

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



DEPARTMENT OF TRANSPORTATION

RALEIGH, NORTH CAROLINA

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2014



NCOSA
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STATE OF NORTH CAROLINA
Office of the State Auditor



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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
Anthony J. Tata, Secretary
Department of Transportation

As part of our audit of the State of North Carolina's compliance with requirements applicable to its major federal programs, we have completed certain audit procedures at the Department of Transportation for the year ended June 30, 2014. We conducted the audit 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 was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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 State Auditor expresses an opinion on the State's compliance with requirements applicable to its major federal programs in the State's *Single Audit Report*.

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

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Beth A. Wood, CPA
State Auditor

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Article V, Chapter 147 of the North Carolina General Statutes, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency and any organization that receives public funding. The Auditor also has the power to summon people to produce records and to answer questions under oath.



INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
Office of the State Auditor



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State Auditor

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**INDEPENDENT AUDITOR'S 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**

Anthony J. Tata, Secretary
and Management of the Department of Transportation

Report on Compliance for Each Major Federal Program

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, 2014, 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:

- CFDA 20.205, 20.219, and 23.003 Highway Planning and Construction Cluster
- CFDA 20.319 High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants
- CFDA 20.509 Formula Grants for Rural 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.

Management's Responsibility

Management is responsible for compliance with laws, regulations, contracts, and grants applicable to federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the State of North Carolina's major federal programs based on our audit of the types of compliance requirements referred to above, which we issue in the State's *Single Audit Report*. 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. However, our audit does not provide a legal determination of the Department's compliance with those requirements.

Opinion on Each Major Federal Program

As stated above, our opinion on compliance for each of the State of North Carolina's major federal programs is included in the State's *Single Audit Report*.

Other Matters

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, 3, 5, 7, 8, and 9 in the Findings, Recommendations, and Responses section of this report.

Report on Internal Control Over Compliance

Management of the Department of Transportation is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered internal control over compliance with the types of requirements that could have a direct and material effect on a major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we consider the deficiencies described in findings 1, 3, 5, 6, 7, 8, and 9 in the Findings, Recommendations, and Responses section of this report to be material weaknesses in internal control over compliance. Furthermore, we consider the deficiencies described in findings 2 and 4 in the Findings, Recommendations, and Responses section of this report to be significant deficiencies in internal control over compliance.

Department of Transportation's Responses to Audit Findings

The Department's responses to the findings identified in our audit are included in the Findings, Recommendations, and Responses section of this report. The Department's responses were not subjected to the auditing procedures applied in the audit of compliance or consideration of internal control over compliance, and accordingly, we express no opinion on them.

Purpose of Report on Internal Control Over Compliance

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 24, 2015



FINDINGS, RECOMMENDATIONS, AND RESPONSES

MATTERS RELATED TO FEDERAL COMPLIANCE OBJECTIVES

CFDA 20.205 HIGHWAY PLANNING AND CONSTRUCTION CLUSTER

1. Quality Assurance Testing Standards Not Met

The Department did not have controls in place to ensure consistent performance of the required minimum tests of asphalt and concrete quality used in highways and other construction projects that were funded by the Highway Planning and Construction cluster grant.

As a result, the Department failed to determine that materials used in federally funded highway projects met minimum safety and durability requirements.

We reviewed the quality assurance testing that was performed on 60 asphalt formulas and 30 projects that used concrete.

In our test of 60 out of 657 asphalt formulas¹ used for road paving on federally funded projects, we noted the following errors:

- 19 out of 60 (32%) asphalt formulas did not receive sufficient asphalt mix testing. The vendor producing the asphalt mix and the Department perform separate tests on the mix to verify the quality of the product. The vendor performed sufficient tests, but the Department did not perform the minimum tests required per the Department's federally approved Minimum Sampling Guide.
- 22 out of 60 (37%) asphalt formulas did not receive sufficient roadway density testing. The contractor laying the asphalt pavement and the Department perform separate density tests on the asphalt. Neither the contractor nor the Department performed the minimum tests required per the Department's federally approved Minimum Sampling Guide.

In our test of 30 out of 432 contracts where concrete was used, we noted the following errors:

- 14 out of 30 (47%) contracts did not receive sufficient independent assurance tests for the period of July 1, 2013 through December 31, 2013.

