



STATE OF NORTH CAROLINA

DEPARTMENT OF TRANSPORTATION

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF TRANSPORTATION

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR



Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the 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>

AUDITOR'S TRANSMITTAL

The Honorable Beverly Eaves Perdue, Governor
Members of the North Carolina General Assembly
Mr. Eugene A. Conti, Jr., 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 *Single Audit Report* for the year ended June 30, 2009. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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 major federal 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.

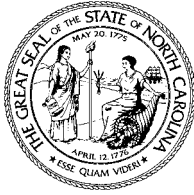
Our audit objective was to render an opinion on the State of North Carolina's administration of major federal programs and not the Department's administration of major federal programs. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

The audit findings referenced in the report are also evaluated to determine their impact on the State's internal control and the State's compliance with rules, regulations, contracts, and grants. If determined necessary in accordance with *Government Auditing Standards* or the Single Audit Act, these findings are reported in the State's *Single Audit Report*.

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 cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the 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>

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Mr. Eugene A. Conti, Jr., Secretary
and Management of the Department of Transportation

Compliance

As part of our audit of the State of North Carolina's compliance with the types of requirements described in the *OMB Circular A-133 Compliance Supplement* that are applicable to each of its major programs for the year ended June 30, 2009, we have performed audit procedures at the Department of Transportation. Our report on the State of North Carolina's compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 is included in the State's *Single Audit Report*. Our federal compliance audit scope at the Department of Transportation included the following:

- Highway Planning and Construction Cluster
- Formula Grants for Other Than Urbanized Areas

The audit results described below are in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of compliance with those requirements.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

The results of our audit procedures at the Department of Transportation disclosed instances of noncompliance that are required to be reported in accordance with OMB Circular A-133 and which are described in findings 1 and 4 in the Audit Findings and Responses section of this report.

Internal Control Over Compliance

Management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

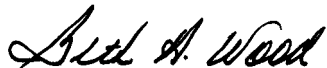
A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in findings 1 through 4 in the Audit Findings and Responses section of this report to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the Audit Findings and Responses section of this report, we consider findings 1 and 4 to be material weaknesses.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

Management'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.

This report is intended solely for the information and use of management, Mr. Conti, others within the entity, the Governor, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Beth A. Wood". The signature is written in a cursive, flowing style.

Beth A. Wood, CPA
State Auditor

March 17, 2010

[This Page Left Blank Intentionally]

AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

1. TESTING STANDARDS WERE NOT MET

The Department did not always perform the required testing for materials used in contracts funded by the Highway Planning and Construction grant. The failure to meet the requirements limits the Department's ability to ensure that materials used in construction projects conform to approved specifications.

Our test of the Department's testing of Portland cement (cement specified for making the concrete pavement in roads) used in the three federally funded highway paving contracts revealed that the number of Portland cement samples taken for two contracts did not meet the Department's minimum material and test requirements. The testing is necessary to determine that the cement contains the specified level of ingredients. The errors noted are described below:

- The Department should have taken 56 cement powder samples for Acceptance testing and 6 cement powder samples for Independent Assurance testing for one contract. The Department did not take any cement powder samples for this contract.
- The Department should have taken 58 cement powder samples for Acceptance testing and 6 cement powder samples for Independent Assurance testing for the other contract. The Department took 29 cement powder samples for Acceptance testing and exceeded the requirement for Independent Assurance by testing 19 samples.

Title 23 CFR section 637.205 requires the Department to have a testing program for construction projects to ensure that materials and workmanship conform to approved plans and specifications.

This audit finding was also reported in the prior year.

Federal Grant Award Information: Highway Planning and Construction 2009

Recommendation: The Department's Materials and Tests unit should formalize a monitoring procedure to ensure that the correct number of material samples is taken for all Federal Highway Administration funded projects.

Agency Response: The Materials and Tests Unit implemented a quarterly audit process in June 2009 that impacts the 51 Resident Engineer offices throughout the State. In these audit sessions the Section Materials Specialists reviews records to verify compliance with the Minimum Sampling Guide. In addition the Section Materials Specialists will begin monthly project reviews of pertinent data in the Highway Construction and

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Materials System database (HiCAMS) in April 2010. Issues discovered through this review will be identified for resolution.

NCDOT implemented a reorganization plan last year to provide an additional concrete technician to assist with the Assurance Sampling for concrete pavement. In addition a bi-annual audit, performed by the Field Operations Engineer who manages the Section Materials offices across the State, was implemented. We will combine these efforts with formal training for all Section Materials staff emphasizing the importance of compliance with the Independent Assurance Program.

Training workshops for Resident Engineers is underway throughout the State that includes a presentation on the importance of compliance with the Minimum Sampling Guide and the consequences of non-compliance. The Chief Engineer of Operations will address this finding and the Department's corrective action plan at an Operations staff meeting. This action will ensure support of the 14 Division Engineers along with their respective staff members.

In February 2010, a work group was formed at Materials and Tests to make recommendations based on risk factors in order to better evaluate and address business practices inclusive of concrete pavement and other concrete elements that contain Portland cement.

