



Audit Report #21-01

A Report to the City of Killeen Audit Committee

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EXECUTIVE SUMMARY



AUDIT REPORT HIGHLIGHTS

Why Was This Audit Conducted?

The City Auditor proposed this audit to the Audit Committee, in accordance the requirements of Ordinance 18-045, which states that the "Street Maintenance Special Revenue Fund shall be audited twice annually, once by the city's internal auditor and once by the external auditor."

The City Auditor appreciates the cooperation of Public Works and Finance staff in the completion of this audit.

Street Maintenance Special Revenue Fund Audit

Mayor and Council,

I am pleased to present this audit of the Street Maintenance Special Revenue Fund.

Audit Objectives

The objectives of the audit were to (1) evaluate the implementation of the Street Maintenance Fee, (2) review the expenditures charged against the Street Maintenance Special Revenue Fund to ensure charges were accurate, authorized, and appropriate; and (3) evaluate the City's efforts to incorporate best practices into its street maintenance curriculum.

Audit Results

The City Auditor's review of the Street Maintenance Fee in its first year found that management's implementation of the fee was generally well executed. Expenditures charged against the Street Maintenance Special Revenue Fund were properly authorized and directly related to street maintenance. The prior administration's decision to include General Fund activity in the Street Maintenance Special Revenue Fund was somewhat problematic in that it lessened the overall transparency of the fund. However, management revisited the initial set-up during the FY 2021 budget process and obtained approval from City Council to return General Fund activity to the General Fund. Finally, management took an important step forward when it expanded its "toolbox" of pavement treatments beyond traditional seal coat treatments to include the HA5 High Density Mineral Bond treatment. Historically, management has been slow to embrace such emerging best practices, even as neighboring cities and cities across the State have adopted them. Going forward it will be incumbent upon management to continue to add innovative products to its "toolbox" of options to ensure that Street Maintenance Fee revenues are used as effectively and efficiently as possible.

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INTRODUCTION

The City Auditor conducted this performance audit of the Street Maintenance Special Revenue Fund pursuant to Article III, Chapter 40 of the City Charter, as Amended May 11, 2013, and in accordance with the City Auditor's Annual Audit Plan, approved by the Audit Committee on June 4, 2020.

This audit was conducted in accordance with City Ordinance 18-045, which states that the "Street Maintenance Special Revenue Fund shall be audited twice annually, once by the city's internal auditor and once by the external auditor."

The objectives of the audit were to (1) evaluate the implementation of the Street Maintenance Fee, (2) review expenditures charged against the Street Maintenance Special Revenue Fund to ensure that transactions were accurate, authorized, and appropriate, and (3) evaluate the City's efforts to incorporate best practices into its Fee-funded street maintenance curriculum.

