



STATE OF NORTH CAROLINA

DEPARTMENT OF TRANSPORTATION

STATEWIDE FINANCIAL AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2007

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



STATE OF NORTH CAROLINA
Office of the State Auditor

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

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

March 20, 2008

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, 2007. 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: Highway Fund

Special Revenue: 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

Highway Safety 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 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 Responses section of this report.

We noted certain other matters that we reported to management of the Department of Transportation in separate letters dated January 18, 2008 and February 29, 2008.

The Department of Transportation's responses to the findings identified in our audit are included in the Audit Findings and Responses section of this report. We did not audit the responses, and accordingly, we express no opinion on them.

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." with a stylized flourish at the end.

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

AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings were identified during the current audit and discuss conditions that represent significant deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants. Finding number 1 was 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 five years. While the condition continues to exist, the Department did make considerable improvement in its process this year.

The Department had recorded over \$249 million in accounts payable at year-end. Upon review of a sample of 51 expenditures subsequent to year-end, we identified 12 payments totaling \$2.9 million in unrecorded liabilities. The amounts identified or the projected misstatements were not material to the financial statements.

Recommendation: The Department should continue in its efforts to capture all liabilities at year-end and effectively implement procedures to achieve accurate financial reporting.

Agency Response: The Department did not include \$2.9 million in outstanding obligations for FY 2006-2007. The majority of these items were contract payments that were not identified in the year-end manual analysis. The total audit finding is one percent of the total outstanding obligation accruals (\$249 million) identified by the Department. Procedures have been put in place to review year-end estimates of accounts payable. Due to the lack of materiality, no audit adjustment to the final CAFR statements was required.

2. SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS CONTAINED ERRORS

We identified a number of misclassifications in the agency's Schedule of Expenditures of Federal Awards (SEFA):

- Expenditures totaling \$1,738,780 which should have been classified under CFDA 20.604 were classified under CFDA 20.605.
- Expenditures totaling \$1,434,182 which should have been classified under CFDA 20.609 were classified under CFDA 20.604.
- Expenditures totaling \$93,508 which should have been classified under CFDA 20.602 were classified under CFDA 20.601 and CFDA 20.605.

Controls were not in place to ensure that the Schedule of Expenditures of Federal Awards (SEFA) was prepared in accordance with federal requirements. As a result, expenditures for the Highway Safety Cluster were incorrectly classified on the SEFA. OMB Circular A-133 requires that the SEFA provide total federal awards expended for each individual federal program. Each section of the Highway Safety Cluster is assigned a specific section number based on the federal law or regulation that authorized the program.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Recommendation: The Department should implement controls to ensure that the SEFA is prepared in accordance with federal requirements and that expenditures are correctly classified to the CFDA programs.

Agency Response: We agree. The Department assigns the CFDA number at the time a detail fund is established in the accounting system. The Department also reports at year end, as part of the Single Audit Reporting package, a Schedule of Expenditures of Federal Awards, which includes federal amounts by CFDA number. This report goes to the Office of State Controller and Office of State Auditor. The Department encountered issues with the conversion to the SAP R3 accounting system and some of the detail funds were loaded with incorrect CFDA numbers.

3. LEVEL OF EFFORT NOT MAINTAINED FOR HIGHWAY SAFETY CLUSTER GRANT

The Department did not maintain the level of effort for two components of the Governor's Highway Safety Program group as required by federal regulations.

- Total funds spent on Alcohol Traffic Safety for Fiscal Year 2006 was \$254,409. This is \$152,781 less than the amount that should have been spent.
- Total funds spent on Occupant Protection for Fiscal Year 2006 was \$495,670. This is \$196,303 less than the amount that should have been spent.

Federal regulations require the State to maintain its level of expenditures for alcohol traffic safety programs and occupant protection programs at or above the average level of expenditures for these activities in fiscal years 2003 and 2004.

This finding impacts grant award year 2006.

Recommendation: The Governor's Highway Safety Program Group should institute controls to ensure that the Level of Effort is maintained.

Agency Response: We agree. Late funding (January 2006) from the federal government in FY 2006 caused the level of effort of the Governor's Highway Safety Program (GHSP) to slip below the required levels in base alcohol and occupant protection funding. GHSP will institute controls on the front end of the planning process to assure that an appropriate minimum amount of funding is placed on the program areas that are affected by the requirements. Currently, the GHSP will be concerned with Section 402 funding in the Alcohol, Occupant Protection, Motorcycle, and Traffic Records Sections of the Highway Safety Plan in order to match special funding received in each of these program areas.

4. FEDERAL BILLINGS EXCEEDED ACTUAL COSTS

During our test of 64 transactions totaling \$2,068,142 we found that in 12 cases the expenditures billed to the National Highway Traffic Safety Administration (NHTSA) were either under or over the actual costs.

- There were six transactions, totaling \$16,395, where the amount billed to NHTSA was greater than actual expenditures.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

- There were six transactions, totaling \$1,997 where the amount billed to NHTSA was less than actual expenditures.

