



# **STATE OF NORTH CAROLINA**

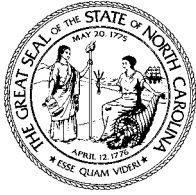
## **RESULTS OF STATEWIDE FINANCIAL AUDIT PROCEDURES AT THE DEPARTMENT OF TRANSPORTATION**

**FOR THE YEAR ENDED JUNE 30, 2004**

**OFFICE OF THE STATE AUDITOR**

**LESLIE W. MERRITT, JR., CPA, CFP**

**STATE AUDITOR**



STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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April 7, 2005

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 of North Carolina reporting entity as presented in the *Comprehensive Annual Financial Report (CAFR)* and *Single Audit Report* for the year ended June 30, 2004. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts and grants applicable to the State's financial statements and to its federal financial assistance programs. Our 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 the Single Audit Act as applicable. Our audit scope at the Department of Transportation included the following:

State of North Carolina's Financial Statements

*Special Revenue: State Highway Fund*  
*Special Revenue: State Highway Trust Fund*  
*Capital Assets Used in Governmental Activities*

State of North Carolina's Administration of Federal Financial Assistance Programs

*Highway Planning and Construction Cluster*  
*Airport Improvement Program*

Our audit procedures at the Department of Transportation were less in scope than would be necessary to report on the financial statements that relate solely to the Department or its administration of federal programs. Therefore, we do not express such conclusions.

The results of our audit procedures yielded audit findings and recommendations for the Department related to the State's financial statements and federal financial assistance programs that may require disclosure in the aforementioned reports. These findings are included in the findings and recommendations section contained herein. Our recommendations for improvement and management's response follow each finding.

*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.

A handwritten signature in black ink that reads "Leslie W. Merritt, Jr." in a cursive script.

Leslie W. Merritt, Jr., CPA, CFP  
State Auditor

## AUDIT FINDINGS AND RECOMMENDATIONS

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### **Matters Related to Financial Reporting or Federal Compliance Objectives**

The following findings and recommendations were identified during the current audit and discuss conditions that represent deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants. Finding numbers 1, 3, 4 and 5 were also reported in the prior year.

#### 1. SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS WAS MISSTATED

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. Changes made to correct a prior year error in a computer program were not effectively communicated to the employee responsible for preparing the SEFA. Therefore, a computer program meant only for use in fiscal year 2003 was used to extract information for the fiscal year 2004 SEFA. As a result, expenditures for various programs totaling \$195 million were omitted from the SEFA.

The Department produced a revised report, which was used to adjust the SEFA in October 2004.

*Recommendation:* Changes made in computer programs should be communicated to users to enable adequate review and testing. Transactions linking to computer operations that have been superceded should be removed from the accounting system to eliminate confusion and prevent incorrect selection.

*Agency's Response:* NCDOT agrees with the finding. IT staff will remove the ability to run the system generated report from user access. Additional management review is required prior to submitting the schedule.

#### 2. RECEIVABLE FROM FEDERAL GOVERNMENT NOT RECORDED

The Department did not have a process to identify and accrue amounts due from the federal government at year end. Therefore, receivable and revenue account balances submitted for inclusion in the State's *Comprehensive Annual Financial Report* were understated.

Our review of billings after year end identified \$19.6 million in unrecorded receivables. Adjustments were made to correct affected accounts.

## AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

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*Recommendation:* The Department should develop a method to identify amounts due from the federal government at year end and ensure that appropriate accrual entries are made to achieve accurate reporting.

*Agency's Response:* NCDOT agrees with the finding. Federal Highway Administration billings will be timed to record receivable and revenue account balances in the applicable fiscal year and accrual entries will be posted if applicable.

### 3. 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 account balances submitted for inclusion in the State's *Comprehensive Annual Financial Report* were understated.

Upon review of a sample of expenditures subsequent to year end, we identified \$17.6 million in unrecorded liabilities. Adjustments were made to correct affected accounts.