Background

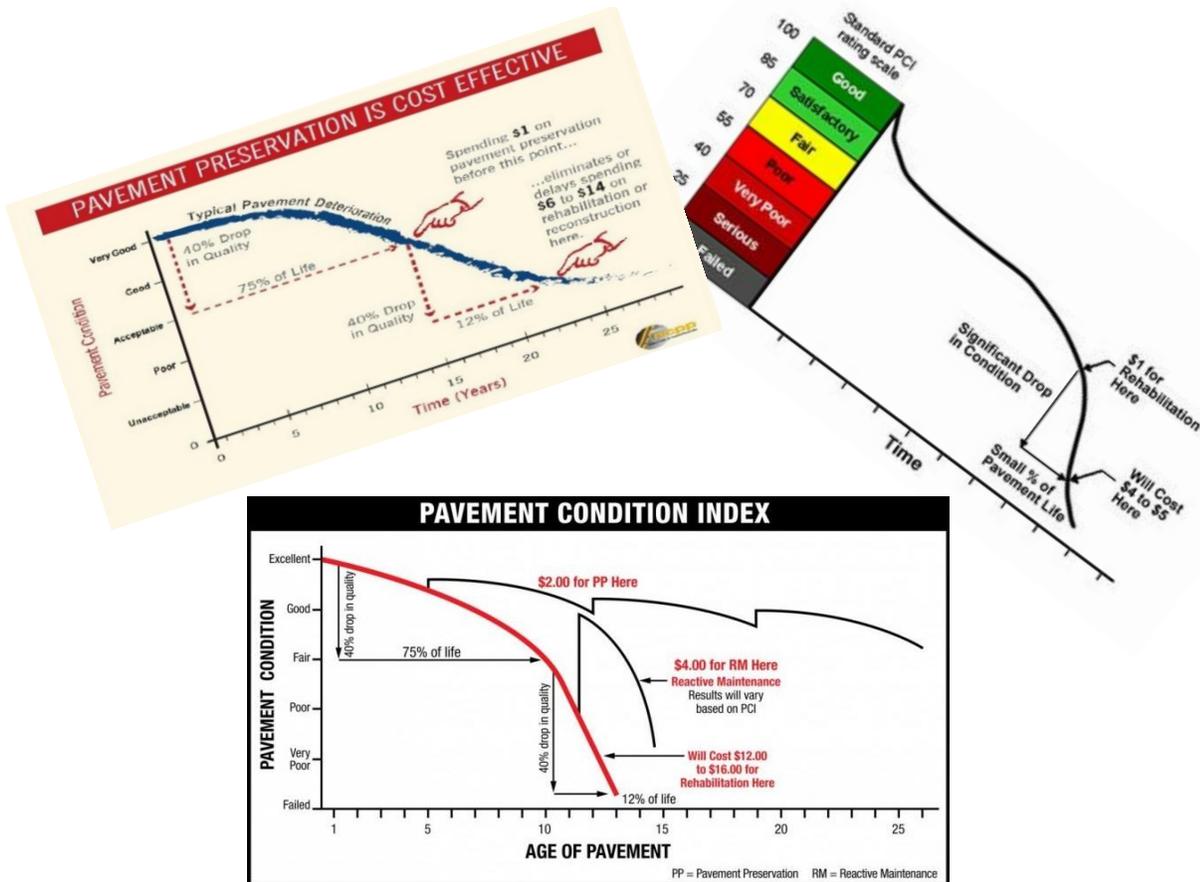
On December 11, 2018, City Council approved Ordinance 18-045, establishing a Street Maintenance Fee and a Street Maintenance Special Revenue Fund to account for all fees collected. The purpose of the fee, per the ordinance was "to protect the citizenry from the deterioration of the quality and safety of the road system which they rely upon and use on a regular basis and to provide a properly maintained road system." More specifically, the fee was designed to address a chronic shortfall in General Fund dollars available to pay for street maintenance projects.

The ordinance discussed street maintenance in terms of the transportation system as a whole. However, the purpose of the Street Maintenance Fee, itself was more narrowly defined to what management termed "pavement treatments" in its staff report, specifically, the materials, supplies and contract costs associated with street maintenance projects.

At the time the Ordinance was enacted deferred maintenance for City streets stood at approximately \$40 million, having more than doubled since the previous pavement condition assessment conducted in 2013, which had estimated deferred maintenance at \$16.7 million.

Pavement Management

Pavement management refers to a systematic process for maintaining, upgrading and operating a network of paved streets. Public works agencies typically employ the use of pavement management software to develop a pavement management strategy based on multiple factors, including pavement condition, vehicle usage, climate, etc.



There are a number of models depicting the 20-to-25-year life cycle of a street and the maintenance costs relative to the various stages of a street's life. However, all of the models share a similar relationship between the deferral of maintenance and its associated impact on the cost of that maintenance. That relationship can best be summed up by the 18th Century proverb, "A stitch in time, saves nine," i.e., the earlier preservation work begins, the greater the cost avoidance down the road. According to the American Association of State Highway and Transportation Officials every dollar spent "keeping a good road good" precludes the need to spend \$6 to \$14 later to return a deteriorated road to good condition.

The Road to Deterioration

Asphalt is composed primarily of two components: (1) Aggregate Rock, and (2) Asphalt Binder, typically a petroleum-based product, which coats and binds the aggregate particles together.



The primary cause for deterioration is oxidation, a process that occurs when ultraviolet rays, moisture and manmade chemicals conspire to breakdown the asphalt binders that hold a road together, resulting in cracks, potholes, and other defects that ultimately lead to road failure.



Best-First Strategy (keeping a good road good)

The Federal Highway Administration defines preventative maintenance as *"a major component of pavement preservation aimed at extending the service life of a road by applying cost-effective treatments."*

Toward that end, one of the asphalt industry's best practices regarding pavement management strategy is that of "Best First/Worst Last," wherein scarce street maintenance dollars are dedicated to preserving good roads first. Under a First-Worst strategy, by contrast, scarce resources spent on rehabilitating or reconstructing one bad road could come at the expense of allowing several good roads to devolve into a deteriorated state.