The Department did not have adequate controls in place to ensure the required minimum amount of tests was performed for asphalt and concrete. The Department had controls to monitor the rate at which asphalt tests were performed but did not consistently perform corrective measures when testing levels were insufficient. During the first half of the year, no controls were in place to ensure that sufficient testing was performed on concrete since the Department indicated they focused their resources on implementing the new "system basis" testing.

¹ The number of asphalt formulas was determined by combining the number of producers with the number of unique formulas used.

The Department's quality assurance program for concrete requires that acceptance tests and independent assurance tests be conducted at specified intervals for all concrete used on a project. Independent assurance tests are required to ensure that acceptance sampling is performed correctly and that the testing equipment is operating effectively.

In response to prior audit findings and with federal agency approval, the Department changed its procedures for testing concrete effective January 1, 2014 and no errors were found for testing performed during the period of January 1, 2014 through June 30, 2014. Under the new "system basis" testing, independent assurance tests are performed for each technician performing acceptance tests instead of testing each individual project. The "system basis" testing is a method approved by the federal agency and used by other states.

A significant part of this finding was reported in 2013.

Federal Award Information

CFDA 20.205 Highway Planning and Construction Cluster 2014. This finding also affects funds administered under the American Recovery and Reinvestment Act.

Recommendation

The Department should implement controls to ensure that sufficient tests are performed on asphalt. Effective January 1, 2014, the deficiency related to concrete testing was corrected.

Agency Response

Corrective Action Plan (Asphalt Mix and Density Testing and Independent Assurance Testing for Concrete): We have reviewed the results of the Audit and are in agreement with the findings. The following are the corrective actions that will be implemented for each of the three separate items:

Asphalt Mix QA and V Testing:

As of February 28, 2015 all QA Asphalt Labs that formerly reported to NCDOT's 14 Divisions now report to the Materials and Tests Unit. The 14 QA Supervisors that are responsible for the day-to-day operations now directly report to the State Asphalt Materials Engineer. The State Asphalt Materials Engineer will develop a HiCAMS (Construction & Materials Database) query similar to what was used by the State Auditor's Office to track the sampling and testing performed by the QA. The QA Supervisors will have access to this query and will perform the query quarterly to assess whether their sample and test frequency requirements for asphalt mix are being met. Each QA Supervisor will report the findings of the query to the State Asphalt Materials Engineer copying the State Materials Engineer and use the query results to ensure that they meet the minimum frequency established for each asphalt formula they are responsible for. A meeting has been scheduled for March 24, 2015 to discuss this process with representatives from each of the 14 QA laboratories. They will be instructed to begin the quarterly review process starting April 1, 2015. Additionally, the language in the QMS Asphalt Manual, which provides requirements related to sampling and testing of Asphalt, will be reviewed and discussed to clarify the sampling and testing requirements.

Asphalt Roadway Density QC, QA and V Testing:

The responsibility for insuring the appropriate amount of density testing is performed lies with Division personnel. Research of the Audit data will be performed to determine the details of findings for each specific contract reviewed. The information from this research will be reviewed with the Division personnel responsible for accomplishing these duties in order to provide education on proper processes and documentation to ensure that minimum sampling and testing are met. Additionally, the results of the audit will be shared with representatives from each Resident Engineer's office via four regional training workshops beginning on March 9, 2015 and ending on April 1, 2015.

A formal memorandum to Division Engineers and appropriate staff detailing the audit findings and corrective actions will be sent by April 15, 2015.

A similar HiCAMS query to the process noted above will also be developed to establish a method for reviewing the density process. The query will be used to determine when the required frequencies for roadway densities are not being met. This will trigger a review by the Asphalt Pavement Specialists responsible for the area that a particular project is in to conduct an in depth review of sampling and testing data and documentation. The Resident Engineer will be notified of any deficiencies and immediate corrective actions will be required. This review process will be run quarterly for each project beginning April 15, 2015.

Modifications will also be made to the M&T 605 (Asphalt Roadway Inspector's Daily Report) to ensure that the required information is clearly entered on the form. Additionally, the language in the QMS Asphalt Manual, which provides requirements related to sampling and testing of Asphalt, will be reviewed and discussed to clarify the sampling and testing requirements. This will be accomplished by May 1, 2015.

