



Audit Committee Agenda

Tuesday, March 26, 2024
1 p.m.

Welcome to SANDAG. The Audit Committee meeting scheduled for Tuesday, March 26, 2024, will be held in person in the SANDAG Board Room. While Audit Committee members will attend in person, members of the public will have the option of participating either in person or virtually.

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Public Comments: Members of the public may speak to the Audit Committee on any item at the time the Audit Committee is considering the item. Public speakers are generally limited to three minutes or less per person.

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Mission Statement: *We are the regional agency that connects people, places, and innovative ideas by implementing solutions with our unique and diverse communities.*

Our Commitment to Equity: *We hold ourselves accountable to the communities we serve. We acknowledge we have much to learn and much to change; and we firmly uphold equity and inclusion for every person in the San Diego region. This includes historically underserved, systemically marginalized groups impacted by actions and inactions at all levels of our government and society.*

We have an obligation to eliminate disparities and ensure that safe, healthy, accessible, and inclusive opportunities are available to everyone. The SANDAG equity action plan will inform how we plan, prioritize, fund, and build projects and programs; frame how we work with our communities; define how we recruit and develop our employees; guide our efforts to conduct unbiased research and interpret data; and set expectations for companies and stakeholders that work with us.

We are committed to creating a San Diego region where every person who visits, works, and lives can thrive.

Audit Committee

Tuesday, March 26, 2024

Comments and Communications

1. Non-Agenda Public Comments/Member Comments

Members of the public shall have the opportunity to address the Audit Committee on any issue within the jurisdiction of the Committee that is not on this agenda. Public speakers are limited to three minutes or less per person. Public comments under this agenda item will be limited to five public speakers. If the number of public comments under this agenda item exceeds five, additional public comments will be taken at the end of the agenda. Audit Committee members and SANDAG staff also may present brief updates and announcements under this agenda item.

2. Update - Office of the Independent Performance Auditor Activities

Courtney Ruby, Independent Performance Auditor

The Independent Performance Auditor will present an update on the Office of the Independent Auditor's activities and other sharing events.

Consent

+3. Approval of Meeting Minutes

Tessa Lero, Francesca Webb, SANDAG

Approve

The Audit Committee is asked to review and approve the minutes from its February 2, 2024, meeting.

[Meeting Minutes.pdf](#)

Reports

+4. Discussion of SANDAG Board Policy No. 039

Chair David Zito, Audit Committee; Courtney Ruby, Independent Performance Auditor

Discussion/
Possible
Action

The Audit Committee is asked to discuss SANDAG Board Policy No. 039 to determine if any recommendations or amendments to the policy are needed.

[Discussion of SANDAG Board Policy No. 039.pdf](#)

[Att. 1 - Proposed SANDAG Board Policy No. 039 with Redline Changes.pdf](#)

+5. The Office of the Independent Performance Auditor's Report on SANDAG's State Route 125 Toll Operations

Courtney Ruby, Independent Performance Auditor

Discussion/
Possible
Action

The Audit Committee is asked to discuss the Independent Performance Auditor's report and consider any actions to be taken by the Audit Committee.

[OIPA Report on SR 125 Toll Operations.pdf](#)

[Att. 1 - OIPA Report on SR 125 Toll Operations.pdf](#)

6. Adjournment

The next Audit Committee meeting is scheduled for April 5, 2024, at 9 a.m.

+ next to an agenda item indicates an attachment

March 26, 2024

February 2, 2024, Meeting Minutes

[View Meeting Video](#)

Chair David Zito (Board Member) called the meeting of the Audit Committee to order at 9 a.m.

The members of the Audit Committee and Office of the Independent Performance Auditor (OIPA) staff provided brief introductions to the new Public Members of the Audit Committee.

1. Non-Agenda Public Comments/Member Comments

Public comments: Blair Beekman, The Original Dra, and Truth.

Member comments: None.

2. Office of the Independent Performance Auditor Activities

Independent Performance Auditor (IPA) Courtney Ruby presented an update on the active audits and investigations of the OIPA.

Public comments: Truth, The Original Dra, and Blair Beekman.

Action: Information.

Consent

3. Approval of Meeting Minutes

The Audit Committee was asked to approve its January 5, 2024, meeting minutes.

Public comments: The Original Dra.

Action: Upon a motion by Vice Chair Dave Druker and a second by Public Member Rowena Dorsey, the Audit Committee voted to approve the meeting minutes from its January 5, 2024, meeting, as amended to correct the meeting adjournment time.

The motion passed.

Yes: Chair Zito, Vice Chair Druker, and Public Member Dorsey.

No: None.

Abstain: Public Member Agnes Wong Nickerson.

Absent: Public Member Shawnee Pickney-Forrest.

Reports

4. Office of the Independent Performance Auditor's Staffing Needs and Structure

The Audit Committee was asked to discuss the need for additional professional staff to support the OIPA mandate.

Public comments: The Original Dra, Truth, and Blair Beekman.

Action: Upon a motion by Vice Chair Druker and a second by Public Member Dorsey, the Audit Committee voted to recommend to the Board of Directors to authorize as part of the FY24-25 budget process the necessary funding for two OIPA audit positions: a Principal Independent Auditor and a Senior Independent Auditor, and additional funding to cover the increased costs associated with the Deputy IPA position.

The motion passed.

Yes: Chair Zito, Vice Chair Druker, Public Member Dorsey, and Public Member Wong Nickerson.

No: None.

Abstain: None.

Absent: Public Member Pickney-Forrest.

5. Discussion of SANDAG Board Policy No. 039

The Audit Committee was asked to discuss Board Policy No. 039 to determine if any recommendations or amendments to the policy are needed.

Public comments: Truth, The Original Dra, and Blair Beekman.

Action: Upon a motion by Vice Chair Druker, and a second by Public Member Dorsey, the Audit Committee recommended that the Board of Directors approve the proposed amendments to Board Policy No. 039, including the clarification of the language to Section 4.2.4, and excluding revisions to Section 2.4.

The motion passed.

Yes: Chair Zito, Vice Chair Druker, and Public Member Dorsey.

No: Public Member Wong Nickerson.

Abstain: None.

Absent: Public Member Pickney-Forrest.

Action: Upon a motion by Public Member Wong Nickerson, and a second by Public Member Dorsey, the Audit Committee voted to recommend the Board of Directors approve the proposed revisions to Section 2.4 of Board Policy No. 039.

The motion failed.

Yes: Public Member Dorsey and Public Member Wong Nickerson.

No: Chair Zito and Vice Chair Druker.

Abstain: None.

Absent: Public Member Pickney-Forrest.

6. Upcoming Meetings

The next Audit Committee meeting is scheduled for Friday, March 1, 2024, at 9 a.m.

7. Adjournment

Chair Zito adjourned the meeting at 10:40 a.m.

Confirmed Attendance at SANDAG Audit Committee Meeting

February 2, 2024

Jurisdiction/Organization	Name	Member/ Alternate	Attended
Board Member	David Zito (Chair)	Primary	Yes
Board Member	David Druker (Vice Chair)	Primary	Yes
Public Member	Shawnee Pickney-Forrest	Primary	No
Public Member	Agnes Wong Nickerson	Primary	Yes
Public Member	Rowena Dorsey	Primary	Yes
Board Member	Ed Musgrove	Alternate	No

March 26, 2024

Discussion of SANDAG Board Policy No. 039

Overview

In accordance with Assembly Bill 805 (Gonzalez, 2017), [SANDAG Board Policy No. 039](#): Audit Policy Advisory Committee and Audit Activities (BP 039) was established to provide guidance on how to carry out the bill. Each year policies are reviewed and, if necessary, revised. Members of the Audit Committee previously discussed and proposed areas of the policy that would benefit revisions or clarifications and thus require Board action. These revisions were to be presented to the Executive Committee of the Board of Directors (Executive Committee) on December 8, 2023, however, at the November 3, 2023, Executive Committee meeting it was requested that the newly appointed Independent Performance Auditor (IPA) review, comment, and confer with the Chair of the Audit Committee on the proposed revisions before being presented to the Executive Committee.

Action: Discussion/Possible Action

The Audit Committee is asked to discuss SANDAG Board Policy No. 039 to determine if any recommendations or amendments to the policy are needed.

Fiscal Impact:

None.

Schedule/Scope Impact:

None.

Key Considerations

[SANDAG Board Policy No. 039](#): Audit Policy Advisory Committee and Audit Activity is the document that provides direction on how to carry out the AB 805, as it relates to the Audit Committee and the Office of the Independent Performance Auditor.

The intent of the meeting today is for Chair Zito to review all the proposed revisions with the Audit Committee, given there is a new IPA and new Audit Committee members. The Chair will focus specifically on the area that most changes are being proposed: Section 4 – Selection of Audit Committee Members.

Members are asked to discuss and take possible action in regard to the following:

1. Public Membership Selection Process and composition of Selection Committee
2. Public Members term limits and staggering of members terms
3. Appointment of the Chair and Vice Chair; and
4. Addition of a Public Member to serve as an alternate

Next Steps

The Audit Committee is asked to discuss and determine next steps including possible actions to move [SANDAG Board Policy No. 039](#) proposed revisions forward.

Councilmember David Zito, Audit Committee Chair

Attachment: 1. Proposed SANDAG Board Policy No. 039 with Redline Changes



BOARD POLICY NO. 039

AUDIT POLICY ADVISORY COMMITTEE AND AUDIT ACTIVITIES

1. Purpose

The purpose of this policy is to specify the functions of the Audit Committee and the SANDAG Independent Performance Auditor.