This does not mean that deteriorating roads should be ignored. Indeed, there may be issues of public safety, quality of life, or cost avoidance that dictate deviation from a Best-First strategy. In general, however, the most cost-effective strategy for the use of scarce street maintenance resources is one that prioritizes the preservation of good roads. Failed or failing roads, it should be noted, are not within the scope of the Street Maintenance Fee. They are considered capital projects, which are typically funded through the issuance of public debt in the form of certificates of obligation or general obligation bonds.

Pavement Condition Index

Pavement Condition Index (PCI) is a numerical index between 0 and 100, which is used to describe the general condition of a section of pavement. Originally developed by the U.S. Army Corps of Engineers, the PCI was later standardized by the American Society for Testing and Materials (ASTM). In terms of pavement management, municipalities use a PCI survey to assess the overall condition of a road system, in order to develop a comprehensive pavement management strategy. The classification of PCI ranges and their associated pavement treatments are as follows:

PCI Range	Class	Pavement Treatment	Funding Source
85-100	Good	Preventative	Street Maintenance Fee
71-85	Satisfactory		
56-70	Fair	Rehabilitative	Street Maintenance Fee
41-55	Poor		
25-40	Very Poor	Reconstruction	Public Debt Issuance
10-24	Serious		
0-10	Failed		

Source: Internet

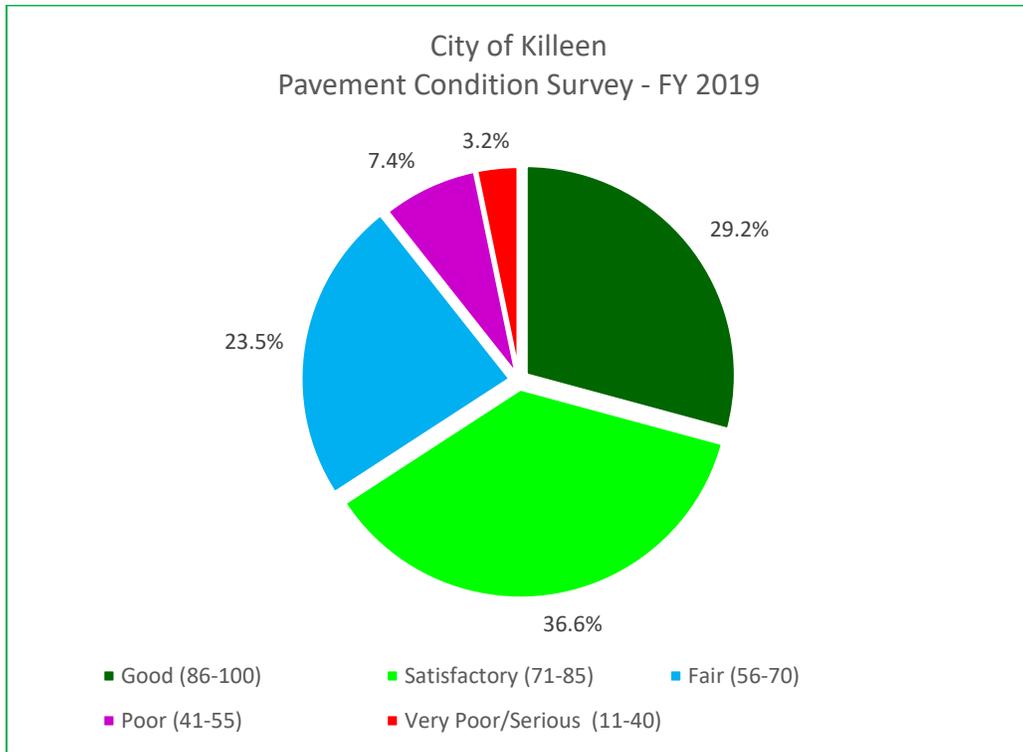
Street Condition Assessment

In April 2019 the City Council authorized a professional services agreement with Transmap Corporation to conduct a street condition assessment. The assessment was authorized in accordance with City Ordinance 25-227, which mandates that a road condition study be conducted every three years.