*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 agrees with the finding. The Department will analyze financial transactions in further detail for non-purchase order items to report all liabilities in the fiscal year.

### 4. LAND BALANCES NOT VERIFIED

Controls were not in place to ensure the accuracy of all land recorded on the Department's financial statements. The Department recorded \$11 million of land based on information obtained from the Department of Administration State Property Office without performing any kind of inventory or verification process to corroborate completeness and accuracy.

*Recommendation:* The Department should perform an inventory to determine if land recorded on the financial statements is fairly stated. Differences should be resolved with the Department of Administration State Property Office.

*Agency's Response:* NCDOT agrees with the finding. An internal audit process has been defined within the Department to ensure accuracy of the land recorded on the financial statements. Discrepancies will be identified and resolved with the Department of Administration.

## **AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)**

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### **5. 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 in the Highway Construction and Materials System (HiCAMS) for aggregate types used in current contracts indicated:

- The required number of Producer's Quality Control (QC) tests was not performed by four of 39 producers reviewed. These tests are used by the producer to monitor the quality of material being shipped to projects or placed in an approved stockpile. These test results should be provided to DOT;
- The required number of DOT's Quality Assurance (QA) tests was not performed on materials received from two of 39 producers tested. These tests are used by DOT to verify the performance of the Producer's Quality Control plan;
- The required number of Roadway Quality Assurance (RA) tests was not performed on materials received for eight of 39 contracts reviewed. These tests are performed to verify the quality of the in-place material used on a specific project;
- The required number of Independent Assurance (IA) tests was not performed on materials received for 11 of the 17 affected federal contracts. The IA tests are to provide an independent test to verify the performance of DOT's acceptance program to the Federal Highway Administration;
- Materials received at the division level were not always coded to the correct material description. Since some testing requirements vary by material type, accuracy is important to ensure that adequate testing is done on each specific material type.

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. Title 23 CFR section 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.

## **AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)**

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*Agency's Response:* Training was provided in 2004, by Construction Unit staff to at least one member of each Resident Engineer and District Engineer that regularly administers highway construction contracts. The training addressed the Minimum Sampling Guide requirements, recommended frequency for reviewing compliance with those requirements, and the procedure for auditing materials through HiCAMS.

New HiCAMS functionality was deployed in December 2004, to evaluate compliance with material sampling and testing requirements. By April 1, 2005, we will survey the users as to the adequacy of the new functions and consider modification based upon the survey results.

During the 2004, audits of the Resident Engineer's contract procedures by Construction Unit and M&T staff, emphasis was placed the importance of compliance with the sampling and testing requirements. During the 2005, audits of the Resident Engineer's contract procedures by Construction Unit, a single contract was reviewed for compliance with the sampling and testing requirements. Results of the 2005, audits will be evaluated not later than May 1, 2005, to determine if additional action is required.

During 2005, each Section Material Specialist will audit at least one contract per month to determine compliance with material sampling and testing requirements. Results of these audits will be evaluated not later than July 1, 2005, to determine if additional action is required.

Construction Unit staff will provide training to each Resident Engineer and District Engineer that regularly administers highway construction contracts. The training will cover the use of the new HiCAMS functions and method for correcting deficiencies. Training will be completed not later than November 30, 2005.

Materials Inspectors will closely monitor the plants QC sample frequency for compliance with the Producer's Quality Control plan and reporting of test results. This will also allow QA samples to be taken at the appropriate time.

A plan will be developed and implemented for monitoring that the IA sampling frequency is in compliance with the requirements. A follow-up review of the IA performance will be by August 1, 2005, and additional action will be taken if the sampling frequency is not within compliance.

## **DISTRIBUTION OF AUDIT REPORT**

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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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Lieutenant Governor of North Carolina  
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State Budget Officer  
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Director, Fiscal Research Division

April 13, 2005



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