2. Governance and Role of the Audit Committee

- 2.1 The Audit Committee shall be overseen by the SANDAG Board of Directors and shall govern itself in accordance with Public Utilities Code Sections 132351.4 and 132354.1, and the policies and procedures applicable to all SANDAG Policy Advisory Committees.
- 2.2 Membership of the Audit Committee shall be as set forth in Board Policy No. 002:
- 2.3 Policy Advisory Committee Membership. The Audit Committee shall consist of five voting members with two members of the Board of Directors and three members of the public, all of which shall be appointed by the Board of Directors. Due to the qualification requirements and selection process described in this policy, Audit Committee members and alternates shall be selected according to the processes below.
- 2.4 ~~The Chair of the Board will select~~The Audit Committee members themselves will select by a majority vote of the Committee which members of the Audit Committee will hold the Chair and Vice Chair positions on the Audit Committee ~~every two years or whenever a position is vacant~~for a term of one year.
- 2.5 The role of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities and provide a forum for pursuing the opportunities for improvements in operations, financial reporting and internal controls identified through the agency's audit products.

3. Authority of the Audit Committee

- 3.1 The Audit Committee may hear items within the subject areas of audits, internal controls and investigations into fraud, waste, or impropriety, and may be asked to provide actions or recommendations on other matters within the Audit Committee's purview. The responsibilities of the Audit Committee include:
 - 3.1.1 Recommend to the Board which firm to contract with to conduct the annual financial statement audits and oversee the conduct of such audits.
 - 3.1.2 Meet with management and the independent performance auditor to review and discuss SANDAG's annual financial statement audits, internal control reports and other audits performed by external auditors.

- 3.1.3 Review and oversee the implementation of corrective action to address noted audit deficiencies.
- 3.1.4 Based on the Board's direction regarding whether to hire an individual or firm, recommend to the Board which individual or firm to hire to carry out independent performance auditor responsibilities.
- 3.1.5 Recommend to the Board the annual compensation of the independent performance auditor.
- 3.1.6 Oversee the work of the independent performance auditor in preparing and issuing audit and investigative reports and other audit, review or attest activities.
- 3.1.7 Approve the annual audit plan after discussion with the independent performance auditor, pursuant to Public Utilities Code Section 132354.1(b), and make recommendations to the Board regarding the budget needed to carry out the annual audit plan of the independent performance auditor.
- 3.1.8 Monitor the implementation of the annual audit plan and provide an annual report to the Board.
- 3.1.9 Monitor the implementation of corrective action identified in audit and investigative reports and inform the Board when corrective action is insufficient or untimely.
- 3.1.10 Independently communicate with the IPA consistent with the limitations set forth in the Brown Act.
- 3.1.11 Conduct the independent performance auditor's annual performance evaluation against performance measures established and adopted by the Audit Committee.
- 3.1.12 Vote on whether to remove the independent performance auditor for cause including, but not limited to incompetence, dishonesty, unethical behavior, violation of state or federal laws, or failure to maintain required professional certifications; such removal being subject to an approving vote by two-thirds of the Audit Committee and the Board.
- 3.1.13 Recommend internal control guidelines to be adopted by the Board to prevent and detect financial errors and fraud based on the internal control guidelines developed by the State Controller pursuant to Government Code Section 12422.5 and the standards adopted by the American Institute of Certified Public Accountants.

4. Selection of Audit Committee Members

- 4.1 The Board members serving on the Audit Committee shall be appointed by the Board using the procedures in this subsection 4.1.
 - 4.1.1 The two Board members and any Board member alternates serving on the Audit Committee shall be recommended for appointment by the Chair of the Board. The Chair of the Board shall select Board members to recommend to the Board based on the following criteria:

- 4.1.1.1 The Board member shall have served on the Board for at least three years;
 - 4.1.1.2 The Board member shall have a basic understanding of the role of the Audit Committee; and
 - 4.1.1.3 The Board member shall express a willingness to work through the Audit Committee to pursue opportunities for improvements in operations, financial reporting, and internal controls identified through the agency's audit products.
- 4.1.2 The Board members recommended by the Chair of the Board shall be subject to approval by a majority vote of the Board.
- 4.1.3 Audit Committee members shall serve until their successors are appointed. In the event that the Board member who has been appointed to serve on the Audit Committee is no longer a primary or alternate member of the Board of Directors, the position shall be considered vacant. If and when vacancies in the voting membership of the Audit Committee occur, the same selection process as outlined above shall be followed to select a replacement.
- 4.1.4 Board members appointed to the Audit Committee shall serve a term of two years. At the completion of a term, eligible incumbent members will need to apply for reappointment for another term. In no case shall any member serve more than ~~five-six~~ years on the Audit Committee, but may reapply after a hiatus of a full term.
- 4.2 The public members serving on the Audit Committee shall be appointed by the Board using the procedures in this Subsection 4.2.
 - 4.2.1 Whenever there is a vacancy for a public member seat on the Audit Committee, application forms will be made available on the SANDAG website for persons interested in applying for an Audit Committee position. Applications shall be due within 30 days after the application forms are posted. Only candidates who submit an application by the deadline will be considered.
 - 4.2.2 Applicants shall possess the independence, experience, and technical expertise necessary to carry out the duties of the Audit Committee. This expertise includes, but is not limited to, knowledge of accounting, auditing, and financial reporting. The minimum professional standards for public members shall include at least ten years of experience as a certified public accountant or as a certified internal auditor, or ten years of other professional accounting, financial, or legal experience in audit management.
 - 4.2.3 ~~The candidates shall be recommended by a majority vote of a screening committee composed of a member of the Board selected by the Chair of the Board, the chief financial officer or finance director of a SANDAG member agency, and at least one outside financial expert appointed by the other two members of the screening committee and confirmed by the Board. A five~~ person Selection Committee shall be convened comprised of a Board Member or Board Member Alternate sitting on the Audit Committee , a

Public Member or Public Member Alternate sitting on the Audit Committee, SANDAG's ~~current~~ Independent Performance Auditor or an OIPA upper management level staff person, and SANDAG's Chief Financial Officer or an upper management level staff person from SANDAG Finance, and one outside government financial expert. The Chair of the Audit Committee, the Independent Performance Auditor, and the Chief Financial Officer shall appoint the members of the Selection Committee subject to the composition rules in this section. The outside government financial expert will be confirmed by the Board of Directors. The outside government financial expert may serve until replaced by the Board's appointment of a new outside government financial expert to the Selection Committee.

Persons serving on the screening committee shall sign a declaration establishing that they do not have a conflict of interest.

4.2.4 ~~The screening committee may interview one or more of the candidates. The screening committee shall submit its recommended nominee(s) for the position(s). The screening committee also may nominate alternates from among the applicants. The Selection Committee shall score the applicants against criteria which are informed by section 4.2.2 above and which are agreed upon by the Audit Committee.~~

4.2.5 ~~In the event that the screening committee is unable to recommend any of the applicants for any or all positions, or an insufficient number of applications have been received, the screening committee may recommend a supplemental process, subject to Board approval. The constraints set forth in the normal nomination process shall not be mandated to apply to the supplemental process. The Selection Committee may choose to interview applicants to help determine finalists to be considered, and the results of such interviews shall be incorporated into the final scoring.~~

4.2.6 ~~The public members nominated by the screening committee shall be subject to approval by a majority vote of the Board. Applicants scoring within no more than 20% of the top-scoring candidate shall be considered finalists.~~

~~4.2.7~~ The applicants to be forwarded to the Board for approval shall be chosen by a random draw from the finalists.

~~4.2.7~~4.2.8 Audit Committee members shall serve until their successors are appointed. If and when vacancies in the voting membership of the Audit Committee occur, the same selection process as outlined above shall be followed to select a replacement to fill the remainder of the term.

4.2.9 Public members appointed to the Audit Committee shall serve a term of ~~two~~ three years. At least two months prior to the completion of a term, eligible incumbent members ~~will need to apply for reappointment for another term, may request reappointment for another term, and it will be at the discretion of the Selection Committee either to approve such request or require the full advertisement and selection process described above in this section. Other than instances in which a term is extended because of a delay in selecting a successor or to otherwise avoid having all three public members term out in the same year, members may not serve more than six~~

consecutive years on the Audit Committee, but may reapply following a hiatus of at least one full term. To avoid having all three public members termed out at the same time, the Selection Committee will be given the discretion to lengthen the term of a sitting public member by no more than one year. In no case shall any member serve more than five years on the Audit Committee.

4.2.10 A public member non-voting alternate shall also be selected, with a term pursuant to 4.2.98. Such public member alternate shall be chosen by the Selection Committee from volunteers among prior public members. Should no prior public member volunteer, the selection committee will select a member from finalists, per 4.2.4 above, not selected for Committee membership or a prior public member who has notified the Audit Committee in writing by the application deadline, per 4.2.1. In the event a prior public member serves as a non-voting alternate, consecutive service cannot exceed 4 terms (2 terms as a public member and 2 terms as a public member non-voting alternative) without a hiatus of a full term.

5. Selection of Independent Performance Auditor

- 5.1 The independent performance auditor shall serve a two-year term and shall be selected by the Board on the basis of qualifications and experience, which include, but are not limited to:
 - 5.1.1 At least ten years of experience performing audits under Government Audit Standards;
 - 5.1.2 At least five years of management experience;
 - 5.1.3 A Bachelors or higher degree in business, public administration, finance, accounting or a related field; and
 - 5.1.4 Possession of a Certified Public Accountant or Certified Internal Auditor license or certificate.

