



October 15, 2010

To: Finance and Administration Committee
From: Will Kempton, Chief Executive Officer
Subject: Review of 91 Express Lanes Toll Road Collections

Overview

The Internal Audit Department has completed a review of the 91 Express Lanes toll road violation collection process. The review was performed to ensure adequate controls exist over delinquent collections and that toll road operator, Cofiroute USA, LLC, and its delinquent violation collection subcontractor, Law Enforcement Services, Inc., are compliant with contract requirements, California Vehicle Code, and Orange County Transportation Authority Ordinance 2004-1. Based on the review, the Internal Audit Department provided three recommendations to enhance compliance with contract requirements and the California Vehicle Code. The Internal Audit Department also recommended that management consider enhanced financial statement reporting to better identify the nature of revenue and expenses.

Recommendation

Direct Cofiroute USA, LLC, and Orange County Transportation Authority staff to implement recommendations included in Review of 91 Express Lanes Toll Road Collections, Internal Audit Report No. 08-016.

Background

In 2003, the Orange County Transportation Authority (OCTA) took public ownership of the 91 Express Lanes, a ten-mile toll facility operating within the median of the Riverside Freeway (State Route 91) in Orange County. OCTA contracts with Cofiroute USA, LLC (Cofiroute) to provide management and operation of the 91 Express Lanes. Under the terms of the contract, Cofiroute is responsible for performing toll violation processing and must perform these duties in accordance with California Vehicle Code (Code). Cofiroute subcontracts with Law Enforcement Services, Inc. (LES), to perform delinquent violation collection services. Delinquent toll violations are defined as those that

remain unpaid at 90 days. LES earns a percentage of the amount of tolls and fees collected through its direct efforts.

Discussion

The objective of this review was to ensure that adequate controls exist in the processing and collection of delinquent toll violations, and that Cofiroute and LES are compliant with contract terms, Code, and OCTA Ordinance 2004-1. The Internal Audit Department (Internal Audit) also verified that recommendations made by its staff in a 2006 review were implemented.

During the review, Internal Audit noted that Cofiroute has implemented good controls to monitor compliance with the Code with regard to timely issuance of toll road violation notices. Cofiroute had the 91 Express Lanes software vendor develop a system report that allows for regular compliance monitoring. Internal Audit recommended that 91 Express Lanes software, currently under development, provide these necessary tools and Cofiroute management concurred.

The Code requires that recipients of toll road violations (recipients) be provided a means by which to challenge violations. First, recipients must request an administrative investigation. If the recipient is not satisfied with the results of the administrative investigation, an administrative hearing may be requested. Under the Code, the administrative hearing must be conducted by a "public agency or a private entity that has no financial interest in the facility" and the administrative hearing officer must be designated by the agency's governing body or chief executive officer. Internal Audit noted that Cofiroute does not have an administrative hearing officer under contract and recommended that one be appointed and approved. Cofiroute has now entered into a contract with an administrative hearing officer, and will develop additional written procedures to ensure fair and impartial reviews.

While reviewing collection packages provided to OCTA by Cofiroute, Internal Audit noted that fees charged by LES bank for insufficient funds (NSF) were being deducted from the remittance to OCTA. While the monthly charges are minimal, OCTA's contract with Cofiroute does not address them. Internal Audit recommended that OCTA and Cofiroute clarify this in the next contract amendment. Management indicated that the contract agreement with LES will be amended to address the NSF fees.

Finally, Internal Audit reviewed the 91 Express Lanes audited financial statements for the fiscal year ended June 30, 2009, and noted that the Statement of Revenues, Expenses, and Changes in Fund Net Assets lacks

clarity with regard to revenue sources and expense classifications. In addition, as an enterprise fund, financial statement users are not provided comparative results of operations. Internal Audit recommended that financial statement disclosures be enhanced, comparative financial information be provided, or that management include a Management Discussion and Analysis section to illuminate significant financial transactions, trends, or operating results. Management will make changes for the fiscal year ending June 30, 2011, to income statement classifications to better detail the nature and amount of income and expenses for the 91 Express Lanes stand-alone financial statements.

Summary

Based on a review of delinquent toll road violation processing by Cofiroute and LES, Internal Audit has provided three recommendations to improve compliance with contracts and the Code. Internal Audit has also recommended that OCTA management consider enhancing its financial statement reporting to provide users with more information concerning revenues, expenses, and fluctuations therein.