Transmap’s street condition study assessed the City’s overall PCI rating at 76, or Satisfactory. This was a decline of 8 index points from the City’s prior PCI rating of 84, which was assessed in the condition assessment conducted in FY 2013. The decline coincided with a decline in funding for street maintenance, which fell from \$820,000 in FY 2013 to \$300,000 in FY 2018.

Despite the increase in funding from the Street Maintenance Fee, Transmap projects that the road system’s overall PCI rating will continue to decline over the next five years to 67, or Fair. It should be noted that Transmap’s “what if” analysis does not consider the potential positive impact on the overall assessment should management choose to pursue debt-funded reconstruction projects on some of the City’s failed roads.

A more granular look at the assessment results is shown in the chart below. The study found that 66 percent, or two-thirds of the City’s 539 center lane miles were in “Good” or “Satisfactory” condition, while 31 percent were in “Fair” or “Poor” condition. Collectively, this represents the 97 percent of center lane miles falling within the purview of the Street Maintenance Fee.



Source: Public Works Department

The remaining 3 percent of center lane miles were deemed "Very Poor" or "Serious" representing failed or failing roads that fall within the purview of public debt issuance for funding purposes.

It should be noted that PCI rating assessments are grouped by road sections with similar ratings, and these road sections are not necessarily contiguous. For example, there may be isolated sections of failed roads with PCI ratings above 40, which would therefore be included in the 97 percent of lane miles falling under the purview of the Street Maintenance Fee. For practical purposes; however, these sections would be reconstructed along with failed sections as part of a road reconstruction effort. For that reason, the 3 percent figure should be considered a conservative estimate.

The Pavement Manager's Toolbox

A common theme encountered in conducting research for this audit was that of the "toolbox" as metaphor for a comprehensive approach to pavement management. The toolbox in this case refers to pavement treatment options, the idea being to have an expanding array of possible pavement treatments to choose from when executing a pavement management plan.

One industry expert refers to "filling one's toolbox" as the key for executing a successful pavement management plan. Another encapsulates the need for maintaining a broad array of options, as having "the right treatment, on the right road, at the right time." In reference to "filling one's toolbox," experts stress the need for a proactive approach to pavement management that focuses on innovation in seeking out the most beneficial and cost-effective pavement treatments available on the market.

Preventative Pavement Treatments

While deterioration begins immediately, a new road will typically maintain its structural integrity for about 10 years, according to industry experts. After which the road will begin to slip from "good" condition into "fair" condition. Preventative pavement treatments aimed at "keeping good roads good" usually involve the application of seal coats designed to prevent oxidation by protecting the asphalt from the elements. The sooner pavement treatments are applied, the greater the benefit in terms of adding years to the life of a road. Depending on when the preventative maintenance begins this can mean forestalling the need for more costly intervention from 5 to 10

years. As previously noted, approximately 66 percent of the City’s center lane miles fall under the umbrella of preventative maintenance. Examples of preventative treatments include Slurry Seal, Crack Seal, and HA High Density Mineral Bond, which are described below:

Pavement Treatment	Description	
Slurry Seal	Slurry seal is a mixture of water, asphalt emulsion, aggregate, and other additives designed to seal cracks and restore lost flexibility to a pavement surface.	
Crack Seal	Crack seal is a hot sealant applied to working cracks to prevent water intrusion. The rubberized treatment seals cracks, while staying flexible with pavement’s movement.	
HA5 High Density Mineral Bond	Developed in 2002 for residential streets as an alternative to traditional seal coats, HA5 High Density Mineral Bond has been embraced by industry experts for its ability to prevent the oxidative effects from both UV rays and moisture.	

Source: Internet

Rehabilitative Pavement Treatments

While preventive maintenance can slow the deterioration process, it cannot stop it entirely. Eventually a road’s condition will move beyond the scope of preventative measures and into the realm of rehabilitative cures. Rehabilitative treatments seek to reverse the effects of

deterioration by adding or replacing material from the pavement structure. Examples of rehabilitative pavement treatments include the following:

Pavement Treatment	Description	
Hot In-Place Recycling (HIR)	A three-step process that involves heating up and removing the 1-to-2-inch asphalt surface layer, remixing the asphalt with a rejuvenating agent, then repaving the street with the recycled asphalt.	
Cold In-Place Recycling (CIR)	Similar to HIR, but without the heating step, the CIR process is typically used on highways due to the size and weight of the vehicles, and the depth of asphalt layers removed.	
Full Depth Reclamation (FDR)	In Full Depth Reclamation the pavement and a pre-determined portion of the underlying materials are crushed, pulverized or blended to create a new stabilized base course.	