6. Scope of Authority and Responsibilities of Independent Performance Auditor

- 6.1 The independent performance auditor shall report to the Audit Committee and shall be independent of SANDAG's internal management and administration, except that SANDAG's Director of Finance role shall maintain administrative oversight of the IPA's monthly timesheets and tracking of annual leave.
- 6.2 The objective of the IPA is to serve as the Board of Directors oversight function that objectively evaluates and recommends improvements to SANDAG including prioritizing its efforts by continuously facilitating an objective risk assessment. The Independent Performance Auditor's audit functions are designed to include timely reporting of significant issues to appropriate oversight authorities.
- 6.3 The IPA may facilitate and conduct a risk assessment process to assist management to logically identify key risks within SANDAG and its components and shall annually present and discuss risk with the Committee to receive input and feedback. As part of the aforementioned process, the IPA shall receive input from SANDAG's executive

management and staff, the Committee, and the Board of Directors as to the risk factors that the Committee deems most important to SANDAG.

- 6.4 Based upon the results of the risk assessment, the independent performance auditor shall annually prepare an audit plan and conduct audits in accordance therewith. The independent performance auditor shall have authority to conduct, or to cause to be conducted, performance audits of SANDAG departments, offices, boards, activities, agencies, and programs and perform those other duties as may be required by the Board or as provided by the California Constitution and general laws of the state.
- 6.5 The IPA will oversee and conduct independent examinations, including audits, of SANDAG programs, functions, operations, or management systems and procedures. In performing such audits, the IPA will independently and objectively assess whether:
 - 6.5.1 Activities and programs being implemented have been authorized by the appropriate governing laws or codes, state or local law, or applicable federal law or regulations.
 - 6.5.2 Activities and programs are in compliance, properly conducted, and funds expended in accordance with the applicable laws.
 - 6.5.3 The departments, divisions, or agencies are acquiring, managing, protecting, and using its resources, including public funds, personnel, property, equipment, and space, economically, efficiently, equitably, and effectively, and in a manner consistent with the objectives intended by the authorizing entity or enabling legislation.
 - 6.5.4 The entity, programs, activities, functions, or policies are effective, including the identification of any causes of inefficiencies or uneconomical practices.
 - 6.5.5 The desired result or benefits are being achieved.
 - 6.5.6 Financial and other reports are being provided that disclose fairly, accurately, and fully all information required by law, to ascertain the nature and scope of programs and activities, and to establish a proper basis for evaluating the programs and activities including the collection of, accounting for, and depositing of revenues and other resources.
 - 6.5.7 Management has established adequate operating and administrative procedures and practices, fiscal and accounting systems, and an adequate system of controls or internal management controls.
 - 6.5.8 Indications of fraud, abuse, waste, misappropriation, or illegal acts are valid and need further investigation.
- 6.6 The IPA may also perform external reviews of contracts or service programs of entities that are awarded funds overseen by SANDAG.
- 6.7 The independent performance auditor shall from time to time advise the Audit Committee on existing and evolving governance practices that may be best suited for SANDAG.
- 6.8 The independent performance auditor shall follow the most recent version of

Generally Accepted Government Auditing Standards as published by the United States Government Accountability Office.

- 6.9 The Committee shall approve the processes pertaining to follow-up audit procedures, if appropriate. The IPA shall have procedures in place to track, monitor, and evaluate the status of identified control issues with a tracking mechanism and with consideration to the risk of each issue and the cost and benefit of various audit procedure alternatives.

All officers and employees of SANDAG shall furnish to the independent performance auditor unrestricted access to employees, information, and records, including electronic data, within their custody regarding powers, duties, activities, organization, property, financial transactions, contracts, and methods of business required to conduct an audit or otherwise perform audit duties. It is also the duty of any consolidated agency officer, employee, or agent to fully cooperate with the auditor, and to make full disclosure of all pertinent information, with the exception of information that is protected by law from disclosure.

- 6.10 The IPA shall hold data and information obtained during the course of its audit activities with due care and the appropriate level of confidentiality. Unless otherwise mandated by law, the IPA shall have authority to grant, limit, and restrict access to work papers and records.
- 6.11 The IPA shall communicate results of its work and otherwise known issues to management and the Committee. The IPA shall form and report appropriate opinions based on audit evidence. Management shall provide responses to issues in a prompt and efficient manner. Written reports may be distributed to the Committee, SANDAG's Management, and if appropriate for reports containing significant issues or when there is a disagreement with management other than minor in nature, to the Board of Directors. The IPA shall provide summary information to the Committee pertaining to issues resulting from audit procedures as well as known issues outside of the audit scope of review. Additionally, the IPA shall provide the Committee with an annual assessment as to the effectiveness of management's attention to resolving identified control issues.
- 6.12 The independent performance auditor shall prepare a proposed budget and submit it to the Audit Committee for a recommendation to the Board of Directors for its approval 180 days prior to the beginning of each fiscal year or as otherwise requested by the Director of Finance.
- 6.13 The independent performance auditor shall have the power to appoint, employ, and remove assistants, employees, and personnel as deemed necessary for the efficient and effective administration of the affairs of the independent performance auditor. The independent performance auditor may prescribe the duties, scope of authority, and qualifications of employees and consultants overseen by the independent performance auditor. The independent performance auditor's authority shall be subject to the annual audit plan and the budget approved by the Board, SANDAG rules and policies related to the management and hiring of SANDAG employees and consultants, and the scope of the independent performance auditor's purview as determined by the Board.

- 6.14 The independent performance auditor may investigate any material claim of financial fraud, waste, or impropriety within SANDAG and for that purpose may summon any officer, agent, or employee of the consolidated agency, any claimant, or other person, and examine him or her upon oath or affirmation relative thereto. The independent performance auditor will conduct investigations generally following the procedures recommended by the Association of Certified Fraud Examiners' Fraud Examiners Manual for any allegations of financial fraud, waste or impropriety. ^(L)~~(S)~~ Prior to questioning any person under oath, the independent performance auditor shall advise the members of the Audit Committee of that intention, seek legal counsel from the Office of General Counsel or outside counsel under contract to SANDAG regarding the relevant legal issues, and document the reasons why the questioning must be done under oath instead of by some other form of affirmation.
- 6.15 The independent performance auditor shall coordinate audit functions such that there is no duplication of effort between the audits undertaken by the independent performance auditor and audits undertaken by the Independent Taxpayer Oversight Committee.
- 6.16 Pursuant to Government Code section 8546.7, when the amount of a contract will exceed \$10,000, SANDAG and the State Auditor, at the request of SANDAG or as part of any audit of SANDAG, have authority to examine and audit a contracting party for a period of three years after SANDAG's final payment on the contract, whether or not audit language is included in the contract document. As an additional measure, all SANDAG contracts with consultants, vendors, or agencies in excess of \$25,000 in aggregate within a fiscal year, which call for a contracting party to provide goods or services to SANDAG over a period of time, will be prepared with an adequate audit provision to allow the independent performance auditor access to the entity's records needed to verify compliance with the terms specified in the contract. The intent of this provision is to put parties contracting with SANDAG on notice that the independent performance auditor will have the right to audit both the party's accounting methods and performance on such contracts
- 6.17 Results of all audits and reports shall be made available to the public in accordance with the requirements of the California Public Records Act (Chapter 3.5 [commencing with Section 6250] of Division 7 of the Title 1 of the Government Code). Final versions of formal reports also shall be posted on the SANDAG website.

- 6.18 All materials or services needed by the independent performance auditor shall be procured using an open and competitive basis with solicitation of proposals from the widest possible number of qualified firms as prescribed by SANDAG procedures for procurement. The scope of work of all such consultant work shall be subject to approval by the independent performance auditor prior to any such solicitation.

Adopted: December 2017

Amended: January 2019

Amended: September 2019

Amended: 2023

March 26, 2024

The Office of the Independent Performance Auditor's Report on SANDAG's State Route 125 Toll Operations

Overview

The Office of the Independent Performance Auditor (OIPA) became aware of some concerns regarding inappropriate customer charges, lax system controls related to the State Route 125 toll collection, and the overall toll collection system. As a result, the OIPA initiated an investigation to look into the concerns presented.

Key Considerations

The Independent Performance Auditor (IPA) will present the OIPA report to the Audit Committee for discussion. The Audit Committee will discuss and consider any recommendations or actions to be taken.

Next Steps

The Audit Committee is asked to determine any next steps.

Courtney Ruby, Independent Performance Auditor

Attachment: 1. The Office of the Independent Performance Auditor's Report on SANDAG's State Route 125 Toll Operations

Action: **Discussion/Possible Action**

The Audit Committee is asked to discuss the Independent Performance Auditor's report and consider any actions to be taken by the Audit Committee.

Fiscal Impact:

Unknown.

Schedule/Scope Impact:

Unknown.



INVESTIGATION

DATE: March 25, 2024

TO: Chair Nora Vargas, Board of Directors
 Chair David Zito, Audit Committee
 SANDAG Board of Directors
 SANDAG Audit Committee
 Coleen Clementson, Interim Chief Executive Officer
 Ray Major, Chief Deputy CEO
 John Kirk, General Counsel
 Andre Douzdzian, Chief Financial Officer
 Residents of San Diego County and Toll Users

FROM: Courtney Ruby, Independent Performance Auditor

SUBJECT: Office of the Independent Performance Auditor's Investigation Report
 on SANDAG's State Route 125 Toll Operations

Introduction

In December 2023, the Independent Performance Auditor, Audit Committee, Board Chair, and several Board members determined that the publicly disclosed allegations of SR 125 Toll customer mischarges and accounting issues warranted an independent investigation. Given the impact on SR 125 Toll customers and the community at large, it is critical the SANDAG Board of Directors (BOD) and the public to understand what occurred and how SANDAG management can prevent this from happening in the future.

Background

SANDAG operates tolling on the Interstate 15 (I-15X) Express Lanes and State Route 125 (SR 125) Toll Road in the San Diego region using FasTrak®, the statewide toll collection system, that allows customers to pay tolls electronically in California.