Attachment

- A. Review of 91 Express Lanes Toll Road Collections, Internal Audit Report No. 08-016

Approved by:

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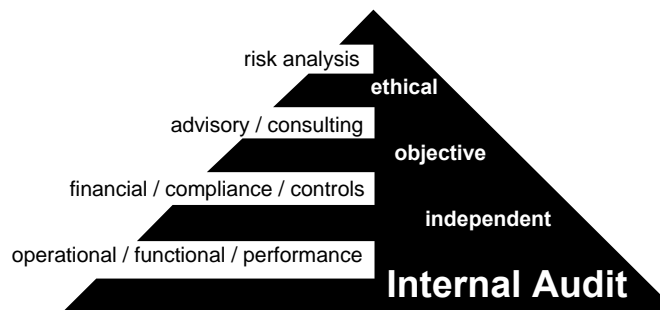
Orange County Transportation Authority Internal Audit Department



Review of 91 Express Lanes Toll Road Collections

INTERNAL AUDIT REPORT NO. 08-016

September 30, 2010



Internal Audit Team:

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Conclusion

The Internal Audit Department (Internal Audit) has completed a review of the Orange County Transportation Authority's (OCTA) 91 Express Lanes toll road violation collection process. The objective was to evaluate the collection performance of Cofiroute USA, LLC (Cofiroute) and its contractor Law Enforcement Services, Inc. (LES), these contractors' compliance with California Vehicle Code, OCTA Ordinance 2004-1, and compliance with agreements between OCTA, Cofiroute, and LES. Additionally, Internal Audit followed up on related recommendations made in Internal Audit Report No. 06-021, Cofiroute Contract Compliance and Operational Audit issued August 2, 2006. Based on the procedures performed, Internal Audit identified several areas in which the violation collection process could be improved. Internal Audit has also offered a recommendation to improve financial statement disclosure with regard to the 91 Express Lanes Fund.

Background

The Toll Road

On January 3, 2003, OCTA took public ownership of the 91 Express Lanes from a private firm that had owned and operated the facility since its construction in 1995. The 91 Express Lanes is a ten-mile high-occupancy toll road / full toll way hybrid contained entirely within the median of State Route 91 in Orange County, California. It runs from State Route 55 interchange in Anaheim east to the Riverside County line. The 91 Express Lanes consist of two primary lanes in each direction. Access to the 91 Express Lanes is limited to its east and west ends. OCTA contracts with Cofiroute to provide management and operation of the 91 Express Lanes. Under the terms of the contract, Cofiroute is responsible for performing vehicle toll violations processing, and must perform these duties in accordance with California Vehicle Code and OCTA policy.

Collection Services

Cofiroute subcontracts with LES to perform delinquent account collection services. Delinquent toll violations are those that remain unpaid at 90 days despite two statutory notices generated by Cofiroute's violation processing system. Cofiroute's contract with LES (LES Agreement) is performance based, meaning LES earns a percentage of the amount of tolls and upgrade fees¹ collected through its direct efforts. Under the LES Agreement, LES earns a 30 percent fee on all "Pre-Legal Collection Services" and a 45 percent fee (plus court costs) on all "Legal Collection Services". LES also earns a 30 percent fee for collections received via intercept programs with the California

¹ Upgrade fees are comprised of processing fees and penalties assessed to toll road violators that fail to respond to toll violation notices. Under a policy adopted May 10, 2010, each violation is assessed an initial \$25 processing fee. If the violator fails to respond to the first notice, a second notice is mailed with an additional \$30 processing fee. These penalties can escalate to \$100 for the first violation, \$150 for the second violation and \$200 for each additional violation within one year. Under the prior policy, the penalties were \$100, \$250, and \$500, respectively.

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Franchise Tax Board and the California State Lottery. During fiscal year 2007-08, a total of \$1,972,449 of tolls and upgrade fees were collected by LES. During this same period, LES earned approximately \$696,740 in collection fees. The table below summarizes LES' collection activity for fiscal year 2007-08:

	Tolls	Upgrade Fees	Total Collections	LES Fees
Violations > 90 days	\$38,521	\$874,802	\$913,323	\$273,997
Judgments, Legal Collection Services	12,056	687,978	700,034	315,015
Franchise Tax Board Intercept	4,819	350,917	355,736	106,721
Lottery Intercept	36	3,320	3,356	1,007
Total	\$55,432	\$1,917,017	\$1,972,449	\$696,740

Collections Processing

Once a week, Cofiroute transfers all toll violations exceeding 90 days to LES. A report listing all violations exceeding 90 days is generated from Cofiroute's toll road software, TollPro. The violations are extracted into an electronic text file and transferred to LES through a File Transfer Protocol (FTP) process. LES then uploads the violation data received from Cofiroute into a parallel TollPro system maintained by LES.