Independent Assurance Testing for Concrete:

As detailed in the finding, this was also a finding for fiscal year 2013. As such, corrective actions have already been implemented as of January 1, 2014. The corrective actions have been in place for over one year and the Department met its targets for calendar year 2014, which was to assess a minimum of 80 percent of all actively testing technicians. The finding for fiscal year 2014 also notes that tests were performed on the implemented "system based" Independent Assurance process for the period of January 1, 2014 through June 30, 2014 and that no errors in the process were found. The Department will continue to operate under the new system and has controls in place to monitor the performance throughout the calendar year to ensure compliance.

Anticipated Completion Date: The corrective action implementation for Asphalt Mix will begin on March 24, 2015 and will be completed by May 1, 2015. The corrective action implementation for Asphalt Roadway Density will begin on March 9, 2015 and will be completed by May 1, 2015.

The corrective action implementation for Independent Assurance Testing for Concrete began prior to January 1, 2014 and was completed on January 1, 2014.

2. Controls Were Not Operating Effectively to Ensure Payment of Minimum Pay Rates

The Department's process to ensure that minimum federal pay rates are paid to workers on projects funded by the Highway Planning and Construction cluster grant was not followed. The Department and federal law requires contractors and subcontractors that work on construction contracts in excess of \$2,000 submit to the Department a certified payroll for each week in which any contract work is performed. The Department's process requires the preparation of an internal report (FAP-1) to indicate the payrolls that should be received and requires the resident engineer to sign the FAP-1 to indicate his receipt and review of all payrolls. Department personnel review the wages for compliance.

Our test of 44 construction expenditures and their related project files out of 3,342 construction expenditures during our audit period revealed the following deficiencies:

- There were two instances where the FAP-1 reports were not complete. The reports did not include all contractors and subcontractors that worked on the project during the test week.
- There were two instances where the FAP-1 reports included contractors that had not worked on the project during the test week.
- There were four FAP-1 reports that were not signed by the Resident Engineer to indicate review.

As a result, there is an increased risk that the Department did not ensure that laborers working on projects funded by federal funds are being paid at the federally required minimum rate. Although the process to verify receipt and review of certified payrolls was not in place, we did not find any errors in our test.

Federal regulation 29 CFR Section 5.5 requires that contractors and subcontractors that work on construction contracts in excess of \$2,000 submit the awarding agency (the Department) a certified payroll for each week in which any contract work is performed. The Department is required to review the payrolls to ensure all laborers and mechanics are paid wages not less than those established by the U.S. Department of Labor for the locality of the project.

Federal Award Information

CFDA 20.205 Highway Planning and Construction Cluster 2014.

Recommendation

The Department should ensure staff properly completes required weekly reports and executes the Department's designed procedures to ensure payment of required wages.

Agency Response

Section 107-22 of the Construction Manual will be reviewed to determine if clarifications in the processes are needed or if form FAP-1 needs to be revised or automated to better facilitate data entry.

The audit findings will be highlighted at four regional Construction Engineers' Workshops to be held in March and April 2015. In addition, for the offices where the

audit findings occurred, the specific findings will be reviewed with the Resident Engineer and the office staff responsible for reviewing Davis-Bacon payroll data. Existing procedures will be reviewed to make sure they understand the procedures.

Internal reviews will take place for all offices administering Federal projects to make sure the responsible staff understands the processes that need to be followed. Follow up visits will be made where issues are identified.

Completion Date: The first two items in above corrective action plan will be completed by April 30, 2015. Follow up reviews, if needed, will be completed by June 30, 2015.

CFDA 20.319 HIGH-SPEED RAIL CORRIDORS AND INTERCITY PASSENGER RAIL SERVICE – CAPITAL ASSISTANCE GRANTS

3. Federal Report Contained Errors

The Department of Transportation (Department) did not submit accurate quarterly financial reports for the High Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grant to the Federal Rails Administration.