The I-15X is an Express Lanes facility, whereby carpoolers do not need a SANDAG account nor transponder to use the Express lanes and single occupancy vehicles with a FasTrak account and transponder can pay a toll which is dynamically determined based on the amount of traffic in the general-purpose lanes in order to maximize traffic flow. The California Highway Patrol is responsible for enforcement of the use of the lanes.

The SR 125 is a tolled road, whereby all drivers are charged at the time of use. Customers pay by FasTrak account, cash, or credit card. Equipment on the roadway monitors use of the lanes and SANDAG sends violation notices to drivers who do not pay.

SANDAG purchased the SR 125 toll facility out of bankruptcy in December 2011. At the time of purchase, the existing back-office system (InTrans Group Inc.) and roadside equipment were dated. In addition, the I-15X was on a different system (TransCore) and the roadside equipment also needed to be replaced.

To bring the back-office system up to industry standards and consolidate the agency's two existing customer service center systems and operations (SR 125 and I-15X) into a new regional back-office system, SANDAG carried out a competitive Request for Proposals in 2016. SANDAG also carried out a competitive Request for Proposals in late 2016 to early 2017 for roadside (toll collection) equipment.

The Board approved awarding a contract to ETAN for the back-office system at its meeting on December 16, 2016, and to Kapsch TrafficCom USA, Inc. (Kapsch), for roadside equipment at its December 15, 2017, meeting. The purpose of the contract awards was to replace and consolidate the equipment and back-office system between the two toll facilities.

Additionally, HNTB was awarded a task order (Task Order 8), on June 28, 2013, to act as the Tolling Systems Advisory Services consultant to facilitate implementation of both the roadside and back-office systems. HNTB's Task Order 8 detailed a scope of work (SOW) specifying nine assignments including overall project management, engineering design, procurement and contracting support, and construction management. The SOW covered these efforts for both the Back-Office System and the Roadway Systems. To continue work beyond the task order expiration, HNTB was awarded a new non-competed contract to continue providing implementation and support services over ETAN for the BOS project, including additional oversight tasks for installation, training, testing, transition, Go-Live and post Go-Live support services. The SOW for this contract specifies two tasks in which HNTB was responsible for oversight of ETAN's scope of work and providing oversight on the effectiveness of the BOS.

ETAN's contract with SANDAG provides services for the provision of the Regional Back-office System (BOS) and associated Maintenance and Software Support Services. The BOS serves SANDAG's I-15 Express Lanes and South Bay Expressway toll facilities.

Kapsch's contract with SANDAG provides system design, building and maintenance services to replace SANDAG's two existing Roadway tolling facilities, the I-15 Express Lanes and SR 125, with a new Toll Collection System and to maintain the new system.

History

In October 2023 the SANDAG's Board of Directors (BOD) was notified during a closed session of extensive issues related to ETAN's Back-office Tolling System serving the I-15X and SR 125 and the immediate need to procure another tolling system vendor to replace ETAN.

In November 2023, SANDAG's former Director of Accounting and Finance filed a lawsuit against SANDAG after she was terminated. Her lawsuit and the media coverage of her lawsuit

publicly reported concerns as to the accuracy of SANDAG FasTrak customer account balances and SR 125's financial accounting records.

In December 2023, the Independent Performance Auditor, Audit Committee, Board Chair, and several Board members believed the issues raised publicly warranted an investigation. The Office of the Independent Performance Auditor conducted the investigation.

Objectives

The objectives of the investigation were to determine:

1. If SANDAG's SR 125 financial accounting can be relied upon;
2. If SANDAG rectified the publicly reported errors with customer accounts shared with the Board of Directors in December 2023, and
3. If there were other significant matters noted during the investigation

Findings

1. ETAN's Fastlane¹ financial reporting cannot be relied upon.
2. SANDAG's Finance department lacks adequate internal controls including proper review and supervision to ensure SR 125 financial information is accurately recorded, accounted for, and reported accurately.
3. For the publicly disclosed general ledger errors, none of the underlying software programming or configuration issues in ETAN's Fastlane (ETAN's BOS) have been fixed. Some errors have been adjusted in both ETAN's BOS general ledger and SANDAG's QuickBooks, while others have only been fixed in QuickBooks for financial statement purposes. Lastly, some errors continue to be researched.
4. ETAN's implementation of the Back-Office System (BOS) Fastlane was headed for trouble from the beginning. SANDAG executive management failed to address the situation in a timely manner, including informing the Board of Directors.
5. SANDAG has suffered significant revenue losses due to a lack of adequate and timely monitoring.
6. At least \$1 million in revenue has been lost due to a function in ETAN BOS not being turned on.
7. The beginning customer account balance changed, no longer matching the original beginning balance, in a subset of accounts tested.

¹ Etan's Fastlane is the Back-office System for tolling transaction management.

SECTION ONE: SR 125 Accounting Issues

FINDING 1: ETAN's Fastlane financial reporting cannot be relied upon

FINDING 2: SANDAG's Finance department lacks adequate internal controls including proper review and supervision to ensure SR 125 financial information is accurately recorded, accounted for, and reported accurately.

SR 125 went live on June 6, 2022 with the knowledge that ETAN did not fulfill many of its contractual requirements. A SANDAG project management report titled *Combined Roadway/Back-office Status Report* dated May 23, 2022, identified key risks and the response to such risks. The status report listed the first key risk as:

ETAN BOS will not be ready to Go-Live in time to avoid delay to Kapsch RS installation.

This risk was categorized as "High" and the SANDAG's response to mitigate the risk was to reduce level of functionality delivered for the BOS and balance the risk of BOS go live with risk of further delays on the Roadway (Kapsch roadway system).

Once the decision was made to go live, the data was migrated from the Legacy BOS system, and SANDAG was reliant on ETAN for reliable reporting, including financial reporting.

We reviewed status reports from HNTB and ETAN at the time SR 125 went live with Fastlane and they all document a project suffering from significant risks, including being delayed by 30 months and not meeting many of the contractual requirements initially set out for the Go-Live to SR 125, yet the decision to go-live with SR 125 was made.

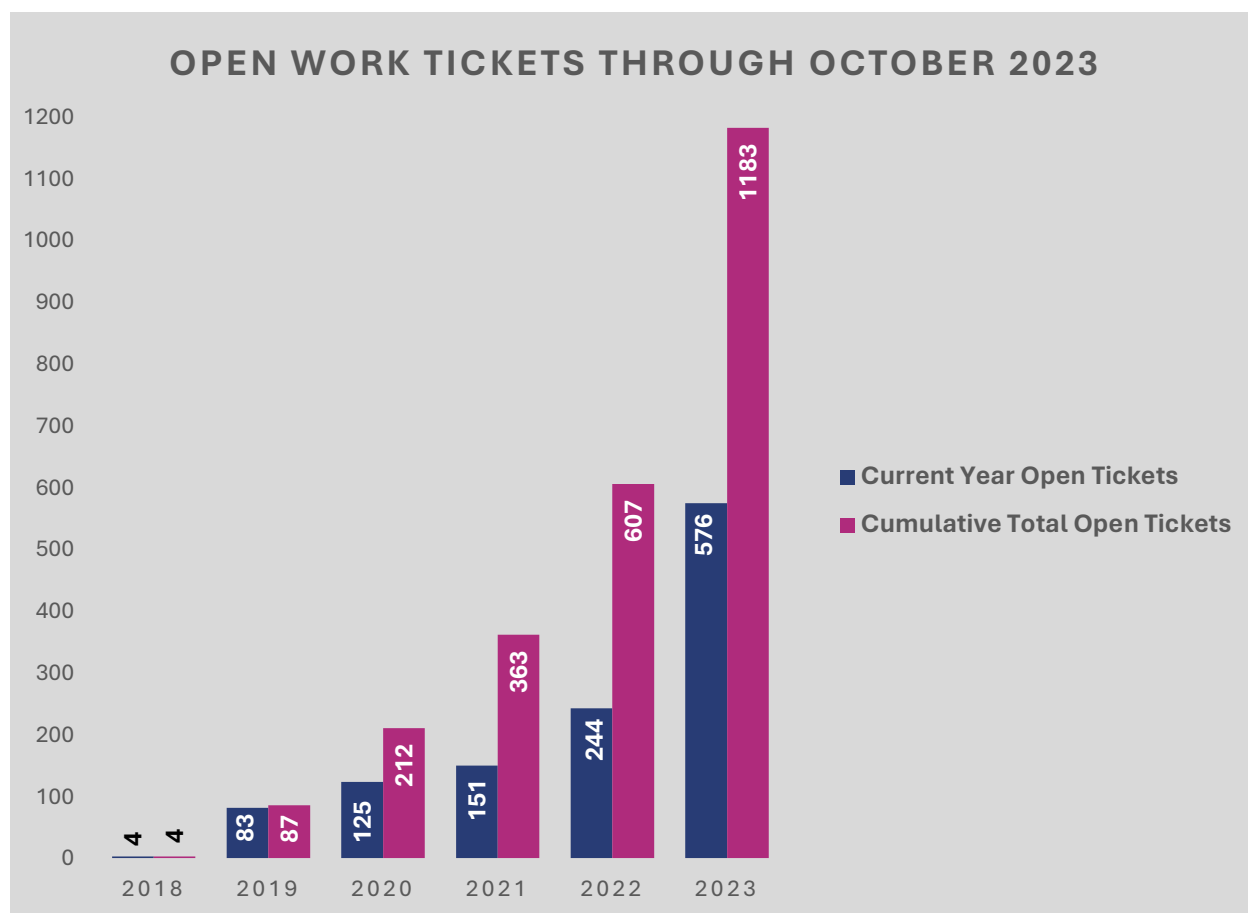
SANDAG's May 23, 2022 Status report also listed the following key risk, categorized as "high" risk:

Inadequate system monitoring or performance issues following Go-Live and major deployments.

