



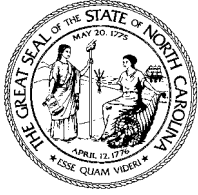
STATE OF NORTH CAROLINA

AUDIT RESULTS FROM
CAFR AND SINGLE AUDIT PROCEDURES
DEPARTMENT OF TRANSPORTATION
FOR THE YEAR ENDED JUNE 30, 2002

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR



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Date April 1, 2003

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. Lyndo Tippet, Secretary
Department of Transportation

We have completed certain audit procedures at the Department of Transportation related to the State's *Comprehensive Annual Financial Report (CAFR)* and the State's *Single Audit Report*, for the year ended June 30, 2002. Our audit was made by authority of Article 5A of Chapter 147 of the General Statutes.

The results of these procedures, as described below, yielded audit findings and recommendations for the Department related to the State's financial statements and the State's federal financial assistance programs which may require disclosure in the aforementioned reports. The findings noted above are included in the findings and recommendations section contained herein. Our recommendations for improvement and management's response follow each finding.

We noted internal control weaknesses and instances of noncompliance in several federal programs. The deficiencies noted were as follows:

- Audit requirements incorrectly stated in subrecipient contracts.
- Required suspension and debarment certifications not obtained.
- Subrecipient monitoring procedures not documented.
- Funds provided to subrecipients without executed contract agreements.
- Equipment purchased without required approval.
- Time records not approved by supervisor.
- Year-end financial reporting process does not identify all liabilities.
- Unallowable costs charged to grant.
- Computerized system does not report testing results.

The accounts and operations of the Department of Transportation are an integral part of the State's reporting entity represented in the *CAFR* and the *Single Audit Report*. In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the results of tests on the State's internal control and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget Circular A-133.

As part of the work necessary for issuance of the *CAFR* and the *Single Audit Report*, the following individual funds and federal programs of the State were subjected to audit procedures at the Department of Transportation as we considered necessary:

Funds for the Comprehensive Annual Financial Report:

Special Revenue: State Highway Fund

Special Revenue: State Highway Trust Fund

General Fixed Asset Account Group

Federal Programs for the Single Audit Report:

Highway Planning and Construction Cluster

Highway Safety Cluster

Motor Carrier Safety Assistance Program

Public Assistance Grant

The individual funds and federal programs subjected to audit at the Department of Transportation are substantially less in scope than would be necessary to report on the financial statements that relate solely to the Department or the administration of federal programs by the Department. Therefore, we do not express such conclusions.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

Respectfully submitted,



Ralph Campbell, Jr.
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

Current Year Findings and Recommendations Also Reported in Prior Audit - The following findings and recommendations were identified during the current and prior audits and discuss conditions which represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, or grants.

1. AUDIT REQUIREMENTS INCORRECTLY STATED IN SUBRECIPIENT CONTRACTS

Audit requirements included in subrecipient contracts executed by the Department of Transportation's Governor's Highway Safety Program were inconsistent with federal requirements and contained inaccurate references to federal regulations. Misstated requirements could result in noncompliance at the subrecipient level.

OMB Circular A-133 requires pass-through entities to advise subrecipients of requirements imposed on them by federal laws and regulations. As of June 2002, the Department revised its contract forms used in subgranting funds to correctly communicate requirements.

Recommendation: The Department should ensure that the revised contract forms are used when contracting with subrecipients.

Agency's Response: We agree. Contract forms have been revised to correctly communicate requirements in all GHSP contracts.

2. REQUIRED SUSPENSION AND DEBARMENT CERTIFICATIONS NOT OBTAINED

The Department of Transportation did not obtain the required suspension and debarment certifications from subrecipients of Highway Safety Cluster Grant funds. Failure to secure certifications increases the risk that the Department may contract with or provide funds to subrecipients who have been denied participation by the federal government.

OMB Circular A-133 states that subrecipients must certify that the organization and its principles are not suspended or debarred. As of June 2002, the Department revised its contract forms used in subgranting funds to include the required certification.

Recommendation: The Department should ensure that the revised contract forms are used when contracting with subrecipients.

Agency's Response: We agree. The Department has revised its GHSP contract forms to include the required certification and has strengthened controls to ensure the use of the revised form.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

3. SUBRECIPIENT MONITORING PROCEDURES NOT DOCUMENTED

The Department of Transportation did not present adequate documentation to demonstrate that it performed sufficient monitoring of subrecipients of Highway Safety Cluster Grant funds. Subrecipients received \$11 million of grant funds during the fiscal year.

OMB Circular A-133 requires that a pass-through entity monitor subrecipient's activities to provide reasonable assurance that the subrecipient administers federal awards in compliance with federal regulations.

Since October 2002, new monitoring procedures have been developed that should improve the quality of monitoring and the documentation of procedures performed.

Recommendation: The Department should implement and evaluate the new monitoring procedures to ensure that documentation is present to support adequate monitoring of subrecipients.

Agency's Response: We agree. The GHSP form used to monitor the subrecipient has been revised to allow the Highway Specialist to document all necessary monitoring activities. Procedures are being developed and personnel are being trained to fully ensure that sufficient monitoring is performed and documented.

4. FUNDS PROVIDED TO SUBRECIPIENTS WITHOUT EXECUTED CONTRACT AGREEMENTS

Payments were made to three subrecipients for equipment purchases without a contract defining the allowable use of funds and requiring compliance with standards of accountability and compliance with federal regulations. Forty-nine CFR 18.20 sets forth standards for financial management systems in order to ensure that funds have not been used in violation of grant restrictions.

