

STATE OF NORTH CAROLINA

**DEPARTMENT OF TRANSPORTATION
CIVIL PENALTY COLLECTIONS
FINANCIAL RELATED AUDIT**

APRIL 2012

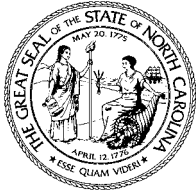
OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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AUDITOR'S TRANSMITTAL

April 5, 2012

The Honorable Beverly Eaves Perdue, Governor
Members of the North Carolina General Assembly
Mr. Eugene A. Conti, Jr., Secretary, Department of Transportation

This report presents the results of our financial related audit at the Department of Transportation. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The objective of our audit was to identify improvements needed in internal control over the collection of civil penalties and forfeitures.

The results of our audit disclosed deficiencies in internal control that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Responses section of this report. We also noted other matters outside our objective that we reported to management of the Department of Transportation in separate writings dated December 21, 2011, and February 28, 2012.

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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FINANCIAL RELATED AUDIT

INTRODUCTION

The Department of Transportation (Department), along with other state agencies, collects the proceeds of certain civil penalties, forfeitures, and fines that are required to be deposited into the Civil Penalty and Forfeiture Fund. Monies from this fund are ultimately transferred to local school systems.¹ Examples of proceeds collected by the Department include civil penalties assessed for:

- Violations against the Vehicle Financial Responsibility Act of 1957 for the lapse of liability automobile insurance² and
- Violations against statute that establish the proper size and weight of vehicles operating on state highways.³

The North Carolina State Constitution dictates that the clear proceeds of all civil penalties, forfeitures, and fines that are issued for any breach of the State's penal law will belong to the local school system and are to be used exclusively for maintaining free public schools.⁴ The Civil Penalty and Forfeiture Fund is administered by the Office of State Budget and Management. Monies in this fund are appropriated by the General Assembly to the State Board of Education to be distributed to the local school systems on a per student basis.

During State fiscal years 2010 and 2011, the Department collected and submitted to the Civil Penalty and Forfeiture Fund approximately \$24.1 million and \$23.4 million, respectively, in proceeds from all civil penalties, forfeitures, and fines.

OBJECTIVE, SCOPE, AND METHODOLOGY

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the Department of Transportation. There were no special circumstances that caused us to conduct the audit, but rather it was performed as part of our effort to periodically examine and report on the financial practices of state agencies and institutions.

The objectives of a financial related audit may include determining whether (1) the organization has complied with finance-related laws, regulations, and provisions of contracts or grant agreements; (2) assets have been safeguarded; (3) financial resources have been prudently managed; and/or (4) improvements are needed in internal control over any of these fiscal matters or in internal control over the accounting and financial reporting functions. The specific objective for this engagement was to identify improvements needed in internal controls over the collection of assessed civil penalties and forfeitures.

¹ *General Statute 115C – 457.3*

² *General Statute 20-311*

³ *General Statute 20-118*

⁴ *Article IX Section 7 of the North Carolina State Constitution*

FINANCIAL RELATED AUDIT

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

To accomplish our audit objective, we gained an understanding of internal control over matters described below and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that provide evidence about our audit objective. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing records, and examining documentation supporting controls.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Our audit scope included a review of internal controls over the collection of assessed civil penalties and forfeitures during the period July 1, 2010, to June 30, 2011.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the Audit Findings and Responses section of this report. We also noted other matters outside our objective that we reported to management of the Department of Transportation in separate writings dated December 21, 2011, and February 28, 2012.

AUDIT FINDINGS AND RESPONSES

1. LAPSED LIABILITY INSURANCE PENALTIES ARE NOT COLLECTED IN COMPLIANCE WITH DEPARTMENT POLICY

The Department of Transportation (Department) did not take three actions necessary to comply with the intent of the Department's Cash Management Plan (Plan). First, the Department did not review approximately \$179 million in open (unresolved) lapsed automobile liability insurance records to identify the amount owed to the state. Second, the Department did not take action to force the closeout of over three million open lapsed liability records worth approximately \$172 million in possible penalties. Finally, the Department did not use all available means to pursue collection of outstanding lapsed automobile liability insurance penalties. As a result, \$7.3 million in penalties have not been collected and transferred to North Carolina local school systems.