SANDAG's plan to mitigate this risk was to conduct daily system check meetings and require contractors to submit regular monitoring reports. When SR 125 went live, it was clear SANDAG and ETAN had not anticipated the volume of system issues. SANDAG Toll Operations and the Finance department began submitting a high number of work tickets² and the volume impaired ETAN's ability to address the system issues in a timely or effective manner. Given the level of documented performance issues, monitoring would not have been a sufficient solution to mitigate this high risk. By October 2023 there were almost 1200 open work tickets, see exhibit 1 below. While it is not uncommon for a system implementation to include a work ticket system with known performance issues and errors, it is uncommon for work tickets to continually build without the system implementor/developer (ETAN) having the capacity or sufficient knowledge of their own system to address them in a timely manner, or at all.

² A work ticket could be submitted by the toll operations team, or the finance team, to report performance issues including the system not working as designed, known errors, or concerns.

Exhibit 1: Open Work Tickets through October 2023



Source: ETAN JIRA from 2018-2024.xlsx, provided by ETAN or ETAN Internal Ticketing system

Other risks were listed in the *Combined Roadway/Back-office Status Report* dated May 23, 2022, however, we selected only a few identified as “high” risk to demonstrate SANDAG’s mitigation strategy was insufficient given the significant and volume of issues Fastlane was experiencing.

Significant ETAN Concerns Were Noted by SANDAG’s Finance Staff

SANDAG Finance staff was aware the first month after SR 125 goes live that Fastlane’s trial balance was not working. In an email dated, July 25, 2022, from the senior accountant to his direct supervisor and the CFO, he stated:

At this point, I need them (ETAN) to make a functional trial balance³ work...

³ A trial balance is a summary report listing the balances of all general ledger accounts of an organization at a certain point in time. Each general ledger account records the financial transactions related to the particular accounts. The general ledger transactions include the transaction date, description, and amount. The account totals for general ledgers account are summarized and presented in the organization’s trial balance.

SANDAG Finance staff noticed something wrong with the deferred revenue and account receivable accounts in the fall of 2022. However, they did not have the capacity to investigate it until the spring of 2023 as they were working on FY22 year-end financial statements for the annual audit, and the FY23 second quarterly bond disclosures. This matter was the start of a series of issues identified by Finance and HNTB surrounding the accuracy of Revenue, Deferred Revenue, and Accounts Receivable. These issues continued beyond the Fall of 2023 and are discussed later in this section and in section 2 of the report.

ETAN Did Not Prioritize SANDAG's Finance Staff Needs

Early in 2023, SANDAG's finance staff become more frustrated with ETAN's inability to prioritize their needs and provide reliable reports. Project meeting notes from SANDAG's project manager on February 9, 2023 include references to "System before the cutover in May was ok", "Finance is not "prioritized" and told too often to work around." The Finance team responsible for producing SR 125 financials are tasked with performing workarounds to record financial information and reconcile the books while ETAN is still struggling to deliver baseline accounting functionality. Additionally, the Finance staff, like Toll Operations staff, and HNTB are relied upon to assist ETAN in troubleshooting Fastlane.

On March 2nd the following email is sent from an ETAN Tolling staff member to the SR 125 Senior Accountant:

March 2, 2023

Hi SANDAG Finance staff person,

I am requesting the following information to facilitate the financial needs of your department. As discussed in our meeting on 2/28/23 we would like to put together a financial project calendar to track all key accounting deadlines and reporting needs so that ETAN can better support the SANDAG finance team.

1. List of daily reports needed from FL to reconcile – Ex: Deposit Detail report; GL Detail report; Interface Merchant Settlement report. Please list any other reports used for daily reconciliations and provide the date needed for these reports – Ex: following business day.
2. List of monthly reports that are used to prepare monthly close – Trial Balance report, GL Summary report, Customer reports, CTOC Summary and Detail reports, CTOC Agency invoice, Nuvei statements from ETAN. Please list any other reports from FL that are needed, and the date needed – example: 2nd business day of month.
3. List of quarterly reports and the date needed – KPI reporting.
4. List of annual reports needed – Bond reporting requirements that need to be addressed.
5. Important dates – I know that you need to close the Financial Period on the 10th day after month end. Are there any other dates that are critical for meeting deadlines?

Please reach out to me if you have any questions. Thank you for your assistance.

Kind regards,

ETAN Tolling staff person

The email exchange illustrates Fastlane's limited accounting functionality at the beginning of March 2023, seven months after SR 125 went live. ETAN made little progress to address Finance's concerns from March 23 forward, and in January 2024, at the request of SANDAG staff, the Board authorized the CEO to execute a sole source contract for a new back-office system.

SANDAG Initiated Workarounds to Reconcile the Information Outside the Back-Office System

SANDAG Finance department addressed the lack of reliable financial reporting from ETAN's BOS by initiating workarounds to reconcile the information outside the BOS. For example, Finance relied upon the bank statements and credit card company records to record revenue. This method allowed SANDAG to record revenue for tolling transactions where cash or credit was involved. However, it would not be able to identify if transactions were missed by the bank or the credit card company. A reconciliation is a process of comparing an organization's records against a bank's records or vendor's records. Both sets of records should agree with each other. If not, the organization needs to figure out why and fix any errors in the accounting records.

Both SANDAG Toll Operations and Finance employed the use of queries as a workaround to compensate for the lack of reliable reports. This workaround utilizes a few SANDAG staff analysts and ETAN to run queries to extract needed operational and financial data when researching issues or accumulating various data points from the system. However, queries can be limited in their usefulness as analysts relied upon the ad-hoc documentation produced by an ETAN developer. This documentation may not represent the complete design or parameters necessary to extract the correct data from the system. This workaround, for example, was used immediately prior to SR 125 going live. The HNTB Combined Roadway/Back-office System Status Report for May 23, 2022 stated:

ETAN made good progress on the data migration and provided an initial validation of the finance starting balances, which included queries of customer account balances. These queries were provided in place of reports which are currently not functioning as designed.

HNTB's Validation Issues Related to ETAN's Back-Office System Reports

Meeting notes from a February 28th project meeting with HNTB state:

Reports are messy—needs to be accurate and formatted better. Performance problems. Test procedures should include validating and reconciling relevant reports."

In May of 2023, HNTB was responsible for validating reports provided by ETAN as part of HNTB's contractual responsibilities. Most of the reports ETAN provided could not be successfully validated, meaning they failed, and for some of the requested reports, ETAN was unable to run in the system.

ETAN's Reporting System is Inconsistent and Balances Cannot Always be Relied Upon

In one example we reviewed the beginning balance used in the reconciliation failed to match the final ending balances from the prior year trial balance by almost \$150,000. It was explained the trial balance amounts changed because there were discrepancies on how the reports were run; sometimes prior dates were inserted into the apply date field, which reports used, when the posting date should have been used for reporting. The lack of consistency in how dates are applied, and how reports are run is concerning, and indicates a lack of consistency and stability in Fastlane accounting system. Accounting systems are designed to accurately post transactions in the proper accounting period to ensure financial reports accurately report financial information in the correct accounting period.

The ETAN system was unable to consistently close the books In the Fastlane general ledger system. This inconsistency to close the books was referenced in meeting notes, interviews, and in emails exchanges, including an email stating the account balances for month-end changed because transactions were allowed to be posted in prior periods.

SANDAG's Control Environment over SR 125 Financial Reporting was Insufficient to Ensure Reliable Reporting

Several examples of poor internal controls and concerning accounting issues involving both ETAN and SANDAG were noted during our investigation:

- Unearned revenue is only reconciled at year end for the year-end financial statements. If the unearned revenue was appropriately reconciled monthly, or quarterly, errors could be identified sooner, and it would be easier to research the differences. The fact that it took SANDAG months to reconcile the differences between the Customer Account Balance Summary and the General Ledger demonstrated the difficulty in researching a large number of discrepancies over a long period of time.
- Financial statements are produced quarterly or annually to satisfy bond disclosures and the annual financial statement audit requirements instead of ensuring financial information is reported in a timely manner. Controls need to be in place to ensure accounting information is accurately recorded and reported. Timely month end reconciliations are an important part of this process to ensure accurate financial statements, fraud detection, better cash management, compliance with regulatory requirements, improved planning and better relationships with investors and lenders.
- Some year-end journal entries were posted without supporting documentation, and upon request for such supporting documentation for this investigation, the accountant in charge needed to retrace their steps and gather or prepare the supporting documentation. Some journal entries were provided that did not have adequate supporting documentation, but instead were numbers recorded to true up or true down an account balance, in essence a number is plugged in to balance the journal entry.
- Common fee revenues and expenses for both the SR 125 and I-15X are recorded in common general ledger accounts in ETAN's Fastlane BOS and then allocated to the individual books for each toll way in QuickBooks based upon account numbers on SR 125 and I-15X from 2019. When requested, no documentation could be provided to support how the allocation percentage was determined, instead Finance staff had to interview other Finance staff and then prepare an analysis to support the 64/36 percentage allocation. This analysis demonstrated a 64/36 allocation split of common fee revenue and expenses based upon 2019 account numbers. It is important that such an allocation methodology is clearly documented and reviewed for reasonableness by management on a regular basis to ensure the allocation method remains reasonable. The allocation method should be captured in a department standard operating procedure.
- Accounts Receivable Policy does not exist, instead an analysis was provided to us during the investigation documenting how accounts receivable was accrued for the June 30, 2023 year-end. From our review of the documentation, it is clear the methodology applied is consistent from previous years, and the accrual appears reasonable. However, this year the ETAN BOS system could not produce an accounts

receivable aging report, which is a problem. The accountant in charge included the ETAN's BOS ending trial balance amount of \$68 million in the A/R analysis. This balance cannot be verified as accurate. Fortunately, this balance does not have an impact on the financial statements because it is netted against a contra asset of the same amount.