2. FAILURE TO COMPLY WITH FEDERAL SUSPENSION AND DEBARMENT REQUIREMENTS

The Department did not ensure that the federal suspension and debarment requirements were met for a number of contracts funded by Highway Planning and Construction funds. The failure to comply with these requirements heightens the risk that the Department may have contracted with suspended or debarred parties.

The Department did not verify that vendors receiving contracts in the Traffic Control Unit were not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System maintained by the General Services Administration, collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity. Our review of the Excluded Parties List System revealed that none of the contractors tested were debarred. Federal expenditures for these contracts totaled \$4,792,739.

Federal Grant Award Information: Highway Planning and Construction 2009

Recommendation: The Department should establish and implement procedures to ensure compliance with federal suspension and debarment regulations in all units.

Agency Response: Agency review validated the debarment clause was not found on five agreements executed in 2005 for Traffic Control services and the vendors were not debarred parties. The formation of a centralized Program Management Office in 2008

AUDIT FINDINGS AND RESPONSES (CONTINUED)

will ensure debarment requirements are clearly defined consistently for agreements with third parties.

3. FINANCIAL STATUS REPORTS CONTAINED ERRORS

The Department did not accurately report the unobligated balance of federal funds and unliquidated obligations on its financial status report submitted for the Formula Grants for Other Than Urbanized Areas program. Errors in the report reduce the usefulness of the data to the users.

The Department reported \$14,545,087 as the recipient and federal share of unliquidated obligations in its report for the quarter ending June 30, 2009. This amount was overstated by \$3,578,155. The amount reported for the unobligated balance of federal funds was understated by 3,225,509.

The Department made similar errors in all financial status reports submitted during the audit year for this program. It was not until the current year through a training session that the Department learned that for reporting purposes, amounts are not considered obligated until they are funded to a specific project. Therefore, unliquidated amounts are the amounts that have been funded to projects but not expended.

Title 49 CFR section 18.20(b) of the Code of Federal Regulations states that accurate, current, and complete disclosure of the financial results of financially assisted activities must be in accordance with the financial reporting requirements of the grant.

Federal Grant Award Information: NC -18-X028 FY 2009

Recommendation: The Department should ensure that amounts reported are in accordance with federal requirements. The Department should contact the federal agency to determine if a revised report is necessary or if the changes can be reflected on the next cumulative report.

Agency Response: The Public Transportation Division staff has corrected this error in the Financial Status Reports submitted to the Federal Transit Administration (FTA) for the 1st quarter of FY10 at the end of January 2010. We will report only obligated funds expended and unliquidated obligations that have been assigned for projects in SAP as indicated on the federal reports. Any unobligated funds not assigned to a project or set up under SAP will be reported in the unobligated fund balance. We followed previous guidance provided by the FTA. At a training session in Atlanta on January 20, 2010 both FTA and the division were informed by the contractor conducting the training that the guidance was incorrect.

FTA was contacted and they advised to start with the reports submitted for the 1st quarter of FY10 in January 2010 and to make a note in the comment section that the division is

AUDIT FINDINGS AND RESPONSES (CONTINUED)

now aware of the correct reporting requirement. Previous reporting should not be changed.

4. SUPERVISOR REVIEW PROCEDURES NOT PERFORMED

The Department's control procedures to ensure that activities included in the subrecipients' applications for Formula Grants for Other Than Urbanized Areas funds are allowable were not being followed. This increases the risk that funds could be used for unallowable activities.

As part of the internal controls to ensure that only allowable activities are funded by this program, the Department requires a specialist to review the application documentation and prepare and sign a Grant Application Review document that confirms the activity is allowable. The assistant director then reviews the Grant Application Review Document for any obvious errors and signs off as approved.

In our test of a sample of 55 projects, we noted the following:

- Fifty-four Grant Application Review Documents showed no evidence of review and approval by the assistant director.
- One project had no formal grant application yet the recipient was paid \$206,564 in federal funds. Since the required application was not available for audit, we will question these costs.

Federal guidelines require entities receiving federal awards to establish and maintain internal control systems designed to ensure compliance with federal laws, regulations, and program requirements.

Federal Grant Award Information: NC -18-X028 FY 2009

Recommendation: The Department should ensure that established control procedures are followed and ensure that there is adequate management review of subrecipients' applications.

Agency Response: The Assistant Director for Mobility and the Director (in the absence of the Assistant Director) reviews the funding recommendations of staff prior to seeking Board of Transportation approval or inclusion in a funding application to the Federal Transit Administration. For the FY09 application review, the individual had recently assumed the position of Assistant Director. The applications were reviewed by staff and discussed with management; however, no approval signature was provided.

In the future, when positions are vacated, key activities and deadlines will be identified in writing for the incoming employee. Signature approval of applications will be an item on the checklist.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

The company in question provides a rural vanpool service which is a different type of service than that provided by the community transportation systems that contract with human service agencies to provide demand response, subscription service. Some of the systems provide fixed route service along established routes. The nonprofit agency submitted information identifying the employers that would be served, a list of potential new employers, a project budget, and the federal and state certifications and assurances. The application requirements would not mirror that of community transportation systems. For example, there is no transportation advisory board or public hearing requirement since the service area is statewide. The Section 5311 State Management Plan will be updated to reflect the application requirements for rural vanpool projects by March 31, 2010.

[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