Department did not review records to identify amounts owed

Until auditors raised the issue, the Department had not analyzed over \$179 million in lapsed liability insurance records¹ to identify the amount owed to the state. The Department's computer system indicates that this balance has been accumulating since 1998 and includes over \$133 million in real and potential lapses that are over three years old.

The Department does not have policies and procedures in place to perform an analysis and identify amounts owed to the state. Additionally, the Department has not assigned an individual the responsibility to perform this analysis on a periodic basis.

At the auditors' request, the Department performed an analysis of the approximately \$179 million in lapsed liability insurance records and determined that there are \$7.3 million in valid and outstanding penalties.² The outcome of the remaining \$172 million can not be determined because those individuals have not responded to lapsed liability notices.

State law says that penalties are not considered owed until the owner responds to Department notices of a lapse in liability insurance coverage or that a Department hearing determines that a lapse in insurance coverage occurred.³ The unpaid penalties noted above are valid because Department records indicate that the insured acknowledged a lapse in insurance coverage without paying the penalty or received an unfavorable decision from a requested hearing without paying the penalty.

To comply with the intent of its cash management plan, the Department must first review its records to identify amounts owed to the state. The Department's Cash Management Plan states, "It is the intent of the DOT Accounts Receivable Section to aggressively

¹ Balance as of June 30, 2011

² Balance as of February 10, 2012

³ *General Statutes 20-311 (a)(4) and 20-316*

AUDIT FINDINGS AND RESPONSES

pursue collections on every outstanding balance owed to the North Carolina Department of Transportation.” Logically, the Department must identify amounts owed before it can “aggressively pursue collections.”

Failure to timely identify and collect outstanding liability insurance penalties deprives local school systems of needed funds. Any lapsed insurance penalties that the Department collects are ultimately transferred to local school systems through the Civil Penalty and Forfeiture Fund.¹ Because the Department did not review its records and identify amounts owed, it could not collect \$7.3 million rightfully owed to local school systems.

Department does not effectively manage the closeout of open records

The Department does not effectively manage the closeout of open lapsed automobile liability insurance records. When a liability insurance provider notifies the Department that an individual has had a lapse in liability insurance coverage, the Department sends the individual up to two written notices and opens a lapse record in the computer system. If the individual does not respond by the second written notice, the Department revokes the individual’s vehicle registration. The records remain open in the computer system until the owner responds to the Department. Based on the Department’s interpretation of the law, no penalties can be assessed to individuals until they respond to these notices.²

The Department relies on each individual to comply and respond to the written notices in order to close open records. Since 1998, the Department reports that approximately 68% of the lapse notices issued have resulted in almost \$370 million in penalties being assessed or cleared because individuals complied with the notices and responded to the Department in a way that resolved the issue. However, almost 32% of the individuals notified never responded or complied, leaving \$172 million in open lapse records.

The Department does not have policies and procedures in place to take action and force the closeout of open lapse records. Additionally, the Department has not assigned an individual the responsibility to perform any forced closing procedures on a periodic basis.

To comply with the intent of its cash management plan and pursue amounts owed, the Department should take action to force the closure on open lapse records. The Department’s Cash Management Plan states, “It is the intent of the DOT Accounts Receivable Section to aggressively pursue collections on every outstanding balance owed to the North Carolina Department of Transportation.” Logically, the Department must take action to force the closure of open lapse records in an effort to “aggressively pursue collections.”

¹ *North Carolina G.S. 20-311(f)*

² The Department’s interpretation of *G.S. 20-311(a)(4)* prohibits their ability to assess penalties against individuals until the individual responds to the notices sent of a lapse in liability insurance coverage.

AUDIT FINDINGS AND RESPONSES

The Department has access to various databases that, when interfaced with information found in open lapse records, could identify open cases that could be validated or closed. For example, the Department could use:

- Social Security Administration's records to identify open lapses of deceased individuals. These lapses could be closed;
- Vehicle history reports to identify vehicles still operated in North Carolina by the owner or were registered and operated in other states around the same time the lapse in insurance coverage occurred or have no history for a certain duration of time. These lapses could potentially be validated or closed;
- Other public records to identify the location of individuals with open lapses. Additional contact with these individuals could potentially result in the confirmations of lapses or the closeout of open lapses.