- Daily monitoring of trips from the Kapsch roadside system into ETAN's Fastlane BOS is not being done. A SANDAG finance staff member creates a report for management with daily traffic numbers from the Kapsch roadside system, however it is not compared to the trips being posted in the ETAN Fastlane BOS. Daily monitoring would allow for early detection and prevent errors not only from occurring, but from going months unnoticed. Such errors are discussed in more detail in the next section of the report.

Materiality vs Accuracy

The SANDAG Board, the public and other stakeholders have raised concerns to SANDAG's CFO regarding the SR 125 accounting errors and issues that were made known at the end of 2023. The CFO has used the phrase "not material" to describe the financial impact on SANDAG and the public related to these matters. Materiality is a Generally Accepted Accounting Principle (GAAP) that determines whether misstatements in financial reporting, such as an omission or misstatement, would impact a reasonable user's decision-making. This is a principle that is used in preparation of an organization's audited financial statements. Materiality, however, is not a principle applied to an organization's financial record keeping. An accounting system should record transactions accurately and to the penny. For example, a line item in the financial statements may be misstated by \$100,000, however the total line item may equal \$40 million, therefore the misstatement is only .25 percent. This would not be considered a material misstatement. On the other hand, if an organization's accountant failed to record \$500 hotel reimbursement, the accounting records would be inaccurate and would not reconcile.

Other Issues

Another example illustrates ETAN's inability to produce reliable reports and the Finance department prioritizing its need to meet an SR 125 financial statements deadline over first ensuring the reliability of the financial information. While the Customer Account Balance Summary (CABS) report was a required report per ETAN's contract, the report could not be run in the system until July 2023, thirteen months after SR 125 went live, and even then, it was not accurate, and did not reconcile to Fastlane's general ledger.

One of the errors reported to the Board in October 2023 was related to Fastlane's general ledger not reconciling to the customer account balances in the CABS. These errors are discussed in Section 2 of the report.

ETAN's system posted incorrect data when it was inaccurately programmed. Such errors required Toll Operations staff, ETAN, Finance and HNTB to work together to figure out what happened and how to correct it. It was found that the accounts have discrepancies in the

general ledger, and some of the discrepancies occurred because of incorrect posting. These publicly disclosed customer account errors are explained in the next section of the report.

It was reported by consultants and SANDAG staff that it was not uncommon for ETAN to fix one problem, and another problem would occur from the fix, requiring additional SANDAG staff and HTNB time. ETAN reported in their August 2022 BOS Monthly Progress Report the “As-Built Documentation” of the BOS system was 10% complete.” We were informed in December 2023 that ETAN was still writing system documentation as they were being interviewed by SANDAG consultants hired to determine if Fastlane data could migrate to a new BOS system.

ETAN’s contract with SANDAG included having system documentation, and when asked why they only had 10% of the documentation complete for their baseline system, they responded that their government project before SANDAG required “minimal if any” documentation. Regarding SANDAG, they confirmed “We had very little documentation on the system,” and there was very limited baseline documentation.

It appeared that ETAN personnel did not always know how to fix system problems and the lack of system documentation, or poorly written documentation, made fixing the problems difficult and time-consuming. ETAN also experienced significant personnel turnover during the project, contributing to a lack of historical knowledge, and at times insufficient experience to effectively manage and deliver the system they were contracted to provide as discussed earlier.

Conclusion

The investigation found that the financial information in the ETAN Fastlane BOS cannot be relied upon and that SANDAG executive management was aware of the system’s inability to produce reliable financial reports. Additionally, the Finance department lacked sufficient internal controls including proper supervision and timely reconciliation. Senior Financial Management allowed the situation to persist and did not intercede at an operational level to ensure the reliability of the financial information, instead they dismissed concerns as not material.

Recommendation 1:

We recommended an independent assessment of the Finance department’s policies, procedures, and practice to ensure adequate internal controls including proper review and supervision over all of SANDAG’s financial operations.

SECTION TWO: Status of Publicly Reported Errors with Customer Accounts

On December 8, 2023, the SANDAG CFO presented an overview of the implementation of the back-office system for the SR 125 in which he stated:

SANDAG currently services approximately 90,000 customer accounts. In August, SANDAG discovered approximately 55,000 of those accounts did not accurately reconcile to the internal accounting general ledger by a total of \$87,000. It was found certain types of transactions were responsible for the improper posting of transactions from 45,000 of those accounts to the internal general ledger, which has since been corrected. The accounts not currently reconciling to the general ledger are now down to 10,000 accounts. But the variance of \$8,771[sic].

An example of other variances was also noted by the CFO:

For example, approximately 100 recent transactions were posted to the incorrect customer accounts. And charged with incorrect customer credit card.

Of the 88,445 customer accounts referenced as approximately 90,000 by the CFO that existed on June 30, 2023, there were 48,620 accounts, identified by ETAN, HNTB and SANDAG, that had different amounts in ETAN's Fastlane general ledger versus ETAN's Fastlane's Customer Account Balance Summary (CABS) report. The CABS report total should equal the customer's prepaid balance which is reported in SANDAG's financial statements as Unearned Revenue. SANDAG was able to reconcile these accounts in Fastlane with ETAN's and HNTB's assistance. The remaining 8,851 accounts continue to be researched.

SANDAG Finance calculated \$90,646 as the net revenue loss attributed to the errors in the 48,620 accounts. The exhibit below quantifies the impact of each category of error as increasing or decreasing revenue. Next, we will go through the steps ETAN and SANDAG took to rectify each category or error.

Exhibit 2: General Ledger Issues

General Ledger Errors	Debit ⁴	Credit ⁵
Manual Data Fix Error	24,732	
System Generated Errors:		
Penalty Reversal		52,514
Pay by Plate Cancellation	92,519	
Fare Adjustment	62,008	
Invalid System Configuration:		
Missing Transaction Codes/Posting Rules		19,547
Check Payment Cancellation		16,552
TOTAL	179,259	88,613
Net Effect to Revenue	90,646	-

Source: Finance's correcting journal entries to QuickBooks for FY2023

FINDING 3: For the publicly disclosed general ledger errors, none of the underlying software programming or configuration issues in ETAN's Fastlane (ETAN's BOS) have been fixed. Some errors have been adjusted in both ETAN's BOS general ledger and SANDAG's QuickBooks, while others have only been fixed in QuickBooks for financial statement purposes. Lastly, some errors continue to be researched.

General Ledger Errors Impacted 48,620 Customer Accounts

The general ledger errors related to the 48,620 customer accounts were either system generated by incorrect posting rules due to software programming or configurations, or the result of an ETAN programmer making a manual data fix. A manual data fix is when a programmer fixes the data directly in the Fastlane database to correct erroneous data. When the data fix was performed, the corresponding general ledger entries were not included. SANDAG finance staff and HNTB worked with ETAN to identify the accounts affected by each issue.

In a proper operating environment, the maintenance team of a software product would have the knowledge and expertise to perform data fixes that would correct data errors in the customer database while ensuring the general ledger accounts were also corrected to maintain data consistency and financial reliability.

For all the system generated and configuration errors described below, the error was only corrected in QuickBooks for financial statement reporting and, in some cases, the Fastlane general ledger. The underlying software or configuration errors were not addressed. The Fastlane general ledger errors will likely persist, and QuickBooks adjustments will be needed for future fiscal year reporting.

⁴ Debit: an accounting entry to decreases revenue in the general ledger.

⁵ Credit: an accounting entry to increase revenue in the general ledger.

General Ledger Errors

The errors discovered in the general ledger were a result of:

- Manual data fix error
- System generated errors
- Invalid system configurations

This section summarizes the FY2023 financial impact when known, however, some errors occurred before FY2023, and some may still be occurring.

Manual Data Fix Error

Monthly Minimum Toll (MMT) Reversal Data Fix Error

The MMT requires that customers spend at least \$3.50 plus \$1 per transponder in tolls each month or a fee is assessed. The fee is the difference between a customer's total amount of tolls used and the MMT. ETAN's data fix reversed MMT fees on the Fastlane customer accounts, but the reversals were not posted to the Fastlane general ledger for 9,084 accounts in the amount of \$24,732.

This error was corrected in both the Fastlane's general ledger in June 2023 and in SANDAG's QuickBooks in November, 2023.

System Generated Errors

Penalty Reversal

The system posted incorrect general ledger entries when violation penalties were reversed by customer service representatives (CSRs). For example, CSRs attempted to waive \$10 from the \$40 violation payment but the system instead cancelled the \$40 penalty and added a \$30 payment for each violation to Fastrak unearned revenue. This error affected 131 accounts in the amount of \$52,514.

This is a configuration error not fixed in Fastlane's general ledger, yet a journal entry was recorded in SANDAG's QuickBooks in November, 2023 to address the error.

Pay by Plate Cancellation

A Pay by Plate (PBP) trip is created when a customer, who does not have a FasTrak account, uses the SR 125 toll road and later pays for the trip within four business days of their trip. For example, a PBP was paid and then cancelled due to a mis-reported trip or duplicate payment. The error occurred when a customer payment in Fastlane was reversed but the corresponding reversal was not posted in Fastlane's general ledger. This error affected 27,401 accounts in the amount of \$92,519.

This is a software programming error not fixed in Fastlane's general ledger, yet a journal entry was recorded in SANDAG's QuickBooks in November, 2023 to address the error.