On a weekly basis, LES transmits an electronic "Payment Transfer Report" (PTR) file to Cofiroute via FTP. The Payment File is a detailed listing of all amounts collected by LES. Cofiroute staff will place the PTR file into a designated folder. TollPro has a nightly job process that automatically imports the PTR file into TollPro². An exception report is automatically created for any collection transactions that were not updated in TollPro. Cofiroute staff reviews the exception report, researches the exceptions, and updates TollPro accordingly.

A monthly Payment Transfer Report is sent by LES to Cofiroute in hardcopy format along with supporting documents, including a check made payable to OCTA for the total amount collected for the month, net of collection fees. Cofiroute reviews and validates the LES invoice, assembling supporting documentation and prepares journal entries for OCTA's accounting department. The LES payment package sent to OCTA by Cofiroute is reviewed by the Principal Transportation Analyst of the Treasurer/Public Finance department for accuracy, adequate supporting documentation, and contractual compliance.

² During the review period, Cofiroute staff manually updated the Payment Transfer Report collections information into TollPro. In early 2009, a job process was created to automate the process.

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Prior Internal Audit

In August 2006, Internal Audit performed a contract compliance and operational audit of the contract between OCTA and Cofiroute, including OCTA's management of the Cofiroute contract. As part of that audit, a related contract between Cofiroute and LES was also reviewed and the following recommendations were made:

- The Cofiroute/LES contract scope of work should be revised to clarify the relationship between Cofiroute as contractor, and LES as subcontractor.
- OCTA management should periodically verify the accuracy of payments from LES by reviewing detailed support.

Management concurred with both recommendations. As to the first recommendation, a letter dated August 31, 2006, was sent to LES notifying them of the cancellation of the direct contractual relationship between OCTA and LES for the collection of delinquent toll violations. As part of this engagement, Internal Audit evaluated OCTA staff's periodic review of payments from LES to OCTA and noted that monitoring of payments from LES has improved.

Objectives, Scope, and Methodology

This review was included in the Internal Audit Plan for fiscal year 2007-08. The objective of this review was to evaluate the collections process of Cofiroute and LES and test compliance with applicable state regulations and contractual agreements. The review scope included the period July 2007 through November 2008, as well as current operating policies and procedures, California Vehicle Code, OCTA Ordinance No. 2004-01, and agreements between OCTA, Cofiroute, and LES. The review methodology included, but was not limited to, the following:

- Review of California Vehicle Code
- Review of OCTA's policies and procedures and 91 Express Lanes contracts
- Review of monthly 91 Express Lanes reports, and
- Data analysis of toll road violation data from the TollPro System

This review was conducted 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 review objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objectives.

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Audit Comments, Recommendations and Management Responses

Noteworthy Accomplishments

Review of LES Payments

During the review, Internal Audit followed up on a recommendation made in Internal Audit Report No. 06-021, Cofiroute Contract Compliance and Operational Audit. In that report, Internal Audit recommended that OCTA management periodically verify the accuracy of payments received from LES by reviewing detailed supporting documentation. Internal Audit reviewed a sample of LES payments noting that LES' supporting documentation was mathematically accurate and the payment and fee amounts were adequately supported. LES' fees were properly applied and calculated, and there was evidence of review by OCTA staff.

Monitoring of Notices of Toll Evasion Violations

Section 40254 of the California Vehicle Code (Code) requires that a Notice of Toll Evasion Violation (NTEV) be sent to the toll road violator no later than 21 days of the occurrence with an allowance for an additional 45 days, if needed, to obtain address information. For repeat violators, the toll agency has up to 90 calendar days. During the review, Internal Audit noted several instances in which a NTEV was mailed to the toll violator after the deadline established in the Code; however, based on discussions with Cofiroute staff, Cofiroute independently discovered this problem during the review period and subsequently implemented controls to detect violations of code provisions. Cofiroute staff runs daily exception reports designed to detect instances in which NTEVs have not been properly issued by 21 and 66 days of the violation. Internal Audit noted that the reports are reviewed on a weekly basis and exceptions are investigated by Cofiroute staff. Given the limitations in the present TollPro software system, Internal Audit recognizes that Cofiroute will continue these monitoring procedures until the 91 Express Lanes software is upgraded.

Recommendation 1: Cofiroute management should ensure the new 91 Express Lanes Software has sufficient controls in place to prevent NTEVs from being sent to toll road violators past the deadline established in the Code.

