



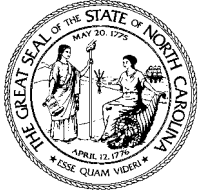
STATE OF NORTH CAROLINA

AUDIT RESULTS FROM
CAFR AND SINGLE AUDIT PROCEDURES
DEPARTMENT OF TRANSPORTATION
FOR THE YEAR ENDED JUNE 30, 2003

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

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April 14, 2004

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, 2003. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina 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 that required 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 noncompliance relating to the State's financial statements and also to some federal programs. The deficiencies noted were as follows:

- All time records were not approved.
- Employees were overpaid due to a clerical error.
- The Schedule of Expenditures of Federal Awards was overstated.
- A receipting function was not adequately segregated.
- The year-end financial reporting process did not identify all liabilities.
- A physical inventory was not performed on all types of capital assets.
- Subrecipient monitoring procedures were not documented.
- Required information was not filed with the Federal Aviation Administration.
- Testing standards were not met in accordance with the quality assurance program.
- Required suspension and debarment certifications were not obtained.
- Financial statements were not submitted timely.
- Inaccurate labor rates were used in calculation of grant charges.

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

Capital Assets Used in Governmental Activities

Federal Programs for the Single Audit Report:

Highway Planning and Construction Cluster

Airport Improvement 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.



Ralph Campbell, Jr.
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings and recommendations were identified during the current audit and describe conditions that represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, or grants. Finding numbers 1 and 5 were also reported in the prior year.

1. TIME RECORDS NOT APPROVED

A review of documentation to support payroll expenditures for fifty-four employees revealed four field payroll worksheets (FR-01 forms) that were not approved by the supervisor, an error rate of 8%. Additionally, three of these worksheets were not signed by the employee. There is an increased risk of errors or irregularities in payroll expenditures when time and attendance records do not receive adequate review.

The Department had not implemented adequate controls to ensure that documents used to record time and attendance were approved in accordance with its *Field Fiscal Procedures Manual*.

Recommendation: The Department should strengthen management oversight to ensure that established internal control procedures are followed regarding the approval of documents supporting time and attendance.

Agency's Response: NCDOT agrees the sample taken did not have the required signatures. A memorandum was sent through interoffice communications by the Secretary of Transportation November 19, 2003 to all areas. In the memo it was enforced that all employees must sign a timesheet with supervisor approval obtained prior to entry into the computer system.

2. EMPLOYEES OVERPAID DUE TO CLERICAL ERROR

The Department overpaid approximately 14,000 employees a total of \$1.7 million dollars in salaries during the fiscal year. The overpayment resulted from a clerical error in calculating total work hours in the fiscal year, a key factor used in the formula to allocate annual salaries to biweekly payrolls. Beginning in July 2002 and continuing throughout the fiscal year, each employee was overpaid by a rate, which, would accumulate to eight hours of additional pay over the period.

The Highway Planning and Construction Grant reimbursed the Department for \$318,771 of the overpaid salaries, and we question these costs. The Department refunded these costs in October 2003, by reducing a current federal billing by that amount.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

The Department also developed a process to recover the overpayment from the employees.

Recommendation: Internal controls should be implemented to ensure that data used in payroll calculations is accurate before computer applications are updated.

Agency's Response: NCDOT agrees with the finding. In May of each year, the Payroll Manager and the Payroll Accountant will calculate independently the work hours for the fiscal year. This will be presented to upper management for review.

3. SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS WAS OVERSTATED

Controls were not in place to ensure that the amounts recorded on the Schedule of Expenditure of Federal Awards (SEFA) were accurate. The OMB Circular A-133 requires that the SEFA be prepared to report the federal awards expended during the year. A computer program written to extract expenditures from the Department's new accounting system did not provide for a proper cutoff of qualifying expenditures at year-end. Therefore, expenditures for various programs totaling \$57 million were included in the SEFA that should not have been included until a subsequent year.

The Department corrected the programming error and produced a revised report, which was used to adjust the SEFA in November 2003.