Fare Adjustment

During normal business operations, FasTrack, PBP and violation trip fares may be lowered. For example, a FasTrack customer's account balance may be negative and they were charged the cash rate for a toll due to insufficient funds, and when they call a CSR to bring their balance positive, the CSR lowers their toll to the FasTrack rate. Consequently, such lowered trip rates on the customer accounts were not posted in Fastlane's general ledger for 4,041 accounts in the amount of \$62,008.

This error was corrected in both the Fastlane's general ledger in August, 2023 and SANDAG's QuickBooks in November, 2023.

Invalid System Configurations

Missing Transaction Codes and Posting Rules

Some financial transactions had no rules on how they should be posted to Fastlane's general ledger, including not having an associated transaction code or a posting rule that would determine what account to post the transaction to in the general ledger. Transactions were posted to Fastlane's customer account but not to the General Ledger. This affected 1,146 accounts in the amount of \$19,547.

This is a configuration error not fixed in Fastlane's general ledger, yet a journal entry was recorded in SANDAG's QuickBooks in November, 2023 to address the error.

Check Payment Cancellation

The cancellation of a payment was recorded as the cancellation of a refund check. This error caused the system to post amounts to incorrect accounts in the general ledger. This affected 30 accounts in the amount of \$16,552.

This is a configuration error not fixed in Fastlane's general ledger, yet a journal entry was recorded in SANDAG's QuickBooks in November, 2023 to address the error.

As stated earlier, SANDAG Finance calculated \$90,646 as the net revenue loss attributed to the errors in the 48,620 accounts. The numbers were taken from Finance's correcting journal entries to QuickBooks for FY2023.

Remaining 8,851 Errors Impacting Customer Accounts in the General Ledger

The remaining 8,851 accounts are still being researched. FAGAN was contracted by the CFO in late 2023 to investigate these remaining differences.

We met with FAGAN to understand the first version of their analysis dated February, 7, 2024. Their work did not include reconciling the information from the KAPSCH system to ETAN's BOS system. Instead, they reconciled information inside ETAN's BOS system. This investigation has documented many challenges inside ETAN's system. FAGAN issued a second version of their analysis dated March 15, 2024 that more clearly qualifies the limitations of their analysis. Their conclusion includes the following qualifiers:

...the correctness of the posted transactions remains to be verified as it was not in the scope of this audit to validate if all tolls, credit cards payments, violation fees, etc. were correctly populated on customer accounts.

While no transaction posting errors were found in the customer accounts, there were several anomalies found regarding the BOS GL2255 entries.

During our investigation, we identified customer account discrepancies that have been provided to SANDAG management, who is currently researching the source of these discrepancies. These discrepancies are included in Section 3.

100 Transactions Posted to Incorrect Customer Accounts

There were 110 customer accounts the system closed with an outstanding balance owed to SANDAG. The Fastlane system attempted to charge the credit cards on the closed accounts, however the system instead incorrectly charged other customers' accounts with active credit cards. The customer service team was notified of this error by a customer who called in to report an incorrect charge on their credit card that was not applied to their FasTrack account balance. The customer service team, Finance and ETAN researched this issue to isolate its impact on only these 110 accounts for a total of \$3,270.99. All identified impacted customers were sent refund checks.

Conclusion

The results of this investigation demonstrate many system limitations must be overcome to arrive at a desired level of accuracy, which may or may not be possible, and even, if possible, may be cost prohibited given the level of effort that would need to occur.

Recommendation 2:

We recommend that SANDAG reconciles the data from the KAPSCH system to ETAN's BOS daily to ensure accurate transmission and posting of customer account data to ETAN's Fastlane.

SECTION THREE: Other Significant Reportable Matters

FINDING 4: ETAN's implementation of the Back-Office System (BOS) Fastlane was headed for trouble from the beginning. SANDAG executive management failed to address the situation in a timely manner, including informing the Board of Directors.

Warning signs related to ETAN's ability to deliver on this project were well documented from early on and an effective project management system with adequate leadership and requisite skills was not in place to avert ETAN's development of a poorly functioning Back-Office system (BOS). The ETAN BOS to this day does not meet many of its requirements, fails to provide most required financial reports,⁶ and overall ETAN's BOS has not reached system acceptance.⁷ Per ETAN's contract, System acceptance was scheduled for September 19, 2018. Instead, ETAN's BOS continues to require excessive amounts of SANDAG's staff and consultants time to keep it operational until SANDAG can transition to a new back-office system.

In January 2024, due to the well documented failures of the ETAN back-office system, SANDAG Management requested the SANDAG BOD approve a sole source contract to Deloitte and A-to-Be to implement a new back-office system to replace ETAN. The sole source justification stated:

Development of the BOS began in 2017. The vendor selected in 2016 has been unable to deliver a BOS to the specifications of the contract; as a result, the toll operation which includes customers for both roadway facilities has experienced ongoing outages, errors in customer accounts, inability to process transactions accurately or timely and resulting in lost revenues. The vendor has conceded that it is not capable of delivering a BOS that meets the needs of the agency or the requirements of its contract.

The Board of Directors approved the sole source solicitation with Deloitte and A-to-Be on January 12, 2024. The migration to a new Back-Office System, per SANDAG management, is anticipated to take 7 months to complete.

Events Leading Up to the Sole Source Procurement in January 2024

SANDAG's CFO was assigned senior executive oversight responsibility of the SR 125 tolling operation in February 2022. In 2022, Fagan Consulting produced a series of reports for SANDAG at the direction of SANDAG's CFO. One of the reports was to assess SANDAG's prior BOS RFP process that led to the selection of ETAN.

⁶ Other required reports are not being provided as well; however, the objectives of this investigation focus primarily on financial reporting.

⁷ System acceptance is when a system meets the requirements set out in the contract and has been tested to verify in an operational environment (either simulated or actual production) that the complete system (i.e., the full complement of application software running on the target hardware and systems software infrastructure) satisfies specified requirements.

FAGAN's summary of findings stated:

There are numerous issues with the content and approaches used in the SANDAG BOS RFP, which almost certainly contributed to the difficulties encountered on the project.

The types of problems found include:

1. Vague, duplicate, or contradictory requirements
2. Untestable requirements
3. Questions about the actual evaluation process
4. Poor system engineering processes applied in developing the RFP

FAGAN's analysis stated:

At the time of the SANDAG RFP, the winning bidder was already experiencing significant financial, schedule, and development issues on at least one other project. Unfortunately, this concern was not discovered or dismissed.

The investigation revealed a system that never worked as designed, and SANDAG staff and consultants as a result became responsible for testing and troubleshooting Fastlane constantly to bring it to its current state of functionality while relying upon workarounds, such as data queries, to meet some of SANDAG's business needs including financial reporting.

FAGAN was contracted in spring 2022 to perform an operational risk assessment of SANDAG's back-office project with ETAN. The report stated:

The SANDAG staff is concerned about ETAN's ability to fully deliver the current system. Additionally, the Otay Mesa project is scheduled to open in two years. Given the issues encountered on the current project, the SANDAG staff has reservations that ETAN will deliver for Otay Mesa.

In June 2022, FAGAN briefed and recommended to members of SANDAG's Senior Executive Management to begin researching alternative procurement options due to significant concerns with ETAN. Shortly after this briefing, SANDAG's CFO communicated to FAGAN in an email:

it was really determined that we need to move away from ETAN (in particular for the new OME Port of Entry, but also in time for SR-125 and I-15). So we need to take an item to our BOD (SANDAG Board of Directors) sooner than later so that we can get the team moving in a direction to prepare a new tolling RFP...

Senior Management did not take an item to the Board of Directors until October 2023, almost 16 months after FAGAN's June 2022 briefing. The former Director of Accounting and Finance, per the published lawsuit, was alleged to have alerted the external financial statement auditors of the financial accuracy issues related to SR 125 in October 2023.

The June 2022 briefing discussed above was delivered before the July 2022 release of the operational risk assessment. FAGAN's risk assessment includes an extensive list of significant cons if SANDAG continues with ETAN including:

- ETAN required considerable support from SANDAG staff to test and bring their system online.
- ETAN software development staff is limited (possible single point of failure if that person leaves ETAN).
- ETAN seemed to significantly under-estimate the actual development cost of the project, leaving them in a precarious financial position on this project.
- Based on a review of the project-level documents, it is not clear that ETAN knows how to manage a project of this magnitude.
- Much of the project and technical documentation is poorly written.
- ETAN has limited experience in this type of software development (i.e., only two (2) operational back-office systems projects).
- ETAN seriously misrepresented the amount of development needed to implement SANDAG's system (RFP compliance matrix indicated >90% of the SANDAG requirements existed in their baseline software, while SANDAG staff told us that > 90% new development was a more realistic assessment).

Many of these points were reiterated in the interviews OIPA conducted, and the documents we reviewed. While all the points are troubling, we would like to highlight four of the points.

Point 1: ETAN software development staff is limited (possible single point of failure if that person leaves ETAN).

ETAN's project manager left the project in August 2022, less than 2 months after the SR 125 Go-live date. As documented by FAGAN in its risk assessment, the loss of this key staff person at ETAN had the potential to be an insurmountable loss to the project as this was ETAN's primary subject matter expert for the project.

Point 2: ETAN has limited experience in this type of software development (i.e., only two (2) operational back-office systems projects).

Point 3: ETAN seriously misrepresented the amount of development needed to implement SANDAG's system (RFP compliance matrix indicated >90% of the SANDAG requirements existed in their baseline software, while SANDAG staff told us that > 90% new development was a more realistic assessment).

Point 4: Much of the project and technical documentation is poorly written.