Established contract application and execution procedures were not followed in these three circumstances where grant funds, administered by the Governor's Highway Safety Program, were used. However, later in the year a specific contract was developed which established terms relating to equipment purchases.

Recommendation: The Department should execute an appropriate contract with each subrecipient organization to define accountability and compliance with federal regulations.

Agency's Response: We agree. The Department will strengthen controls to ensure that each GHSP subrecipient organization has an executed contract.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

5. EQUIPMENT PURCHASED WITHOUT REQUIRED APPROVAL

Several equipment items were purchased with Highway Safety Grant funds without the required federal approval. Twenty-three CFR 1200.21 requires that all equipment with an acquisition cost of \$5,000 or more must receive prior written approval from the National Highway Traffic Safety Administration (NHTSA).

Specifically, our testwork disclosed that two subrecipients were reimbursed without federal approval for two items with purchase prices of \$8,518 and \$19,669. Additionally, another subrecipient was reimbursed for four items, the cost of which exceeded the approved amounts by \$25,664. The total unapproved cost is \$53,851; we are questioning the federal share of \$29,055.

Department procedures have subsequently been enhanced to strengthen controls over the review of subrecipient requests for reimbursement to prevent payment for unapproved equipment items.

Recommendation: The Department should follow its revised procedures to ensure that subrecipients are reimbursed for equipment costs exceeding \$5,000 only when first obtaining NHTSA approval.

Agency's Response: We agree. The Department has received NHTSA approval for the above mentioned equipment items and has strengthened controls to prevent future payment of unapproved equipment items.

Other Current Year Findings and Recommendations - The following findings and recommendations were identified during the current audit and represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, or grants.

6. TIME RECORDS NOT APPROVED BY SUPERVISOR

A review of documentation to support payroll expenditures for 54 employees revealed six field payroll worksheets (FR-01 forms) which were not approved by the supervisor, an error rate of 11%. There is an increased risk of errors or irregularities in payroll expenditures when time and attendance records do not receive adequate review.

The Department of Transportation has not implemented adequate controls to ensure that documents used by the Department to record time and attendance are approved in accordance with their Field Fiscal Procedures Manual.

Recommendation: The Department should strengthen management oversight to ensure that established internal control procedures are followed regarding the approval of field payroll worksheets.

Agency's Response: We agree.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

7. YEAR-END FINANCIAL REPORTING PROCESS DOES NOT IDENTIFY ALL LIABILITIES

The Department of Transportation's method to identify liabilities at year-end does not consider all types of expenditure transactions. Therefore, liability and expenditure accounts reported in the State's Comprehensive Annual Financial Report are understated.

Upon review of a sample of expenditures subsequent to year end, we identified \$2.6 million in unrecorded liabilities.

Recommendation: The Department should develop a method to capture all liabilities at year-end and effectively implement procedures to achieve accurate financial reporting.

Agency's Response: We agree. Our review of outstanding liabilities at June 30, 2002 did not uncover some liabilities.

8. UNALLOWABLE COSTS CHARGED TO GRANT

The Department of Transportation reimbursed a subcontractor of Highway Safety Cluster Grant funds for office renovations, furnishings, and fixtures; these costs are unallowable according to federal regulations. The total cost of these items was \$21,000; we are questioning the federal share of \$15,750.

Twenty-three CFR 1200.20 states that cost principles set forth in applicable Department of Transportation or National Highway Traffic Safety Administration (NHTSA) orders govern the management of highway safety programs. The NHTSA Highway Safety Grant Funding Policy for Field-Administered Grants includes in its definition of unallowable costs, costs for construction, rehabilitation or remodeling for any buildings or structures or for purchase of office furnishings and fixtures.

Recommendation: The Department should strengthen its review of contract applications and subrecipient requests for reimbursements to prevent the approval and reimbursement of costs which are prohibited by federal regulations.

Agency Response: We agree. The Department is requesting the subrecipient to reimburse the amount of unallowable costs. The GHSP will strengthen its review of subrecipient requests for reimbursement to prevent future payment of unallowable costs.

9. COMPUTERIZED SYSTEM DOES NOT REPORT TESTING RESULTS

The computerized system used by the Department of Transportation (DOT) to collect the results of tests performed on highway construction materials and processes was unable to generate reports needed to evaluate compliance with testing standards. Without system reports which provide the nature and frequency of tests performed, the DOT cannot effectively determine if testing requirements have been met at the opportune time to implement corrective action and to maintain compliance with testing standards.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

These standards are part of a quality assurance program developed by the DOT and approved by the Federal Highway Administration for Federal-aid highway construction projects. According to the Department, a lack of programming resources delayed development of the reporting function in the Highway Construction and Materials System (HiCAMS). As of the end of February 2003, some reports are now available.

Twenty-three CFR 637.205 requires the DOT to develop a quality assurance program which will ensure that the materials and workmanship incorporated into each Federal-aid highway construction project on the National Highway System are in conformity with the requirements of the approved plans and specifications.

Recommendation: The Department should evaluate the information currently available from HiCAMS to determine if testing results are provided, as needed, to effectively monitor compliance with prescribed standards. Programming changes should be made, as necessary, to ensure that pertinent information can be retrieved.

Agency 's Response: We agree.

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

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The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
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Mr. Robert L. Powell	State Controller
Mr. Lyndo Tippett	Secretary, Department of Transportation

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Mr. James D. Johnson	Director, Fiscal Research Division

April 14, 2003

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