



STATE OF NORTH CAROLINA

DEPARTMENT OF TRANSPORTATION

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2010

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, 2010

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, 2010. 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; 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*.

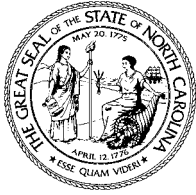
Our audit objective was to render an opinion on the State of North Carolina's, and not the Department's, administration of major federal programs. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

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 OMB Circular A-133, 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 THAT COULD HAVE A
DIRECT AND MATERIAL EFFECT ON 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 could have a direct and material effect on each of its major programs for the year ended June 30, 2010, we have performed audit procedures at the Department of Transportation. Our report on the State of North Carolina's compliance with requirements that could have a direct and material effect on 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

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 the Department's compliance with those requirements.

The results of our audit procedures at the Department of Transportation disclosed an instance of noncompliance that is required to be reported in accordance with OMB Circular A-133 and which is described in finding 2 in the Audit Findings and Responses section of this report.

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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.

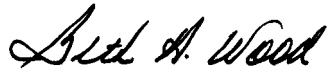
A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we consider the deficiency described in finding 1, in the Audit Findings and Responses section of this report to be a significant deficiency in internal control over compliance, as defined above.

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.

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

This report is intended solely for the information and use of management, Secretary Eugene A. Conti, Jr., others within the entity, the Governor, the General Assembly, 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.



Beth A. Wood, CPA
State Auditor

March 11, 2011

[This Page Left Blank Intentionally]

AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

1. REQUIRED PLANT INSPECTIONS WERE NOT PERFORMED

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.

We tested 13 federally funded contracts that used concrete culvert pipes during the fiscal year and found that pipe was provided by nine different plants. Two of the nine plants had not been inspected by the Department during the year. Three of the 13 projects selected used concrete pipe from these two plants.

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. The Department's policy requires plants that produce concrete culvert pipe to be inspected annually.

Federal Award Information: Highway Planning and Construction Grant 2010

Recommendation: The Department's Materials and Tests Unit should institute controls to ensure that all plants that produce concrete culvert pipes are inspected annually.

Agency Response: Two of the concrete culvert pipe plants that are on the Department's approved supplier list did not have Annual Inspections performed during the period of July 1, 2009 to June 30, 2010. Plant inspections took place within 5 days of this discovery and both plants were in proper order. During the fiscal year, inspections took place of all pipes produced for use on Department projects independent of the annual plant inspections.

The inspector and the inspector's supervisor for the two plants retired during this time frame. The loss of the key personnel led to this issue. A tracking process for plant inspections already exists. Our HiCAMS sample and inspection database is automated to send notifications for various functions required by the Department. Thirty days before the expiration of an approved plant a notification is sent to the inspector assigned to that particular plant. The problem occurred because the inspector had retired when this notification happened. The inspector's supervisor is notified when a plant's certification is actually expired. In this case, that supervisor had retired and both of these positions were still vacant.

As stated above, NCDOT has an inspection process for pipe produced for use on Department projects in addition to annual plant inspections. These inspections consist of the following measures per lot of pipe for each individual size. 1) A piece of pipe from each lot is randomly selected to be tested for conformance to AASHTO specifications.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

2) The inspector observes pipe strength breaks for each lot and size. 3) The inspector obtains samples of the pipe for absorption testing at the Materials and Tests Unit's Central Laboratory for each 5,000 linear feet of pipe. 4) The inspector conducts a walkthrough inspection of the casting operation, the steel cage fabrication process, and a visual inspection of the aggregate stock piles. 5) An inspection of the pipe etching process that identifies each piece of pipe produced is also performed. 6) Approval of an acceptable lot of pipe is designated by each piece of pipe in that lot receiving an NCDOT Approved stamp. This stamp must be present for pipe to be approved and used on any NCDOT project. Before this stamp is applied the inspector visually inspects the entire lot of pipe for cracks and honeycombs or any other defects that may cause the pipe to not perform as intended.

While we feel that the regular inspection and acceptance of concrete pipe significantly reduces any risk the Department has for this material, the Annual Plant Inspections are important and the following measures have been implemented to insure that these inspections occur during the prescribed timeframes. 1) Each functional area of the Unit responsible for performing Annual Inspections of any type is required to update the status of these inspections quarterly to the State Materials Engineer. This metric is included on the Materials and Tests Business Unit Work Plan. The Work Plan is reviewed at least quarterly at Senior Staff Meetings that include the Director of Field Operations, the Chief Engineer and the State Highway Administrator. Whenever these functions are not on schedule a corrective action plan and justification is required for that metric for that particular quarter. 2) Because of the requirement for reporting on the Annual Plant Inspection metric and the results of this specific instance of vacant positions causing a lapse in inspection, the HiCAMS notification process has been updated to notify not only the responsible inspector but that inspector's supervisor and the Field Operations Engineer who manages all the Area Field staff. This additional notification will insure that for such cases when the responsibility has been dropped that there is a thirty day window for supervisors and the manager of these functions to remediate by providing additional staff or reminding the responsible parties when necessary. 3) A copy of this corrective action plan will be distributed to all area staff responsible for performing Annual Plant Inspections and emphasis will be placed on performing these duties in a timely manner.

2. FEDERAL HIGHWAY PROJECT OVERBILLED

The Department of Transportation applied the wrong federal participation rate to one of its Federal Highway Administration projects. Consequently, the Department overbilled this project by \$91,160 for the period April 2009 through October 2010.

Our test of 40 items charged to the Highway Planning and Construction Grant found that the Department overbilled for one transaction. The rate used to bill the federal government for this project had been mistakenly changed in the accounting system. The rate charged was slightly higher than the agreed upon 80% federal participation rate. Therefore, the Department overbilled the Federal Highway Administration by \$91,160

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

since the inception of the project that began in April 2009. We consider the \$91,160 overbilling as questioned costs.

As soon as the error was brought to the Department's attention, the billing rate was corrected in the accounting system and a negative billing amount was created to reimburse the Federal Highway Administration for the overbilled amount.

Federal Award Information: Highway Planning and Construction Grant 2010

Recommendation: The Department should ensure that federal participation rates in its accounting system are accurate.

Agency Response: The existing control has been reinforced with current staff, emphasizing the importance of reviewing the federal billing percentages after the completion of expenditure reclassifications on a project. This will resolve potential billing issues sooner, rather than identifying an issue when making additional modifications to the project during the project life or at the project closure stage. The correction to the one project was made immediately once the issue was identified in the amount of \$91,160.

[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