based on budgeted estimates which are significantly less than actual expenses during a fiscal year, could result in service interruptions. Therefore, in its approach to this process, BPT leans toward maximizing the operational funds available to each provider, rather than minimizing funds. Since BPT provides operating assistance to each provider year after year, there are built-in safeguards, with opportunity to recoup and redistribute the excess provisional payments.

With regard to the specific findings in the report under 1.a., corrective action was implemented as follows, to document the validity of budget increases.

First, project managers will be instructed to ensure that explanations received from local transportation providers regarding any increase that is above the standard have been entered into PTMS and approved by the project manager.

Second, prior to completing the draft budget distribution in June for the following fiscal year, BPT unit supervisors will conduct a comparison between the current year budget and prior year budget and reconciliation report to confirm that an explanation has been entered into PTMS where needed. A report will be provided to the Section Manager for review.

This clarification to existing procedures was outlined in an email from the Section Manager to unit supervisors and project managers on March 27, 2009. Compliance with the procedure will be monitored by the Section Manager. This corrective action has been fully implemented.

BPT agrees with part 1.b. of the finding in that BPT missed some opportunities to adjust payments during the fiscal year. However, BPT believes the report overstates the magnitude of the problem and overestimates the opportunity for improvement. Provisional payments are based on budget estimates generally developed by a provider based on historical experience and anticipated current year's cost. BPT does not believe adequate information in regard to a current year's actual costs is available to begin reducing payment until the third quarter of the fiscal year. Reducing payments after only two quarters of reported expenses could result in an

unnecessary shortfall in a provider's cash flow and could endanger critical transit services available to the public. Under Act 51 of PA 1951, local provider's reports are not due to MDOT until 40 days after the end of each quarter; therefore, it is mid-August before BPT has access to the third quarter report. If it is evident at that point that the local provider is running significantly below budget, BPT adjusts the final payment.

In addition, there are also times when a local provider makes adjustments in the last quarter, such as shifting costs from their state operating budget to a federal preventative maintenance grant, or other year-end adjustments that have a major impact on their total eligible expenses. In these situations, BPT does not have the opportunity to adjust payments.

The audit report noted that there were 27 occasions where the annual distributions to providers exceeded actual expenditures (however, the list the auditors provided to BPT only included 26 instances). BPT reviewed the information provided by the auditors. In 12 instances, BPT agrees that it had information available within the fiscal year that should have lead to a discussion between BPT and the local provider, and if there was not an explanation that expenses would increase in the fourth quarter, BPT should have reduced the final payment to the provider. However, in regard to the other 14 instances, BPT does not believe they represent the lack of BPT evaluation and appropriate action. As indicated in the list below, in the first ten instances, the information available to BPT at the end of the third quarter did not indicate the payment should be reduced. In the last three instances on this list, BPT had reduced the final payment and the amount overpaid as of reconciliation was negligible.

1. 2003 - Interurban Transit Partnership: 3rd quarter at 73% of budgeted expenses.
2. 2003 - Kalamazoo Metro: 3rd quarter at 74% of budgeted expenses.
3. 2003 - Kalamazoo County: 3rd quarter at 81% of budgeted expenses.
4. 2003 - Manistee County: 3rd quarter at 71% of budgeted expenses.
5. 2003 - Bay Area: 3rd quarter at 76% of budgeted expenses.
6. 2003 - SMART Lake Erie: 3rd quarter at 73% of budgeted expenses.
7. 2005 - Flint: 3rd quarter at 78% of budgeted expenses.
8. 2005 - SMART Lake Erie: 3rd quarter at 72% of budgeted expenses.
9. 2006 - Kalamazoo Metro: 3rd quarter at 88% of budgeted expenses.
10. 2006 - St. Joseph: 3rd quarter at 76% of budgeted expenses.
11. 2004 - Interurban Transit Partnership: The Bureau did reduce monthly payments. The provider only owed 2% of budgeted amount at reconciliation.
12. 2004 - St. Joseph: The Bureau did reduce monthly payments. The provider owed less than 1% of budgeted amount at reconciliation.
13. 2005 - Bay Area: The Bureau did reduce monthly payments. The provider owed 5% of budgeted amount at reconciliation.

The 14th instance is 2004 Kalamazoo Metro. They earned 103% of budgeted expenses for both urban and rural combined and MDOT owed Kalamazoo at reconciliation.

To strengthen its review process during the fiscal year as payments are being made, MDOT will undertake the following steps.

In August of each year, after the third quarter reports have been submitted to MDOT, each project manager will analyze the expenses to date in comparison with the provider's

budget. If less than 70% of the budget has been earned as of the third quarter, the project manager will discuss with the local provider and then discuss with their supervisor whether the September payment should be reduced.

MDOT will maintain a spreadsheet showing the results of this analysis for each local provider. MDOT will use the spreadsheet to determine if patterns emerge for a specific provider over several years, and if so, MDOT will consider that information as part of our annual analysis. MDOT believes it is the emergence of patterns over time that holds the greatest opportunity for reducing some overpayments.

This clarification to existing procedures was outlined in an email from the Section Manager to unit supervisors and project managers on March 27, 2009. This corrective action has been fully implemented.