Recommendation: The Department should adequately review and test computer programs to ensure accurate reporting in the future.

Agency's Response: Corrective action was initiated November 3, 2003 to correct the report in the financial system. Analysis by NCDOT staff will prevent this in the future.

4. RECEIPTING FUNCTION NOT ADEQUATELY SEGREGATED

The Division of Motor Vehicles' receipting function to process fees associated with online access to motor vehicle records had an inadequate segregation of duties. The accounts receivable clerk had conflicting duties in that this person prepared invoices, accepted cash receipts, prepared the receipt transmittal, prepared the bank deposit slips, and keyed data into the accounting system. Approximately \$15 million in checks were processed during the fiscal year. Inadequate segregation of duties can allow errors and irregularities to be concealed or undetected.

Recommendation: The Division of Motor Vehicles should segregate the duties relating to initiation, processing and recording of transactions to ensure the integrity of internal control over the receipting function.

Agency's Response: Duties were segregated November 22, 2003 in the Revenue and Collections Unit at DMV.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

5. YEAR- END FINANCIAL REPORTING PROCESS DID NOT IDENTIFY ALL LIABILITIES

The Department's method to identify liabilities at year-end did not effectively discover all outstanding obligations. Therefore, liability and expenditure accounts reported in the State's *Comprehensive Annual Financial Report* were understated.

Upon review of a sample of expenditures subsequent to year-end, we identified \$7 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: NCDOT will be reviewing the memorandums that are distributed throughout the Department to ensure they fully explain the information that is needed to accurately reflect good and services rendered for the year. Meetings will occur with the areas that resulted in the unrecorded liabilities. A review will take place for cost paid in July that must be included within the CAFR.

6. PHYSICAL INVENTORY NOT PERFORMED ON ALL TYPES OF CAPITAL ASSETS

The Department did not perform a physical inventory of motorized and construction equipment, buildings, and land in accordance with Office of State Controller (OSC) policies and procedures. An annual inventory is necessary to ensure that capital assets amounts recorded in the State's *Comprehensive Annual Financial Report (CAFR)* accurately represent assets owned and physically located in the Department.

Recommendation: The Department should include all types of capital assets in its annual inventory process to ensure that assets are accounted for and accurately reported in the *CAFR*. The process should be coordinated with the fiscal section to ensure that assets to be inventoried or verified agree with the accounting records. Office of State Controller procedures should be followed in conducting the inventory.

Agency's Response: NCDOT used information from the Department of Administration for land and buildings but did not have a formal count process in the fiscal year. A count process for land, buildings, and equipment assets will be completed in the fiscal year ending June 30, 2004.

7. SUBRECIPIENT MONITORING PROCEDURES NOT DOCUMENTED

The Department did not present adequate documentation to demonstrate that it performed sufficient monitoring of subrecipients of Airport Improvement Grant funds. This condition limits the Department's ability to ensure that funds granted to subrecipients are expended in accordance with grant requirements. Subrecipients received \$13.6 million of grant funds during the year.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

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.

Recommendation: Monitoring activities should be documented in a format that clearly defines the procedures performed, the results obtained, and the corrective action planned when instances of noncompliance are identified.

Agency's Response: NCDOT agrees with the finding. The Division of Aviation will develop and update forms to document monitoring of subrecipient activities. This will be complete by July 1, 2004.

8. REQUIRED INFORMATION NOT FILED WITH THE FEDERAL AVIATION ADMINISTRATION (FAA)

The Department did not submit the North Carolina Block Grant Status report, an annual report that lists the location of projects, project descriptions, and amount of federal funds applied to the projects. Additionally, the Department did not submit information requested for inclusion in the FAA's National Plan of Integrated Airport Systems and the Department's three-year capital improvement program. The Department's failure to submit the required information hampers FAA's ability to plan for the coming year and may jeopardize the Department's future funding.

A Memorandum of Agreement incorporated in grant agreements between the Department and the FAA requires submission of this information. The North Carolina Block Grant Status report is due by March 1 and the other information is due by March 31.