The report for the quarter ending June 30, 2014, contained the following errors:

- \$15.3 million (11.5% error) in overstated cumulative cash receipts reported on line 10(a) of the SF-425 for the quarter ended June 2014. The Department reported \$148.7 million but should have reported \$133.4 million in federal cash receipts.
- \$441,125 (0.3% error) in overstated cumulative cash disbursements and cumulative federal share of expenditures reported on lines 10(b) and 10(e) of the SF-425 for the quarter ended June 2014. The Department reported \$159.3 million but should have reported \$158.9 million in federal cash disbursements and expenditures.

Inaccurate reports can prevent the Federal Rails Administration from tracking the financial progress of the rails grant and ensuring that there are adequate funds to complete the project. Additionally, there is a risk that Federal Rails Administration may move funding from this grant to another grant if the reports do not reflect the accurate use of funds. Because this project is funded with American Recovery and Reinvestment Act (ARRA) funds which will end, the Federal Rails Administration could move funds to another project to ensure that all ARRA funds are used.

Errors in the report occurred because the accounting system report that the preparer (a consulting firm) used was not filtered properly to account for the correct cash receipts and expenditures. The reported cumulative receipts included funds received in July 2014 which were outside the reporting period and should not have been included. Also, the preparer did not maintain copies of the supporting documents used to determine the amount of cash receipts reported for the first three quarterly reports.

Federal regulations and the grant award document require the Department to submit the quarterly SF-425 Federal Financial Report to the Federal Rail Administration. The report should include all activity of the reporting period and be supported by applicable accounting records to ensure accuracy.

This finding was also reported in 2013.

Federal Award Information

This finding affects funds administered under the American Recovery and Reinvestment Act award FR-HSR-0006-10-01 for the award period of May 24, 2010 – September 30, 2017.

Recommendation

The Department should establish policies and procedures, such as adequate supervisory reviews, to ensure that the preparer uses the proper accounting system reports when preparing the quarterly reports.

Agency Response

The Rail Division Finance & Contracts (F&C) Manager will review and seek input from the Department's Financial Management Division to ensure an optimal approach for financial reporting and the creation of the SF-425 to include:

1. Use of SAP report (FBL3N) as provided this year by the auditors for checking cash receipts.
2. Methods to maintain copies of all supporting documents (screen shots) used when compiling the cash receipts and expenditures reported on SF-425.
3. Update variants in SAP to remove specific cost elements (retainage and assets) from reporting tool to ensure these are not included in future expenditure reports.
4. All SF-425 forms submitted for SFY 2014 and SFY 2015 will be reviewed and revised to reflect necessary changes to satisfy the findings from the SFY 2014 Single Audit. Corrected SF-425 forms will be coordinated with and issued to John Winkle, FRA Grant Manager for approval.
5. Rail Division F&C Manager and Business Officer will conduct quarterly reviews with the contract program coordinator on the preparation of the SF-425 report and provide proof to the Rail Director that the proper accounting system reports are being used when preparing the quarterly reports.

Anticipated Completion Date: June 1, 2015

4. Controls Were Not Operating Effectively to Ensure Payment of Minimum Pay Rates

The Department's process to ensure that minimum federal pay rates are paid to workers on federal projects funded by the High-Speed Rail Corridors and Intercity Passenger Rail Service-Capital Assistance Grants was not followed. The Department and federal law requires contractors and subcontractors that work on construction contracts in excess of \$2,000 submit to the Department a certified payroll for each week in which any contract work is performed. The Department's process requires the preparation of an internal report (FAP-1) to indicate the payrolls that should be received and requires the resident engineer to sign the FAP-1 to indicate his receipt and review of all payrolls. Department personnel review the wages for compliance.

Our test of 37 construction expenditures and their related project files out of 181 construction expenditures during our audit period revealed the following deficiencies:

- There were three instances where the FAP-1 reports were not complete. The reports did not include all contractors and subcontractors that worked on the project during the test week.
- There was one instance where the certified payroll reports were not received for the test week.

As a result, the Department did not ensure that laborers working on projects funded by federal funds are being paid at the federally required minimum rate.

Federal regulation 29 CFR section 5.5 requires that contractors and subcontractors that work on construction contracts in excess of \$2,000 submit to the awarding agency (the Department) a certified payroll for each week in which any contract work is performed. The Department is required to review the payrolls to ensure all laborers and mechanics are paid wages not less than those established by the U.S. Department of Labor for the locality of the project.

