



STATE OF NORTH CAROLINA

DEPARTMENT OF TRANSPORTATION

STATEWIDE FINANCIAL AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2006

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



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February 28, 2007

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Lyndo Tippett, 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, 2006. 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

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 audit 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.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
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 discuss conditions that represent deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants. Both findings were also reported in the prior year.

1. 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, a condition that has been reported for the past four years.

Upon review of a sample of expenditures subsequent to year end, we identified \$23.9 million in unrecorded liabilities. While over \$300 million of liabilities were identified and recorded at year end, the portion applicable to the Highway Fund required adjustment.

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: The Department did not include 23.9 million in outstanding obligations for FY05-06. The majority of these items were division purchase order contracts that were not identified in the year-end manual analysis. The total audit finding is seven percent of the total outstanding obligation accruals (\$307 million) identified by the Department. Procedures have been put in place to identify these items in the future. An Auditor adjustment was made to final CAFR statements.

2. 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 Roadway Quality Assurance (RA) tests was not performed on materials received for two of 15 contracts reviewed. These contracts were funded by federal identification numbers 0049(007), 0055(024), and 0055(028) authorized on 5/15/2002, 2/20/2003 and 2/7/2003, respectively.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- 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 three of the 15 affected federal contracts. Insufficient testing was cited on one of these contracts in the prior year. These contracts were funded by federal identification numbers 0055(024), 0055(028), 0150(015) and 0854(077) authorized on 2/20/2003, 2/7/2003, 10/29/2003 and 2/11/2003, respectively. The IA tests are to provide an independent test to verify the performance of DOT's acceptance program to the Federal Highway Administration.

Documentation of adequate testing has been an issue with aggregate types for the past four years. Improvements were noted in the Quality Assurance (QA) tests used by the Department to verify the performance of the Producer's Quality Control plan, so no issue is cited this year. The error rate for RA tests is comparable with the prior year while the error rate for IA tests has substantially decreased.

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: Efforts should be continued to enhance internal controls and monitor compliance with requirements 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.

Agency's Response: The audit identified that the required number of Roadway Quality Assurance (RA) tests was not performed on materials received for two of fifteen contracts reviewed, and we take no exception to this finding. However, for one of the two deficient contracts, we noted that the RA samples taken over the contract duration represent 65,000 tons and 68,252 tons of ABC was used.

A portion of the aggregate for which RA samples were not taken was used for undercut backfill. While the specification for this work specifies that the aggregate meet the gradation for Aggregate Base Course, the Minimum Sampling Guide specifies the sampling be performed in accordance with the procedure for Select Material, Class IV, which does not require RA samples. The undercut backfill aggregate was reported as Aggregate Base Course (ABC), but should have been reported as Select Material, Class IV with RA samples not required. The extent to which this error has occurred will be determined and the data corrected if warranted.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

As part of its annual audits of contract administration procedures in each Resident Engineer Office, the Construction Unit staff will audit conformance with the Minimum Sampling Guide (MSG) for ABC. The results will be included in the audit summary and will be discussed during the review with the Division Construction Engineer. The audits are expected to be complete by April 1, 2007.

The Construction Unit Staff is conducting training for field personnel on the proper procedure for auditing material in HiCAMS. Special emphasis will be placed on sampling in accordance with the MSG. The training will continue as needed, but at least until January 1, 2008.

In March 2006, the Independent Assurance (IA) Section of the Materials & Tests Unit was completely restructured and placed under the Section Materials Specialists. This provides greater supervision and allows reallocation of human resources to meet the needs. The importance of complying with the IA program was stressed to the responsible staff. Materials and Tests Unit management monitored compliance after the reorganization until June 30, 2006, and the performance was judged acceptable. The Materials and Tests Unit management will continue to monitor performance and further action will be taken if the performance does not remain acceptable. Further investigation into these contracts found that all three IA deficiencies occurred prior to the reorganization of the IA Section in March 2006. It is our expectation that the Department will continue to see a decrease in the number of discrepancies in the IA samples as compared to years past.

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