Recommendation: The Department should establish controls to ensure that the required information is prepared and submitted to the federal agency annually in accordance with the federal agreement.

Agency's Response: The FAA Memorandum of Agreement will be reviewed and updated if necessary to ensure all federal reports are submitted in accordance with the federal government. Quarterly meetings have been established with FAA to discuss programmatic issues. The first meeting will take place March 24, 2004.

9. TESTING STANDARDS NOT MET IN ACCORDANCE WITH QUALITY ASSURANCE PROGRAM

The Department of Transportation (DOT) did not present documentation to demonstrate that the required testing of highway construction materials was performed. This condition limits the Department's ability to ensure that materials used in construction projects conform to approved specifications. A review of information produced by the Highway Construction and Materials System (HiCAMS) for aggregate types used in current contracts indicated:

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- The required numbers of Independent Assurance (IA) tests were not performed on materials received for two of seventeen contracts reviewed.
- Test results generated by the system for the Quality Control (QC) tests were inconsistent and unreliable. This condition caused the Department to request manual documentation from the plants/quarries to document that the required testing was performed on materials used for five contracts. At the completion of our field work, documentation had not been received from two plants/quarries.
- The required numbers of acceptance tests were not performed on materials received for ten of seventeen contracts reviewed. Acceptance or roadway tests entered at the division level were not always coded to the correct material description, therefore testing results did not demonstrate that adequate testing was done on each specific material type.
- The system showed substantial variances in the quantities shipped and quantities accepted through testing in five of seventeen contracts sampled. Overstatements in quantities accepted occur when the maximum quantity applicable to a test is entered into the system instead of the actual quantity represented by the test. Additionally, the system is not properly calculating the quantities accepted for contracts which began before the HiCAMS system was implemented.

The testing 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. 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: Internal controls should be enhanced to ensure that testing information is accurately entered into HiCAMS and that the required numbers of tests are performed in accordance with standards approved by the Federal Highway Administration for Federal-aid highway construction projects. Programming changes should be made, as necessary, to ensure that system output is accurate and consistent.

Agency's Response:

- The audit identified that the required number of IA test was not performed on one contract for "Aggregate Base Course" and "Aggregate Base Course, Type A". The quantity of "Aggregate Base Course" for this contract was overstated in HiCAMS as discussed in item three below. Based upon corrected records, an IA sample is not required for "Aggregate Base Course". The IA inspector was not able to obtain the required number of "Aggregate Base Course, Type A" samples before the material was covered with pavement.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Corrective Action: Better communication between project personnel and the IA inspector is needed to insure all samples are taken prior to the material being covered. This issue has been discussed with the IA Inspector for the contract identified in the audit report. No other action is planned unless additional instances of inadequate IA tests are identified.

- Corrective Action: The Department's QC staff will identify specific instances of inconsistent and unreliable test results that are produced by HiCAMS. Defects in current functionality are classified as "production problems" and will be corrected as soon as possible. Correction of any defects should be implemented with the next version of HiCAMS, which is scheduled to be deployed September 2004.

If additional HiCAMS functionality is needed for reporting the QC test results, development of those function(s) will be included in the project plan and implemented consistent with the priority of the function(s) and available resources.

- Six of ten contracts identified as not having the required number of acceptance tests performed were impacted by the improper material being identified for "Incidental Stone Base". When HiCAMS was initially deployed, the proper material was not available. The proper material was made available three years ago but was not added to existing contracts. Reporting of the quantity of materials incorporated into projects through HiCAMS continues to be adversely impacted on contracts that were originally established with the improper material. Compliance with the Minimum Sampling Guide cannot be accurately monitored without proper reporting of material.

In other instances, users have selected incorrect materials as being used in the work, which gives the appearance that the required number of tests were performed for the material.

The required number of acceptance tests were not performed on materials for at least four of seventeen contracts reviewed.

Corrective Action: A systematic review is being made of the HiCAMS data to identify instances of the improper material being reported. When an instance of the improper material being reported is identified that affects fewer than five records, the records will be corrected immediately. When an instance of the improper material being reported is identified that affects five or more records, the HiCAMS staff will run an automated procedure within 30 days to correct the records.