This finding was also reported in 2013.

Federal Award Information

This finding affects funds administered under the American Recovery and Reinvestment Act award FR-HSR-0006-10-01 for the award period of May 24, 2010 – September 30, 2017.

Recommendation

The Department should ensure staff properly completes required weekly reports and executes the Department's designed procedures to ensure payment of required wages.

Agency Response

The identified deficiencies included:

FAP-1 Form Errors – The standard construction manual procedure for insuring payment of minimum pay rates includes a standard form called the FAP-1. An FAP-1 is completed to record the active/inactive contractor and subcontractor. The audit found three (3) of the FAP-1 forms were filled out incorrectly by not including all active contractors for which certified payrolls were received.

Missing Certified Payroll - There was one (1) instance where FAP-1 and the associated diary were correct but the certified payroll was missing.

Corrective Action Plan:

The Division of Highways is managing the construction contracts for the Department let portion of ARRA Track and Structure projects (the focus of the minimum pay rate audit for SFY2014). The Rail Division will coordinate with the State Construction Engineer on the following corrective action plan:

1. The Construction Unit will review existing Department Construction Manual Davis-Bacon procedures, assure appropriate Department staff are properly trained, serve as a resource for administration of Davis-Bacon requirements, and conduct internal Davis-Bacon audits with the Area Engineers.

2. Rail Division F&C Manager will provide details of the corrective actions taken by the Department staff to the Rail Director including any procedural revisions, proof of training for Department staff, and annual audit reports. These items will be provided to the F&C Manager by the Construction Unit.

Anticipated Completion Date: June 1, 2015

CFDA 20.509 FORMULA GRANTS FOR RURAL AREAS

5. Subaward Obligations Were Not Reported

The Department did not submit subaward obligations exceeding \$25,000 within the time period established by the Federal Funding Accountability and Transparency Act (FFATA).

The Department awarded 38 recipients \$7,046,031 in subawards during November 2013. This 2014 grant award information should have been entered in the federal reporting system by December 31, 2013. As of January 21, 2015, this information has not been entered into the federal reporting system.

As a result, the federal awarding agency and the public did not have timely notification of subawards that were issued by the Department.

The Federal Funding Accountability and Transparency Act was enacted to show citizens how federal funds are spent in their communities. At the time of these subawards, according to Department personnel, they were unaware of the reporting requirement.

The Federal Funding Accountability and Transparency Act requires states to report any subawards issued that are more than \$25,000 in the federal reporting system by the end of the month following when the subaward is issued.

Federal Award Information

This finding affects the Formula Grants for Rural Areas award NC-18-X037-00 for award period July 1, 2013 – September 30, 2014.

Recommendation

We recommend that the Department establish procedures to ensure required reports are submitted timely.

Agency Response

The Public Transportation Division (PTD) has created a master table of all subrecipient required data and enters the information into FFATA (Federal Funding Accountability and Transparency Act) 30 days after notification of grant award from FTA.

Corrective Action Was Completed On: January 5, 2015

6. Subrecipient Data in Federal Reports Not Reviewed

The Department of Transportation did not have a process in place to ensure the subrecipient data in the Formula Grants for Rural Areas' annual financial and operating reports submitted to the Federal Transit Administration was complete and accurate. The

Department contracted with an external vendor to prepare the annual report using data supplied by subrecipients. The Department did not review the data supplied by the subrecipients for reasonableness and it did not review the vendor-prepared report for completeness and accuracy prior to submitting it to the federal agency.

As a result, information on financial and performance data totaling \$14,603,112 for 55 subrecipients was not reviewed for accuracy and completeness and there was an increased risk that the information submitted contained errors that were not detected and corrected by the Department.

In addition, our tests revealed one subrecipient's data was excluded from the reporting. This subrecipient received \$437,405. We agreed the vendor-prepared report to subrecipient supplied data but we did not verify the accuracy of the subrecipient data because the underlying support resides at the subrecipient.

The federal reporting manual for the Rural Areas grant requires an annual reporting of financial and performance information. The state agency administering the grant is responsible for collecting data from all subrecipients and submitting the report. Federal administrative regulations also require recipients of federal awards to ensure federal reports include all activity of the reporting period, are supported by applicable accounting or performance records, and are fairly presented in accordance with program requirements.