The billing process used by the Department caused the errors noted above. Amounts requested were based on the actual cost multiplied by the budgeted federal percentage for the total project. Differences occurred when specific costs within a project had different federal percentages and the actual amounts spent were not in the same proportion as the budgeted amounts.

We did not find any instances where the total amount billed for a project exceeded the award amount. However, the amounts over billed should have been considered as amounts to be carried over to the next year.

OMB Circular A-87 requires federal reimbursements to be based on actual cost incurred. Therefore, we question cost of \$16,395, which is the amount that the amounts billed exceeded the actual costs.

This finding impacts grant award year 2007.

Recommendation: The Department should review expenditure and billing transactions to ensure that only actual costs are billed to the National Highway Traffic Safety Administration (NHTSA).

Agency Response: We agree. An accounting system programming change caused multiple matching GHSP grants to local agencies to be billed incorrectly beginning in FY 2007. GHSP will modify match requirements to have only one level of match required for each project.

5. INTERNAL CONTROL OVER PROCUREMENTS NEEDS IMPROVEMENT

Items purchased with Highway Safety Program funds did not always have the appropriate approval. Additionally, the Department did not always document invoice approvals either on the face of the invoice or in the accounting system. Our review of 10 procurement transactions revealed the following:

- Two transactions were given the incorrect code and therefore they were not routed to the federal funds management unit for review and approval.
- Two transactions had no documentation of any invoice approval.

Department policy requires federally funded purchase requisitions to be reviewed by the federal funds management unit before being converted to a purchase order.

Good internal controls dictate that invoice approvals need to be documented either in the system or on the face of the invoice to attest to the fact that the invoice is valid and ready for payment.

This finding impacts grant years 1998-2003.

Recommendation: The Department should implement controls to ensure that purchase requisitions are assigned the proper code so that they are reviewed and approved at all required levels. In addition, the Department should implement controls to ensure that there is documentation of invoice approvals.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency Response: We agree. Controls should be in place to ensure there is correct coding and documentation of invoice approvals.

6. DEFICIENCIES NOTED IN SUBRECIPIENT MONITORING

The Department did not ensure that subrecipients of the Highway Safety Cluster were made aware of all identifying award information or that subrecipients were adequately monitored. Our review revealed the following:

- Twenty-one of 64 contracts examined did not identify the Catalog of Federal Domestic Assistance (CFDA) number that was applicable to the subrecipient's award. In addition, the identification of the CFDA numbers provided in the Governor's Highway Safety Program Manual for Project Directors was incorrect. The new programs added to the Highway Safety Cluster were not included and other programs were referenced to incorrect CFDA numbers.
- Six of 64 subrecipient projects showed no evidence of monitoring to ensure compliance with grant requirements.
- Twenty-nine of 60 subrecipients did not receive a Performance Management Review (PMR) or failed to receive the number of reviews specified in the Governor's Highway Safety Program Policy and Procedure Manual.

OMB Circular A-133 requires pass-through entities to inform each subrecipient of the CFDA title and number, award name and number, the name of the federal funding agency, and the requirements imposed on them by federal laws and regulations. In addition the Circular also requires pass-through entities to monitor subrecipient activities to ensure that federal awards are used in accordance with federal laws and regulations.

The Governor's Highway Safety Program Policy and Procedure Manual states that Project Management Reviews are to be conducted and documented for each approved contract during a fiscal year. Non-personnel contracts should receive a minimum of one Project Management Review and contracts that involve personnel should receive a minimum of two Project Management Reviews during a fiscal year.

In addition, subrecipients were reimbursed even though they did not submit all documentation required by the Department. The missing documents were to provide evidence that the costs claimed were allowable or that the project is progressing as it should.

- Sixteen out of 64 reimbursement requests tested were not supported with approved timesheets as required.
- Seventeen of 60 subrecipients failed to submit the required monthly, quarterly, and/or final accomplishment reports. These subrecipients were still reimbursed although the Governor's Highway Safety Program Manual for Project Directors stated that they would be subject to having reimbursements withheld for failure to submit required reports.

The Governor's Highway Safety Program reimbursement form instructions and Manual for Project Directors requires that invoices, receipts, timesheets, and other items necessary to substantiate the subrecipient's claim must accompany the request for reimbursement. In addition, the manual also states that subrecipients are required to submit quarterly progress reports and a final accomplishments report.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Recommendation: The Department should ensure that subrecipients are made aware of identifying award information related to their subaward. Additionally, the Department should implement controls to ensure that subrecipients are monitored for compliance with program requirements. The Department should request the required documentation if not submitted with reimbursement requests

Agency Response: We agree. Controls should be in place to ensure that there is correct use and application of CFDA numbers, appropriate levels of subrecipient monitoring, and sufficiency of documentation with monthly, quarterly, and final reports.

[This Page Left Blank Intentionally]

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Telephone: 919/807-7500

Facsimile: 919/807-7647