ETAN started the BOS project without technical documentation for its Fastlane product. ETAN developed the system documentation, with HNTB and SANDAG editing it, well beyond the initial projected finish dates, and as of this date, the System Detailed Design Documentation has not been accepted.

These points illustrate ETAN lacked the requisite experience going into the project, and it is unclear why these issues were not surfaced earlier or taken more seriously.

When the former CEO Hassan Ikhata was questioned at the December 8, 2023, Board of Directors meeting as to why they were not informed sooner, he responded:

You hire your staff to do their job and we were doing our jobs and we knew there were issues...Yeah, we knew there were some operational issues, but we thought the best approach is to overcome the mantle to get to the point where we couldn't get the financial statement, that's when we came to you in October. But yes, I made those decisions based on the authorities you offer me to make. And I don't think you want every time we have an operate small operational issue.

Conclusion

The reasons SANDAG senior management did not address the serious concerns with ETAN's ability to perform sooner is not a part of this investigation, but it is a matter that should be reviewed in detail by SANDAG senior management with the Board of Directors to ensure matters of this magnitude are handled expeditiously with accountability and transparency at the forefront. Such matters should be presented to the Board of Directors and the public in a timely manner.

Recommendations 3 through 6:

We recommend:

3. The Board and the public should be provided with an explanation as to why an RFP process was not initiated a year sooner, and why the Board was instead presented with a request to authorize a sole source contract award on January 12, 2024.
4. The Board should consider a policy that requires a Board report when a multimillion-dollar project is failing to meet its deadlines and deliverables. Such a policy should clearly state under what conditions a report is required, as well as when a report will no longer be required.
5. The Board review SANDAG's sole source awards semi-annually to ensure adherence with public procurement laws and practices.
6. The Board request the Audit Committee and the IPA to include SANDAG's sole source procurement process be included in the IPA's annual work plan for FY 24-25.

FINDING 5: SANDAG has suffered significant revenue losses due to a lack of adequate and timely monitoring.

Revenue Losses

Tolling systems suffer from toll revenue losses, called leakage, due to missing or mis-classified vehicle transactions, unrecoverable owner of record information, and transactions that fail to process. To curb their losses, most Toll Operations departments rely upon daily monitoring to ensure all systems are operating and communicating with each other correctly. Daily monitoring of systems helps alleviate toll revenue leakage by identifying and addressing system issues in a timely manner.

SANDAG's Toll Operations suffered revenue losses from Kapsch roadway system errors, ETAN Fastlane errors and missing system functionality, and SANDAG's lack of adequate and timely monitoring. SANDAG has the option to include these revenue losses in addition to their calculated liquidated damages⁸ for both KAPSCH and ETAN, however the systemic issue of a lack of adequate and timely monitoring has not been addressed. These losses are not limited to FY2023.

KAPSCH ETAN Interface

The Kapsch Roadway system captures vehicle transactions on the SR 125, processes them into trip data and sends the information to the Fastlane Back-office System for customer billing. We have included four notable reported issues when the Kapsch roadway system sent trips to the ETAN Fastlane system with improper charges or failed to send trips to the ETAN Fastlane system. HNTB, Kapsch and SANDAG estimated losses from these issues. The issues were not identified by active daily monitoring of the systems, but instead by system users indicating a problem may exist based on observations or through HNTB's historical data analysis.

1. From May 27, 2022, to October 11, 2022, trips were not properly charged in the Kapsch system, resulting in a minimum fare being billed to customers instead of a higher fare. HNTB estimated this resulted in approximately 200,000 trips being undercharged by \$234,900, which is the average of three separate analyses from SANDAG and Kapsch.
2. From September 14, 2022 to November 3, 2022, three plus axle vehicles were charged the fare for two axle vehicles at two plazas on the SR 125. HNTB calculated 39,562 trips were undercharged by \$116,175.
3. From September 16, 2022 to November 7, 2022, the Kapsch system stopped a subset of trips from being sent to the ETAN Fastlane system. HNTB calculated this impacted 203,451 trips and estimated the impact to be \$508,655.
4. From May 20, 2023 to June 20, 2023, the Kapsch roadway system sent trips to the legacy roadside system as opposed to the ETAN Fastlane system after a system reboot due to a configuration issue. HNTB calculated 35,017 Away Agency Fastrak trips and 310,488 violation trips were not processed and billed for approximately \$948,428.

FASTLANE Error

From January 2022 to October 2023, a specific government agency's trips were not posting to its account. These trips were deemed too old to post when discovered. ETAN provided a list of 10,090 trips totaling \$35,194 that were not charged to the agency.

⁸ Liquidated damages are damages whose amount the parties designate during the formation of a contract for the injured party to collect as compensation upon a specific breach. Google Wikipedia printed page.

Conclusion

SANDAG has sustained significant revenue losses due to their lack of adequate and timely monitoring of toll operations, and even with the knowledge of such losses, a comprehensive monitoring system was not implemented. To curb revenue leakage, SANDAG must carefully monitor Toll Operations daily to help identify and address system issues in a timely manner.

Recommendation 7:

We recommend SANDAG immediately implements daily monitoring to ensure all systems are operating and communicating with each other correctly.

FINDING 6: At least \$1 million in revenue has been lost due to a function in ETAN BOS not being turned on.

Missing DMV Hold Functionality

A DMV hold occurs after a customer has received several notifications for failing to pay their tolls and escalating violation amounts. While this is not an error in the system, if the DMV Hold functionality in Fastlane is not turned on for placing registration holds, revenue is lost.

Violation escalation consists of a first notice and \$40 penalty, a second notice and \$60 additional penalty, followed by forwarding to a collections agency and placing a DMV registration hold on a vehicle's registration. The DMV Hold placement process was turned off from April, 2020 to September, 2021 following the Board of Director's decision to stop issuing violations during the COVID pandemic. From September 2021 until April 2022, the DMV Hold placement process was turned on in the legacy system but was then turned off when ETAN went live on SR 125.

The average net revenue generated by the DMV Holds from July 2016 to August 2020 was \$95,678 per month. At the time the DMV Hold process was turned off in the legacy system for ETAN's SR 125 go-live, the monthly revenue was trending upwards. Since the DMV Hold placement process was never turned on in Fastlane, the DMV Hold monthly revenue decreased over time. The DMV Hold functionality will not be implemented in the new Deloitte and A-to-Be system until the basic system functionality has been established. We estimate at least \$1 million dollars has been lost due to the missing DMV Functionality. This is based upon a conservative monthly revenue of \$75,000 for 21 months (from June 2022 to February 2024) less fees assessed from the DMV for holds placed. These losses will continue until this function has been implemented in the new system.

Conclusion

The DMV Hold functionality not being turned on for ETAN's BOS will result in continuing revenue losses. To quickly begin capturing revenue, SANDAG should prioritize turning on the DMV Hold placement process once Deloitte and A-to-B basic system functionality is established and implemented.

Recommendation 8:

We recommend SANDAG evaluates with Deloitte and A-to-Be if the DMV Hold Functionality can be implemented sooner.

FINDING 7: The beginning customer account balance changed, no longer matching the original beginning balance, in a subset of accounts tested.

Customer Account Balances

Given the concerns regarding customer account balances, we analyzed a subset of customer account balances in the Fastlane system. The subset of accounts included 62,564 FasTrack accounts that had a balance other than zero when the accounts were migrated from the SR 125 BOS legacy system to ETAN's Fastlane system when SR 125 went live in June 2022. Three separate tests were conducted comparing the legacy account balance to the Fastlane account balance and the Fastlane account balance to the transactions that were posted to the Fastlane account. Our review found that 2% of the account balance tests failed, while 98% passed. We conducted a random sampling of failed tests and found that when SR 125 went live, the Legacy customer account balance was confirmed to match Fastlane's new customer account balance, however, one of our tests revealed the beginning balances no longer match. The discrepancies range from \$.02 to \$862.82. We shared these discrepancies with management to research and determine why the beginning customer account balances changed and why transactions do not add up to the customer balance for the accounts that failed the tests.

Conclusion

Great care must be taken to address customer account balances so that confidence can be restored with SANDAG's customers, the Board, and the public. To address customer concerns about account balances, SANDAG executive management should continue to research and determine why the beginning customer account balances in the Fastlane system for the subset of customer accounts changed and why transactions do not add up to the customer balance for the accounts that failed the IPA tests.

Recommendations 9 and 10:**We recommend:**

9. SANDAG implement a daily reconciliation process between the KAPSCH roadway system and the ETAN Fastlane system be put in place immediately to verify the accuracy of customer charges going forward. This should be coordinated with toll operations and Finance.
10. SANDAG establish a process to address customer concerns related to past account balances that have not been verified or that are not able to be verified. If additional discrepancies in customer account balance are identified, these accounts should be included in this process.

Next Steps

The report will be presented to SANDAG's Audit Committee and the Board of Directors for discussion and possible action. SANDAG Management should provide a written response to the report's recommendations within two weeks.

The Office of the Independent Performance Auditor will publicly report on the status of the recommendations to the Audit Committee, and Board of Directors, at a time to be determined by the Audit Committee with consultation from the Independent Performance Auditor.

Methodology

We conducted an investigation to arrive at the findings and conclusions in this report. The following work was completed:

- Attending and reviewing SANDAG board meetings
- Reviewing HNTB and ETAN various project status reports, meeting notes
- Reviewing SANDAG Project Manager meeting notes
- Reviewing SANDAG legislative records
- Reviewing current and former SANDAG staff members emails
- Interviewing HNTB and ETAN representatives
- Interviewing current and former SANDAG staff members
- Analyzing ETAN Fastlane data
- Analyzing SANDAG Finance data
- Reviewing FAGAN reports
- Reviewing ETAN System Documentation