This finding was also reported in 2013.

Federal Award Information

This finding affects the Formula Grants for Rural Areas awards NC-18-X026-00 award period July 1, 2006 – December 31, 2007; NC-18-X028-00 award period July 1, 2008 – December 31, 2009; NC-18-X030-00 award period July 1, 2009 – December 31, 2010; NC-18-X030-01 award period July 1, 2010 – December 31, 2011; NC-18-X032-00 award period July 1, 2009 – December 31, 2010; NC-18-X034-00 award period July 1, 2010 – December 31, 2012; NC-18-X034-01 award period July 1, 2011 – December 31, 2012; NC-18-X034-02 award period November 1, 2011 – June 30, 2013. The finding also affects funds administered under American Recovery and Reinvestment Act awards NC-86-X001-00 for the award period February 1, 2009 – December 31, 2012 and NC-86-X001-01 for the award period of October 9, 2009 – August 30, 2013.

Recommendation

The Department should establish procedures to ensure the accuracy and completeness of the annual financial and operating reports. The subrecipient data supplied for the report should be monitored for accuracy and, prior to submission, the report should be reviewed for completeness.

Agency Response

The Public Transportation Division implemented procedures in FY 15 to validate data:

- Created and maintaining master spreadsheet that shows funds received by subrecipient.
- Requiring all subrecipients to have scheduling / billing software by June 30, 2015.

- Requiring documentation of trips carried from the software with quarter and annual operating statistics (OPSTATS) submissions.
- OPSTATS Annual report is signed by the subrecipients' authorized official and TAB Chairperson certifying the data's accuracy. In FY 15, we will be requiring June invoices no later than July 30, and once again test whether NCDOT SAP reports can match local audit numbers as well as adding a signature for the finance director. To date, this has not been possible.
- Two weeks of total trip data is reported and tested for accuracy by our Mobility Development Specialists at one of their structured site visits. Top to bottom review of manifests, scheduling software and billing.
- NTD's new web portal is only partially developed, so we are currently validating system and data totals for FY 14. When NTD can generate reports, we will be able to review more detailed data. Our procedure for FY 14 NTD reporting forward will be, prior to final submittal to NTD, the Public Transportation Division will:
 - match the master spreadsheet to subrecipients,
 - validate passengers, miles, and hours to what was reported on OPSTATS,
 - validate financial data to what is reported in OPSTATS.

Completion Date: With FY 14 reporting and FY 15 site visits / oversight, all are complete but the last bullet. The last bullet will depend on when FTA's new NTD website is fully functional.

7. Subrecipient Charter Service Reports Submitted Late to the Federal Transit Authority

The Department did not submit the required subrecipient Charter Service Quarterly Reports to the Federal Transit Authority (FTA) website as required by federal regulations. These reports are designed to publically disclose federally funded charter services provided to ensure subsidized charter services do not unfairly impact private charter businesses.

Each quarter, subrecipients of the Formula Grants for Rural Areas program are required to submit reports to the Department detailing the charter services that were provided. The Department is then required to submit these quarterly reports within 30 days of the close of the quarter to the FTA. Five of the 75 subrecipients who are required to report their charter service activity submitted eight reports to the Department indicating that charter service had been provided. Our audit of the reports that were submitted to FTA disclosed:

- Eight reports were from six to 19 months late.
- Four of the eight reports submitted were submitted for the incorrect federal reporting period.
- Also, as reported in another finding, the Department has not performed monitoring site visits since 2010. Without site visits, the Department can't verify the completeness and accuracy of the charter service activity reported on the Quarterly Charter Reports.

According to discussions with agency personnel, the Department did not submit timely the Quarterly Charter Service reports because it was unaware of the requirement for the reports to be submitted to the FTA 30 days after the end of the calendar quarter.