The HiCAMS staff provided initial user training for HiCAMS applications. The need for additional HiCAMS training was identified more than a year ago, but has not been provided because of HiCAMS staff reduction. The Construction Unit staff is currently developing HiCAMS training material, and initial instruction will be provided to staff in each Resident Engineer's office by July 1, 2004. By December 1, 2004, at least two employees in each highway division will be provided detailed training for HiCAMS

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

applications. The employees who receive the detailed training will serve as a resource for other employees in their respective division.

The importance of performing sampling and testing in accordance with the Minimum Sampling Guide will be discussed with the staff of each Resident Engineer's office by July 1, 2004. A follow-up review of compliance with the Minimum Sampling Guide will be made by April 1, 2005.

- By July 1, 2004, the staff of each Resident Engineer's office will be provided instruction for determining the quantity of material represented by samples of various types of material.

10. REQUIRED SUSPENSION AND DEBARMENT CERTIFICATIONS WERE NOT OBTAINED

The Department of Transportation did not obtain the required suspension and debarment certifications from some subrecipients and contractors. Failure to secure the required debarment certifications increases the risk that the Department may contract with or provide funds to debarred companies or subrecipients. Our test work revealed:

- Certifications were not incorporated in subgrantee applications or contract agreements used by the Aviation Division to provide Airport Improvement Program funds to local airports.
- Contracts in excess of \$100,000 issued through the Utilities Unit, Rail Division, Office of Natural Environment, and three contracts prepared in divisions, but processed through the Purchasing Section, did not include certifications. These contracts were funded by the Highway Planning and Construction Grant.
- Four vendors funded by the Public Assistance Grant received amounts in excess of \$100,000 without making the required certifications.

OMB Circular A-133 states that contractors receiving individual awards for \$100,000 or more and all subrecipients must certify that the organization and its principles are not suspended or debarred.

Recommendation: The Department should implement procedures to ensure that persons with whom it intends to do business are not excluded or disqualified from doing business with the federal government. This requirement currently applies to all contracts with subrecipients and all procurement contracts over \$25,000.

Agency's Response: NCDOT is implementing measures to include the debarment clause in agreements.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

11. FINANCIAL STATEMENTS NOT SUBMITTED TIMELY

The Department did not submit timely to the Office of the State Controller (OSC) its financial statements for the fiscal year ended June 30, 2003. This condition jeopardizes the timely completion, audit and issuance of the State's *Comprehensive Annual Financial Report*. General Statute 143-20.1 requires agencies to prepare financial statements within sixty days after the fiscal year end. This year's deadline was August 29, 2003 however the statements were not submitted to OSC until September 11, 2003.

The Department implemented a new internal financial accounting system in April 2003. Situations encountered in the process prevented the Department from closing its books on the internal system in a timely manner. This prevented the fiscal staff from obtaining information necessary to complete the financial statements for OSC in a timely manner.

Recommendation: The Department should make efforts to ensure that the internal financial system is closed early enough to allow for timely completion of the financial statements.

Agency's Response: NCDOT is putting measure in place to meet the deadline in subsequent years.

12. INACCURATE LABOR RATES USED IN CALCULATION OF GRANT CHARGES

The Department did not have controls in place to ensure that current labor rates were used when calculating overtime labor costs charged to the Public Assistance Grant. The Department used labor rates published in August 1999 when calculating overtime labor costs applicable to the December 2003 Ice Storm. The labor rates are updated annually.

The use of incorrect rates resulted in incorrect charges to the grant; in this instance the result was an undercharge of \$3,300.

Recommendation: The calculation of the costs of overtime labor has now been automated. The Department should ensure that the rates used by the accounting system are updated when new rates are published to provide for accurate calculation of grant expenditures.

Agency's Response: Controls are now in place due to the implementation of a new accounting system and manual calculations for overtime will no longer be required.

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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April 29, 2004

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