Source: Internet

As previously noted, approximately 31 percent of the City’s center lane miles are in a state of deterioration where rehabilitative treatments are required. Over the past two decades, the City has not devoted significant resources to rehabilitative type treatments, instead focusing primarily on seal coat treatments, in accordance with the Best-First strategy.

Statement of Compliance with Audit Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Those standards also require that we, as internal auditors, meet the criteria for independence. We believe that we met those independence standards, and that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

FINDINGS AND RECOMMENDATIONS

The City Auditor's review of the City's Street Maintenance Special Revenue Fund found positive results in its first full year of implementation, as well as challenges going forward.

The City's implementation of the Street Maintenance Fee was generally well executed with a minimum of administrative speed bumps. Of the roughly 50,000 customers billed for the fee, only 27 requests for review of the City's initial fee assessment were received through June 30, 2020. Of those 27, only 16 resulted in adjustments to the initial assessment, for an adjustment/error rate of .0003 percent. The City Auditor selected a sample of 10 payment vouchers charged against the Street Maintenance Special Revenue Fund totaling \$1,339,497. All of the charges were properly authorized and directly related to street maintenance. Management took corrective action to improve the overall transparency of the Street Maintenance Special Revenue Fund by reversing the prior administration's decision to include General Fund revenues in the fund. Finally, the Public Works Department used fee revenues in this first year to expand its "toolbox" of options beyond its traditional reliance on slurry seal treatments. Industry experts have embraced the HA5 High Density Mineral Bond as a viable alternative to traditional seal treatments for its effectiveness in protecting asphalt from the oxidative effects of both ultraviolet rays and moisture. Historically, the City has been slow to embrace such emerging best practices, even as cities across the State and the country have adopted them. Going forward management needs to commit itself to adopting the most cost-effective and efficient preventative and rehabilitative treatments available to ensure the most effective and efficient use of its limited street maintenance resources.

Street Maintenance Fee Implementation

The following is a brief discussion of several areas covered in this audit. This includes the roll out of the Street Maintenance Fee; accounting for fee-related revenues and expenditures in the City's financial management system; and the establishment of, and subsequent budgeting for the Street Maintenance Special Revenue Fund.

Rolling Out the Street Maintenance Fee

The Street Maintenance Fee was implemented in accordance with management's estimated timeframe largely without incident. At the time of passage in December 2018, the City Staff Report stated that it would take approximately six months to integrate the new fee into the City's billing system, with collection beginning in the July billing cycle.

Billing for the Street Maintenance Fee began in July 2019, as scheduled. The recurring charges for residential and non-residential customers were integrated into the billing system for Water & Sewer, Solid Waste, and Drainage billings. Remedies for potential errors in the fee-setting process were addressed in the ordinance, under Section 25-233, which states "A user may apply to the City Manager, or designee, for an adjustment in the user's monthly Street Maintenance fee if (1) the user disputes the category of the land use used in calculating the fee for the owner's benefitted property; or (2) the user believes the fee has been calculated in error."

Public Works received and reviewed a total of 27 customer requests for fee reviews from July 2019 through June 30, 2020. Of those 27 requests, 16 resulted in fee adjustments and credits to customers' respective accounts. Based on average monthly utility billings of approximately 50,000, this indicates an overall adjustment/error rate of .03 percent, or 3 hundredths of a percent.

Accounting for the Street Maintenance Fee

The Finance Department established its Street Maintenance Special Revenue Fund for tracking fee revenues and expenditures related to street maintenance. Street Maintenance Fee revenues for FY 2020 totaled \$1,779,596, which included \$1,018,398 from residential services, and \$761,198 from non-residential services. This was slightly more than the \$1.6 million in fee revenue projected in the budget.

The City Auditor selected 10 payment vouchers totaling \$1,339,497 to verify that charges to the account were appropriate. All payment vouchers reviewed were properly authorized, accurately recorded, and were directly related to pavement treatments.

Budgeting for the Street Maintenance Special Revenue Fund

In accordance with Section 25-226 of Ordinance 18-045, the Finance Department established its Street Maintenance Special Revenue Fund “for the purpose of maintenance of the transportation system.” The original language of the ordinance defined the special revenue fund broadly to encompass both maintenance and operational costs of the transportation system. As defined in the ordinance, this included not only street maintenance costs funded directly by the Street Maintenance Fee, but also all other transportation system operating costs, including salaries, vehicles, supplies, training, and equipment, all of which are considered General Fund activities.