Federal Award Information

This finding affects the Formula Grants for Rural Areas awards NC-18-X030-00 award period July 1, 2009 – December 31, 2010; NC-18-X032-00 award period July 1, 2009 – December 31, 2010; NC-18-X034-00 award period July 1, 2010 – December 31, 2012; NC-18-X034-01 award period July 1, 2011 – December 31, 2012; NC-18-X034-02 award period November 1, 2011 – June 30, 2013; NC-18-X034-03 award period July 8, 2010 – June 30, 2014; NC-18-X037-00 award period July 1, 2013 – September 30, 2014. The finding also affects funds administered under American Recovery and Reinvestment Act award NC-86-X001-00 for the award period February 1, 2009 – December 31, 2012.

Recommendation

The Department should ensure that all Charter Quarterly Reports are submitted timely and accurately to the Federal Transit Authority website.

Agency Response

The Public Transportation Division has created a plan to submit Charter Service Reports to the Federal Transit Authority (FTA) as outlined in the FTA guidelines. The procedures include: subrecipients submitting Charter Report Forms to Public Transportation Division, MDS reviewing Charter Report Forms and entering/dating reports on Charter Exception Tracking Form, Project Manager reviewing and uploading Charter Reports into the FTA TEAM process within 30 days of the end of each quarter.

Corrective Action Was Completed On: February 15, 2015

8. Failure to Verify DUNS Number and Valid Local Match Prior to Award

The Department did not have adequate procedures to ensure applications by subrecipients for the Formula Grants for Rural Areas program were complete and accurate. Specifically the Department did not ensure a valid Dun and Bradstreet Universal Numbering System (DUNS) number was included on all applications. This number is used by the federal government to identify entities receiving federal funds and to track the award and disbursement of federal grant money. Further, subrecipients are also required to identify the source of local matching funds when applicable to enable the Department to ensure the match is from an allowable source. The Department reimbursed subrecipients \$24.9 million under this grant.

As a result, the Department approved applications which did not provide necessary information to allow the awarding agency to perform its duties and also failed to ensure that the local matches were from allowable funds.

We reviewed all applications submitted for 18 of 88 subrecipients that received federal reimbursements during the year. These 18 subrecipients had a total of 65 project applications. Our tests revealed the following:

- Three subrecipients included an invalid DUNS number on eight of 10 applications.

- Two subrecipients did not include a DUNS number on three of eight applications.
- One subrecipient did not identify the source of its local match on one of three applications.
- Two subrecipients identified sources, but the sources identified were not eligible to be used as match on three of six applications.

The Department did not consistently follow its identified procedures for validating the DUNS number submitted on the grant application. Further, discussions with some of the Department staff revealed they did not understand what source of local share match was valid when approving the applications.

Federal regulations require the awarding agency, for non-ARRA first tier subawards made on or after October 1, 2010, to have the subrecipient provide a valid DUNS number before issuing the subawards. In addition, federal regulations require the grantees to ensure that subrecipients use only eligible funds as local match.

Federal Award Information

NC-18-X032-00 award period July 1, 2009 – December 31, 2010; NC-18-X034-00 award period July 1, 2010 – December 31, 2012; NC-18-X034-01 award period July 1, 2011 – December 31, 2012; NC-18-X034-02 award period November 1, 2011 – June 30, 2013; NC-18-X034-03 award period July 8, 2010 – June 30, 2014; NC-18-X037-00 award period July 1, 2013 – September 30, 2014.

Recommendations

The Department should ensure that the DUNS number included on the application is valid before funds are awarded.

The Department should also ensure that the local share match identified is from a valid source.

Agency Response

The Public Transportation Division has instructed staff as to eligible local matches.

The Public Transportation Division's online grant program requires subrecipients to enter DUNS numbers with each application. PTD has documented all DUNS numbers in a master spreadsheet and has requested the Financial Management Division and IT to create a placeholder for the DUNS number to be captured in the vendor record, no longer requiring it to be entered with each grant application.

Anticipated Completion Date: Valid Local Match completed January 5, 2015. DUNS anticipated completion date is April 8, 2015.

9. Subrecipient Monitoring Not Adequately Performed

The Department of Transportation did not adequately monitor subrecipients of the Formula Grants for Rural Areas as required by federal regulations. This program provides funding to support public transportation in rural areas, generally bus or van services. Subrecipients expended \$24.9 million of the \$26.6 million (over 93%) in federal expenditures that were incurred for this grant during the year ended June 30, 2014.