Because the Department does not force closure of lapse records, the number of open records will continue to increase. On average, 260,000 new lapse records are opened and remain unresolved each year. There were over three million open lapse records worth approximately \$172 million in potential penalties as of June 30, 2011.

Department did not aggressively pursue collections

The Department did not actively manage the collection of lapsed automobile liability insurance penalties in accordance with portions of the Department's Cash Management Plan.

Specifically, the Department did not:

- Issue a collection letter when accounts are 60 days past due,
- Charge interest on past due accounts,
- Charge a late payment penalty fee on past due accounts,
- Turnover accounts that are more than 60 days old to the Attorney General,
- Turn past due accounts over to collection agencies, and
- Submit past due accounts to the Department of Revenue for setoff debt proceedings against tax refunds.

The Department's Plan requires the Department to use the methods listed above to effectively collect amounts owed to the state. The Plan further states, "It is the intent of the DOT Accounts Receivable Section to aggressively pursue collections on every outstanding balance owed to the North Carolina Department of Transportation."

As noted above, failure to timely identify and collect outstanding liability insurance penalties has deprived local school systems of about \$7.3 million rightfully owed them.

AUDIT FINDINGS AND RESPONSES

Recommendation:

The Department should develop policies and procedures to perform an analysis and identify amounts owed to the state for lapsed automobile liability insurance penalties and should assign an individual the responsibility of performing an analysis of these penalties on a periodic basis.

The Department should work with the General Assembly to develop legislation that would allow the Department to take action and force the closeout of open lapsed automobile liability insurance records in instances where the individual has not responded to notices.

The Department should develop policies and procedures to force the closeout of open lapsed automobile liability insurance records and should assign an individual the responsibility of performing force close procedures on open lapsed automobile liability insurance records on a periodic basis.

The Department should manage the collection of lapsed automobile liability insurance penalties in accordance with its cash management plan.

Agency Response:

On or before May 1, 2012 DMV will provide the Secretary of Transportation an assessment of improvements that will be made to enhance the Department's ability to collect lapsed insurance penalties. The analysis will include policy and procedural recommendations, assignment of roles and responsibilities, reporting requirements, programming needs (30-60-90 day dunning, write-off processes, etc.), and the exploration of a third party to help identify lapses in insurance coverage.

DMV has started discussions with IT staff to define programming requirements to the LITES system (Liability Insurance Tracking and Enforcement System) to enhance fees and penalty collections and the cost associated with the changes.

Effective immediately, DMV will analyze reports monthly to review customer accounts that have been assessed, collected, and remain past due to further formulate optimal processes for collections. Our most recent numbers indicate an outstanding balance of \$6.65 million as a result of confirmed lapses of insurance by the owner and violations upheld by a hearing. Currently the vehicle registrations of the owner have been blocked and the license plates are identified to be picked up.

Additional resources will be identified to actively pursue collections from violators by utilizing the Department of Justice, the State's Debt Set-off Program, and a collection agency.

AUDIT FINDINGS AND RESPONSES

Historically, the LITES system “closes” accounts but does not “remove/delete” the account from the system so that the State of North Carolina has the opportunity to recoup fees and penalties if an owner re-registers the same vehicle at a later date. DMV considers an account “closed” when it is tagged as “closed” within the LITES system. Based on the recommendation of the State Auditor’s Office, DMV will complete a cost benefit analysis to ascertain the cost and timeframe for changing the system prior to asking the General Assembly to grant legislative authority to “remove/delete” records within G.S. 20-311 (within a specified period of time.)

NCDOT’s Cash Management Plan will be expanded to include detailed policies and procedures for collections and remedies to pursue penalty revenue.