The end result of this broad interpretation of the Street Maintenance Special Revenue Fund was one in which the Street Maintenance Fee, itself appeared as a minor participant in its namesake fund. In the FY 2020 Annual Budget, for example, projected revenues for the Street Maintenance Special Revenue Fund were approximately \$6.6 million, of which only \$1.6 million derived from Street Maintenance Fees. The other \$5 million in special revenues came from the General Fund in the form of interfund transfers for salaries, equipment, street sweeping, supplies and other Transportation Division operating costs.



The overall effect of this approach was to diminish transparency by blurring the line between General Fund and Special Revenue Fund activity. Further, by diluting the Street Maintenance Special Revenue Fund with General Fund revenues management was somewhat at odds with Governmental Accounting Standards Board (GASB) guidance on accounting for Special Revenue Funds. Under GASB Statement No. 54, restricted proceeds should “comprise a substantial portion of the inflows reported in the (special revenue) fund.” Restricted inflows from the Street Maintenance Fee represented only 24 percent of total revenues. GASB does allow other revenue sources to be reported in the fund with the caveat that they should be used for the specified purpose of the fund. While management technically adhered to this provision because of its broad interpretation of the fund’s purpose, it could be considered as adhering to the letter, but not necessarily the spirit of GASB.

During the FY 2021 budget process, management revisited the manner in which the Street Maintenance Special Revenue Fund was originally set up. Ordinance 18-045 was amended to narrow the definition of the special revenue fund to include only the Street Maintenance Fee and its associated street maintenance costs. Management then obtained approval from City Council to return all General Fund activity to the General Fund. As a result of the corrective steps taken, the Street Maintenance Special Revenue Fund is now reserved solely for Street Maintenance Fee activity.

Going Forward: Expanding the “Toolbox”

The City’s Public Works Department took an important step forward in April 2020 when it broke from its decades-long reliance on traditional seal coat treatments and obtained approval from City Council to use its Street Maintenance Fee revenue to procure the HA5 High Density Mineral Bond (HA5) asphalt preservation treatment. Historically, the City has been slow to embrace emerging best practices, relying solely on traditional treatments, such as slurry seal, even as neighboring cities, and cities across the State adopted these best practices.

As previously mentioned, industry experts stress the importance of taking a proactive and comprehensive approach to pavement management that embraces “filling one’s toolbox” with innovative and cost-effective pavement treatments. A brief discussion of two of those emerging best practices follows.

HA5 High Density Mineral Bond

First developed in 2002 as an alternative to traditional seal coat treatments, such as slurry seal, HA5 High Density Mineral Bond (HA5) has been embraced by industry experts as a significant breakthrough for its ability to shield asphalt from the oxidative effects of both ultraviolet waves and moisture. HA5 is designed for residential roads in "Good," or "Satisfactory" condition. Over the past decade, the surface treatment has been widely adopted by local governments across the State and the country.

In 2017, the Federal Highway Administration's Texas Local Technical Assistance Program highlighted the HA5 surface treatment as an emerging best practice.¹ Neighboring cities that have adopted the surface treatment include Georgetown, Round Rock, and Waco. Other cities include Midland, Amarillo, San Angelo, Hurst, Westlake, Dallas, Fort Worth, McAllen, Corpus Christi, Hickory Creek and Laredo.

In August 2020, the City's Transportation Division executed the first year of the City's two-year contract for the HA5 surface treatments.



Source: Communications Department

The surface treatments covered 36 sections of road, totaling approximately 20 lane miles, at a cost of about \$760,000. The HA5 surface treatments were carried out in accordance with the Best-First strategy of "keeping good roads, good." As previously stated, every dollar spent keeping a good road, good, will avoid the need to spend from \$6 to \$14 dollars once a road has been allowed to deteriorate.

¹ In 1982 the Federal Highway Administration launched the Local Technical Assistance Program with the goal of improving local roadways. The Texas Local Technical Assistance Program is managed by the University of Texas Arlington's Public Works Institute. Its mission is focused on "preserving and enhancing the local road system by delivering quality training and technical assistance to local city/county agencies in Texas."