Specifically, the monitoring procedures were found inadequate because the Department did not perform the appropriate type of monitoring site visits and did not require all subrecipients to submit the documentation necessary to properly monitor expenditures. There were 88 subrecipients who submitted a total of 821 reimbursement claims. The monitoring deficiencies were:

- For 88 out of 88 (100%) of subrecipients, the Department did not perform site visits specifically designed to monitor subrecipient fiscal operations and compliance with grant requirements. In fact, the Department has not performed such site visits since state fiscal year 2010.
- For 23 out of 72 (32%) cost reimbursement claims sampled, the Department approved the reimbursement claim without documentation to support the expenditures. The amount of federal funds reimbursed to these subrecipients was \$1,404,021.

As a result of inadequate subrecipient monitoring, there was an increased risk that the Department would not detect subrecipient noncompliance with federal requirements. Without performing fiscal and compliance monitoring site visits, the Department could not provide reasonable assurance that subrecipients complied with all federal requirements, such as equipment maintenance, charter service or bus service operation, and accurate performance and financial reporting. Furthermore, without supporting documentation, the Department could not provide reasonable assurance that expenditures were for allowable costs.

According to discussions with Department staff, the Department did not perform adequate monitoring site visits because of a delay in implementing its plans. The Department planned to contract the on-site monitoring procedures with an outside party but delays in finalizing the contract caused a delay in those procedures being performed. The Department performed some on-site monitoring procedures such as attending subrecipients' quarterly meetings of the Transportation Advisory Board, conducting safety checks, evaluating the cleanliness of the environment and vehicles used in the program, and reviewing certain subrecipient policies. However, the on-site visits performed were not designed to ensure compliance with all federal regulations.

The Department lacked the documentation necessary to properly monitor expenditures because of an inadequate policy. Prior to June 2014, the Department policy did not require subrecipients subject to an A-133 audit to provide supporting documentation for cost reimbursements. However, in response to our prior year finding related to this issue, the Department changed its policy so that all subrecipients are now required to provide detailed documentation to support cost reimbursement claims.

Federal and Departmental guidance require adequate monitoring. Federal guidance requires the Department to monitor subgrantee supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Also, the Department's federally approved State Management Plan states that the Department will conduct on-site reviews of every subrecipient every three years to ensure compliance with federal and state regulations and agreements.

This finding was reported in 2013 and also similar aspects of this finding were reported in 2011. This grant was not audited in 2012.

Federal Award Information

This finding affects the Formula Grants for Rural Areas awards NC-18-X026-00 award period July 1, 2006 – December 31, 2007; NC-18-X028-00 award period July 1, 2008 – December 31, 2009; NC-18-X030-00 award period July 1, 2009 – December 31, 2010; NC-18-X030-01 award period July 1, 2010 – December 31, 2011; NC-18-X032-00 award period July 1, 2009 – December 31, 2010; NC-18-X034-00 award period July 1, 2010 – December 31, 2012; NC-18-X034-01 award period July 1, 2011 – December 31, 2012; NC-18-X034-02 award period November 1, 2011 – June 30, 2013. The finding also affects funds administered under American Recovery and Reinvestment Act awards NC-86-X001-00 for the award period February 1, 2009 – December 31, 2012 and NC-86-X001-01 for the award period of October 9, 2009 – August 30, 2013.

Recommendation

The Department should perform monitoring procedures to ensure subrecipients administer federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements. Management should ensure monitoring procedures comply with the Department's State Management Plan.

Agency Response

The Public Transportation Division has implemented the following changes since the FY13 audit:

- All subrecipients, including their Financial Manager, were required to attend training in July 2014, prior to FY 14 grant release. Follow up financial and oversight expectations have been communicated.
- Full documentation is submitted with each invoice, starting May 2014.
- A six year master timeline for oversight was developed and procurement of services completed. The timeline covers compliance oversight, Safety/Drug and Alcohol oversight and planning. These activities started in FY 15.
- Public Transportation Division staff are performing 2 structured site visits each year.
- A more structured review of grant requests was implemented for FY 16 grant review cycle.

Corrective Action Was Completed On: August 15, 2014

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This audit was conducted in 3,782.5 hours at an approximate cost of \$355,555.