BPT agrees with the underlying intent of part 1.c. of the finding, in that timely reconciliation is important. However, BPT does not believe there are significant opportunities to shorten the year-end reconciliation process. BPT has a detailed procedure in place for the reconciliation process with the goal of completing the entire process within nine months after the close of the fiscal year. Within this nine months, the first 40 days are spent waiting for the local year-end reports and the last 30 days are used to issue BPT's draft reconciliation for provider review and comment. This leaves approximately 26 weeks to complete the reconciliation process for 99 reports from 78 providers.

During the reconciliation process, the BPT accountant reviews each report for variances from prior year reconciled reports as well as the reasonableness of the information reported. If the accountant notes areas of concern they are referred to the project managers. BPT's project managers then confer with the local provider and follow-up until a satisfactory resolution is reached on any concerns or variances noted. For complex issues the accountant may work directly with the local provider to resolve the issue and correct the report. If BPT has received the audit report from any local provider during this time, the accountant compares the audit to the reconciled report and makes further adjustments if necessary (which may again, require consultation with the project manager and local provider). This is an interactive process that includes ongoing dialogue between BPT and each provider. Only after the accountant is satisfied that the report reflects the most accurate information available, it is placed into "Approved" status in PTMS.

The BPT accountant responsible for the process works 32 hours per week and has other related responsibilities. Assuming the accountant is never on sick or annual leave and assuming they performed no other duties during this time; they would have an average of 10.6 hours to complete each provider review. This is not an unreasonable or inappropriate time frame.

The accuracy of the reconciliation process is critical. The ongoing dialogue between BPT and each local provider and the analysis/re-analysis done as a result of this dialogue can be very time consuming for some providers. However, for the reconciliation process to be successful, BPT needs to have the best possible information and should be in agreement with each local provider. Thoroughly identifying and addressing problems during the reconciled review avoids large corrections during the audit closeout process and allows for earlier redistribution

of funds. Based on the importance and value of this review, and the need for there to be back and forth discussions and re-analysis, BPT does not feel the time frame is unreasonable.

BPT also concurs with the underlying intent of the finding in 1.d. BPT develops a payback schedule for each local provider with the goal of having all funds paid back to MDOT within 12 months after the redistribution amounts have been determined. This was not so for one of the years the auditors looked at because of unique circumstances. Redistribution for the 2003-2004 reconciliation was significantly longer than normal for two reasons: 1) the year-end redistribution was combined with two audit redistributions and a single provider owed a larger amount back to MDOT under the audit redistributions and was given 18 months to complete the payback.

In redistributing funds, BPT balances the needs of providers that have to pay funds back with the needs of the providers that are due funds. As funds are paid back, BPT distributes the collected funds to the providers that are due funds -- first when 50% of the funds have been collected and again when the remainder of the funds have been collected. BPT also avoids making multiple small payments to each local provider, since many providers find it cumbersome to track and account for multiple checks from the state.

The BPT has developed and is in the process of testing new procedures for redistribution, which may be more effective in meeting the goals of quick payback to each individual provider without having such frequent payments that the providers have trouble tracking them.

The non-financial information on the provider's report will be reviewed by another staff person (who was trained by our accountant) beginning with the FY 2009 reconciliation process. The staff person will look for variances from previous years and report significant issues to the project manager for follow-up and resolution. This procedural change will save the accountant time not only on the reconciliation review but also on a legislatively required report on ridership.

For the FY 2008 reconciled distribution, BPT tested new procedures for redistribution, which may prove to be more effective in meeting the goals of quick payback to each individual provider without having such frequent payments that the providers have trouble tracking them. BPT is testing the following:

A schedule for payback (achieved through withholding from current year payments) is determined for each local provider based on the percent of monthly withholdings compared to monthly payout (i.e., current year monthly payments). The goals for payback are the following:

- Monthly payback (withholding) amounts are set at an amount not to exceed 15% of the total monthly payout unless the provider requests a larger withholding.
- Complete all paybacks in nine months. Any payback schedule requiring more than nine months to complete will require approval by Bureau management.
- Any provider-requested exception which extends the proposed payback schedule will require justification showing hardship and must be approved by Bureau management.

Payments are made out quarterly unless the amount recovered to MDOT is determined to be too small to justify the administrative expense of generating warrants.

The first redistribution will be no later than the second quarter after collections began. For each redistribution, a payment schedule is determined based on the following principles:

- Every local provider that is owed money will receive at least 50% of the funds due them.
- Full repayment will be made to as many providers as possible.
- Full repayment will be made to each local provider within 15 months of initial collection unless prevented by extenuating circumstances.

The BPT will continue to refine this process based on the results of two subsequent redistributions. The first redistribution using this process was very successful and resulted in close to a five-month reduction in the cycle time. After the second redistribution is complete any needed improvements will be implemented and a permanent procedure will be finalized by January 2010.

FINDING

2. Maintenance and Compliance Reviews

RECOMMENDATION

We recommend that BPT conduct timely maintenance and compliance reviews of the public transportation providers.

AGENCY RESPONSE

MDOT concurs with the recommendation. A process was put in place in April 2008 (when this finding was initially released to MDOT), to track our progress at the unit supervisor level, with additional oversight by the Section Manager and Bureau Administrator. The majority of the backlogged reviews were completed in calendar year 2008 and the remainder will be completed in 2009.

This corrective action will be fully implemented by December 2009.

3. Audit Recommendations the agency disagrees with:

None.