Management Response (Cofiroute):

We concur. Cofiroute will continue to run daily exception reports and investigate any exceptions to ensure NTEVs will not be sent to violators past the deadline as established in the Code.

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Administrative Hearings

Recipients of a NTEV or NDTEV who do not believe that they are responsible for the toll road violation have an option to request that Cofiroute perform an Administrative Investigation within the defined timeframes as outlined in the CVC. Once the Administrative Investigation is complete, Cofiroute is required to send the results of the investigation to the NTEV or NDTEV recipient, and if they are not satisfied with the results, they may request an Administrative Review.

Under the Code, “the administrative review shall be conducted before a reviewer designated to conduct the review by the issuing agency's governing body or chief executive officer. In the case of violations on facilities developed pursuant to Section 143 of the Streets and Highways Code, the processing agency shall contract with a public agency or a private entity that has no financial interest in the facility for the provision of administrative review services...” During the review period, Cofiroute did not have an administrative hearing officer under contract to perform Administrative Reviews.

The Code further states, “The review shall be conducted in accordance with the written procedure established by the processing agency which shall ensure fair and impartial review of contested toll evasion violations.” Internal Audit noted that Cofiroute does not have formalized policies and procedures ensuring a fair and impartial review.

No Administrative Reviews were requested by violators and none performed during the period from January 1, 2007 to December 31, 2009; however, in the same period, Cofiroute performed 25,547 Administrative Investigations resulting in the dismissal of 24,268 citations.

Recommendation 2: Internal Audit recommends that Cofiroute contract with an administrative hearing officer through either a public agency or a private entity that has no financial interest in the 91 Express Lanes or Cofiroute. The reviewer should be approved by OCTA's Board of Directors or Chief Executive Officer. Furthermore, Cofiroute should develop policies and procedures to ensure a fair and impartial Administrative Review of contested toll evasion violations.

Management Response (Cofiroute):

We concur. In anticipation of increased requests for administrative hearings generated by Avery v OCTA et al, Cofiroute has entered into a contract with an administrative hearing officer. The hearing officer's contract is currently under review by OCTA 91 Express Lanes management and the OCTA Chief Executive Officer will designate the reviewer to perform the administrative reviews. Although Cofiroute has written procedures for conducting administrative reviews, additional procedures will be included to ensure fair and impartial reviews.

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Deduction of Insufficient Fund (NSF) Fees

Internal Audit noted that LES deducts non-sufficient funds (NSF) fees from its monthly payment to OCTA. On a monthly basis, LES submits a payment package to OCTA for its delinquent account collection services. The package documents the total amount of collections, the fees earned by LES, and the net payment to OCTA. In addition to deducting fees earned for collection services, LES deducts NSF fees from the payment amount.

The contract agreement between Cofiroute and LES allows LES to charge a 30 percent fee on all "Pre-Legal Collection Services" and a 45 percent fee including attorney fees (plus court costs) on all "Legal Collection Services". While the amount of these NSF fees is minimal, the contract agreement does not address NSF fees.

Recommendation 3: Internal Audit recommends that NSF fees be considered during the next contract amendment process between OCTA and Cofiroute.

Management Response (Cofiroute):

We concur. The contract agreement with LES will be amended to address the NSF fees.

Financial Statement Reporting

Each fiscal year, full disclosure financial statements are compiled and issued for The 91 Express Lanes. Internal Audit believes the Statement of Revenue, Expenses, and Changes in Fund Net Assets (Income Statement) could better convey to financial statement users the operations of the 91 Express Lanes.

For the fiscal year ended June 30, 2009, the Income Statement (Appendix A) of the 91 Express Lanes includes only one revenue source, "User Fees and Charges" totaling almost \$44 million. This revenue line item does not detail revenues earned from tolls, toll violations, or other fees. The 91 Express Lanes also incurred approximately \$25 million in operating expenses. Internal Audit noted that several of the expense classifications were ill-defined or redundant. For example, the 91 Express Lanes had approximately \$6.2 million in expenses related to "Professional Services" and another \$6.2 million for "Contracted Services". Furthermore, expenses for "Administrative Services" were \$1.8 million and another \$471,000 was expensed under "General and Administrative".

Internal Audit noted that the income and expense line item classifications in the 91 Express Lanes stand-alone financial statements are largely dictated by the presentation used for OCTA's Comprehensive Annual Financial Report, which presents revenues and expenses for all of OCTA's enterprise funds in the Statement of Revenues, Expenses, and Changes in Fund Net Assets (Appendix B).