About 31 percent of the City's center lane miles in the FY 2019 pavement condition assessment were deemed "Fair" or "Poor," indicating they have deteriorated beyond the scope of the Best-First strategy. For these roads, a more aggressive, rehabilitative approach is required to return the roads to good condition, and more importantly, to avoid the additional cost and quality of life issues associated with completely failed roads. One of the most widely embraced rehabilitative techniques currently in practice is that of Hot In-Place Recycling.

Hot In-Place Recycling

As the name implies, Hot In-Place Recycling uses primarily recycled asphalt, usually with a one-inch virgin asphalt overlay. In laymen's terms, the process involves repaving a road with itself by heating up the existing pavement, milling the softened layers, scooping them into a mixer, adding a rejuvenating agent, and then repaving the road with the rejuvenated asphalt.



Source: Internet

According to the Asphalt Institute, in-place recycling of pavements dates back to the early decades of the 20th Century. However, it wasn't until the energy conservation and environmental movements of the 1970's that the idea of recycled asphalt began to gain traction. By the early 21st Century, technological advances in the recycling process had progressed to the point where a single vehicle could accomplish

the recycling and repaving process in a single setting, thereby eliminating the need to store recycled materials, and minimizing the disruption of local traffic.

Both the Federal Highway Administration and the Texas Department of Transportation have embraced Hot In-Place Recycling as an alternative to standard milling and repaving processes. Benefits of the asphalt recycling process include a reduction in cost due to the reduced need for raw materials, reduction in the carbon footprint, and a lessening of the burden on the nation's landfills. In addition, the efficiency of the single-vehicle process lessens the disruption of local traffic. Given the range of benefits associated with Hot In-Place Recycling, both financial and environmental, it is little wonder that local governments across the country and the State have embraced it as a best practice.

While cities across the state and the country have embraced Hot In-Place Recycling over the past two decades, the City of Killeen has yet to adopt the best practice. This may have been due in part to limited funding in prior years. However, when viewed alongside the City's belated embrace of the HA5 High Density Mineral Bond surface treatment, it suggests a reticence on the part of past administrations to embrace emerging best practices in the field. It should be noted that the current Public Works Executive Director has expressed an interest in expanding the City's "toolbox" of options going forward to include such best practices.

As the City attempts to address its backlog in deferred street maintenance needs, it will be incumbent upon management to ensure that its scarce street maintenance resources are put to their most productive and cost-effective use possible. Toward that end, management should commit itself to researching and identifying established and emerging best practices as part of its pavement management process. This would ensure the most effective and efficient use of scarce street maintenance dollars, as well as mitigate to the extent possible the projected rate of decline for the City's streets over the next five years.

Recommendation:

The City Auditor Recommends that the Public Works Executive Director:

1. Incorporate into the Department's annual work plan process for street maintenance a step to ensure that established and emerging best practices are identified and considered for planned street maintenance projects.

VIEWS OF RESPONSIBLE OFFICIALS

Copies of the draft report were provided to the Executive Directors for Public Works and Finance for review and comment. They both provided very helpful feedback, which is reflected throughout this report.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The objectives of the audit were to (1) evaluate the implementation of the Street Maintenance Fee, (2) review expenditures charged against the Street Maintenance Special Revenue Fund to ensure that transactions were accurate, authorized, and appropriate, and (3) evaluate the City's efforts to incorporate best practices into its Fee-funded street maintenance curriculum.

Scope and Methodology

The audit focused on Street Maintenance Fee activity from its inception in July 2019 through September 2020.

To address the audit objectives, the City Auditor:

- ▶ Interviewed key personnel, including the Executive Director and Finance Manager, Public Works; the Director and Principal Secretary, Transportation Division; and the Controller, Finance Department.
- ▶ Conducted research on industry best practices and reached out to industry experts on emerging best practices.
- ▶ Obtained and reviewed budget data related to street maintenance.
- ▶ Obtained and analyzed summary results of the FY 2019 Transmap pavement condition assessment.
- ▶ Obtained and reviewed current street maintenance contracts, as well as prior City Council Resolutions for street maintenance projects.
- ▶ Selected a sample of payment vouchers charged against the Street Maintenance Special Revenue Fund and reviewed to ensure transactions were accurate, authorized, and appropriate.

Statement of Compliance with Audit Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Those standards also require that we, as internal auditors, meet the criteria for independence. We believe that we met those independence standards, and that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.