2. OVERSIZE/OVERWEIGHT VEHICLE PENALTIES ARE NOT COLLECTED IN COMPLIANCE WITH DEPARTMENT POLICY

The Department of Transportation (Department) did not actively manage the collection of outstanding oversize/overweight vehicle penalties in compliance with the Department’s Cash Management Plan (Plan). The Department and the Department of Crime Control and Public Safety (CCPS) share responsibility for collecting assessed penalties, though neither agency actively pursues amounts past due. As a result, \$4.8 million in penalties have not been collected and transferred to North Carolina local school systems.¹

Specifically, the Department did not:

- Issue a collection letter when accounts are 60 days past due,
- Charge interest on past due accounts,
- Charge a late payment penalty fee on past due accounts,
- Turnover accounts that are more than 60 days old to the Attorney General,
- Turn past due accounts over to collection agencies, and
- Submit past due accounts to the Department of Revenue for setoff debt proceedings against state tax refunds.

Information from the Department’s computer system indicates that over \$4.8 million of oversize/overweight vehicle penalties are due to the Department.² This balance has accumulated since 1997 and includes \$4.5 million in assessments that are over one year old.

The Department’s Cash Management Plan requires the Department to use the methods listed above to effectively collect amounts owed to the State. The Plan further states, “It is the intent of the DOT Accounts Receivable Section to aggressively pursue collections on every outstanding balance owed to the North Carolina Department of Transportation.” The Department stated that the responsibility of collections for oversize/overweight vehicle penalties fell under the authority of the Department of Crime Control and Public Safety (CCPS) when *Section 6 of General Statute 20-99(e)* was ratified in 2001.

¹ G.S 20-118(e)(7)

² Balance as of June 30, 2011.

AUDIT FINDINGS AND RESPONSES

However, *G.S. 20-99* was repealed effective January 1, 2008. As a result, CCPS has taken the stand that the ultimate responsibility for the collection of oversize/overweight vehicle penalties lies within the Department, pursuant to *G.S. 20-118(e)(7)*.

In reality, the responsibility for assessment and collection of oversize/overweight vehicle penalties is spread between two agencies, the Department and CCPS.¹ State Highway Patrol troopers and weigh station operators often collect the penalties for oversize/overweight vehicle infractions when they issue the citations. Additionally, CCPS has procedures in place to establish a payment plan for these penalties that are payable to the Department.

However, once a payment plan is established, neither CCPS nor the Department makes any further collection efforts if the penalties are not paid.

Most drivers penalized for oversize/overweight violations are compliant and pay the fine. Since 1997, The Department reports that State Highway Patrol troopers and weigh station operators assessed \$96.8 million in penalties and the Department collected or cleared \$92 million of that amount for a collection rate of 95%.

Failure to actively manage the collection outstanding oversize/overweight vehicle penalties has deprived local school systems of about \$4.8 million rightfully owed them.

Recommendations:

The Department should manage the collection of oversize/overweight vehicle penalties in accordance with its Cash Management Plan.

Additionally, the Department should pursue legislation to transfer all assessment, collection, reporting responsibilities of oversize/overweight penalties to a single agency.

Agency Response:

DOT will update our Cash Management Plan to detail the process used for the Oversize/Overweight Program inclusive of State Highway Patrol (SHP) responsibilities. During the review, NCDOT consulted with SHP and asked them to reinstate the 60 day dunning letters that were stopped last summer. This will be done by the end of March 2012. Since the inception of the Program, interest and penalties have been assessed for past due accounts.

¹ *G.S. 20-118(e)(1)* and *20-118(e)(3)* gives the sole authority of assessing oversize/overweight penalties to the Department of Crime Control and Public Safety. *G.S. 20-118(e)(7)* states “the clear proceeds of all civil penalties...that are collected by the Department of Transportation...shall be remitted to the Civil Penalty and Forfeiture Fund in accordance with *G.S. 115C-45.2*.”

AUDIT FINDINGS AND RESPONSES

Furthermore, SHP feels that having expanded access to the Motor Carrier Enforcement System would allow officers to better manage and control the process on the roadside thereby increasing collections for outstanding assessments. Today citation look-ups can only be made at the Weigh Stations and by Motor Carrier officers. We will work with SHP on implementing this capability.

Agency leadership at DOT and SHP recognize it is in the best interest of the State if we continue to work together on identifying more efficient ways to enforce and collect Oversize/Overweight citations. The agencies will meet routinely to identify and plan a process to be more effective including the use of the State's Debt Set-off Program, a collection agency, and turning over past due accounts to the Attorney General.

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:

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