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Recommendation 4: Internal Audit recommends that 91 Express Lanes management and OCTA's Accounting and Financial Reporting Department consider expanded income statement classifications, notes to the financial statements, or Management Discussion and Analysis, to better detail the nature and amount of income and expenses in the 91 Express Lanes stand-alone financial statements. Management might also consider comparative financial statements for this enterprise fund as a means of highlighting significant fluctuations in revenue, expenses, and financial position.

Management Response (Accounting & Financial Reporting Management):

Management agrees with the recommendations and will make changes for the fiscal year ending June 30, 2011, to the income statement classifications to better detail the nature and amount of income and expenses for the 91 Express Lanes stand-alone financial statements.

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Appendix A

**91 Express Lanes Fund, Statement of Revenues,
Expenses, and Changes in Fund Net Assets**

91 Express Lanes Fund
 (An Enterprise Fund of the Orange County Transportation Authority)
 Statement of Revenues, Expenses and Changes in Fund Net Assets
 For the Year Ended June 30, 2009

Operating revenues:	
User fees and charges	<u>\$ 43,704,888</u>
Operating expenses:	
Contracted services	6,207,624
Administrative services	1,762,732
Other	792,251
Insurance claims	383,545
Professional services	6,190,424
General and administrative	470,641
Depreciation and amortization	<u>9,151,211</u>
Total operating expenses	<u>24,958,428</u>
Operating income	<u>18,746,460</u>
Nonoperating revenues (expenses):	
Investment earnings	3,151,605
Interest expense	(15,028,418)
Other	<u>32,861</u>
Total nonoperating revenues (expenses)	<u>(11,843,952)</u>
Income before transfers	6,902,508
Transfers out	<u>(3,024,000)</u>
Change in net assets	3,878,508
Total net assets - beginning	<u>52,063,521</u>
Total net assets - ending	<u>\$ 55,942,029</u>

See accompanying notes to the financial statements.

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Appendix B

**OCTA CAFR, Statement of Revenues, Expenses, and
Changes in Fund Net Assets, Proprietary Funds**

2009 | ORANGE COUNTY TRANSPORTATION AUTHORITY

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

PROPRIETARY FUNDS

(thousands)

for the year ended June 30, 2009	Enterprise Funds				
	OCTD	91 Express Lanes	Nonmajor Enterprise Funds	Total Enterprise Funds	Internal Service Funds
OPERATING REVENUES:					
User fees and charges	\$ 54,206	\$ 43,705	\$ -	\$ 97,911	\$ -
Permit fees	-	-	549	549	-
Charges for services	-	-	-	-	6,185
TOTAL OPERATING REVENUES	54,206	43,705	549	98,460	6,185
OPERATING EXPENSES:					
Wages, salaries and benefits	130,542	-	245	130,787	-
Maintenance, parts and fuel	26,207	-	-	26,207	-
Purchased services	36,850	6,208	41	43,099	-
Administrative services	34,027	1,763	135	35,925	167
Other	2,503	792	1	3,296	234
Insurance claims and premiums	8	384	-	392	11,245
Professional services	17,633	6,190	43	23,866	1,451
General and administrative	5,347	471	9	5,827	-
Depreciation and amortization	36,914	9,151	-	46,065	-
TOTAL OPERATING EXPENSES	290,031	24,959	474	315,464	13,097
Operating income (loss)	(235,825)	18,746	75	(217,004)	(6,912)
NONOPERATING REVENUES (EXPENSES):					
Gas tax exchange	23,000	-	-	23,000	-
Federal operating assistance grants	52,639	-	-	52,639	-
Property taxes allocated by the County of Orange	11,295	-	-	11,295	-
Investment earnings	5,514	3,151	1,599	10,264	1,922
Interest expense	(465)	(15,028)	-	(15,493)	-
Other	4,681	33	1	4,715	1,139
TOTAL NONOPERATING REVENUES (EXPENSES)	96,664	(11,844)	1,600	86,420	3,061
Income (loss) before contributions and transfers	(139,161)	6,902	1,675	(130,584)	(3,851)
Capital contributions	61,191	-	-	61,191	-
Transfers in	108,453	-	3	108,456	-
Transfers out	(10,740)	(3,024)	(14,000)	(27,764)	(4,198)
Change in net assets	19,743	3,878	(12,322)	11,299	(8,049)
Total net assets - beginning	450,257	52,064	40,070	542,391	31,274
TOTAL NET ASSETS - ENDING	\$ 470,000	\$ 55,942	\$ 27,748	\$ 553,690	\$ 23,225

See accompanying notes to the financial statements.