

**Audit Results From  
CAFR and Single Audit Procedures**

**Department of Transportation**

**For the Year Ended  
June 30, 2005**

**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY**

**Department of Audit  
Division of State Audit**

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**Department of Transportation  
For the Year Ended June 30, 2005**

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**Department of Transportation  
For the Year Ended June 30, 2005**

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**EXECUTIVE SUMMARY**

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**Finding**

DOT management did not ensure departmental policies and procedures and federal regulations were followed regarding the Davis-Bacon Act, increasing the risk of workers not receiving the prevailing wage rates.

This report addresses reportable conditions in internal control and noncompliance issues found at the Department of Transportation during our annual audit of the state's financial statements and major federal programs. The scope of our audit procedures at the Department of Transportation was limited. During the audit for the year ended June 30, 2005, our work at the Department of Transportation focused on the Highway Fund, a special revenue fund in the *Tennessee Comprehensive Annual Financial Report*. Our audit of the fund included determining whether the department had an adequate system of internal control over financial reporting. We also performed certain audit procedures to obtain reasonable assurance about whether the State of Tennessee's financial statements were fairly presented. In addition, our work at the Department of Transportation included one major federal program: Highway Planning and Construction. We audited this federally funded program to determine whether the department complied with certain federal requirements and whether the department had an adequate system of internal control over the program to ensure compliance. Management's response is included following the finding.



STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**

State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

John G. Morgan  
Comptroller

March 28, 2006

The Honorable Phil Bredesen, Governor  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

and  
The Honorable Gerald F. Nicely, Commissioner  
Department of Transportation  
Suite 700, James K. Polk Building  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith are the results of certain limited procedures performed at the Department of Transportation as a part of our audit of the *Comprehensive Annual Financial Report* of the State of Tennessee for the year ended June 30, 2005, and our audit of compliance with the requirements described in the U.S. Office of Management and Budget Circular A-133 Compliance Supplement.

Our review of management's controls and compliance with laws, regulations, and the provisions of contracts and grants resulted in a finding which is detailed in the Finding and Recommendation section.

Sincerely,

John G. Morgan  
Comptroller of the Treasury

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STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY  
DEPARTMENT OF AUDIT  
DIVISION OF STATE AUDIT

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December 20, 2005

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have performed certain audit procedures at the Department of Transportation as part of our audit of the financial statements of the State of Tennessee as of and for the year ended June 30, 2005. The scope of our work included the Highway Fund, a special revenue fund in the *Tennessee Comprehensive Annual Financial Report*. Our objective was to obtain reasonable assurance about whether the State of Tennessee's financial statements were free of material misstatement. We emphasize that this has not been a comprehensive audit of the Department of Transportation.

We also have audited certain federal financial assistance programs as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement. The following table identifies the State of Tennessee's major federal program administered by the Department of Transportation. We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Tennessee complied with the types of requirements that are applicable to each of its major federal programs.

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**Major Federal Program Administered by the  
Department of Transportation  
For the Year Ended June 30, 2005  
(in thousands)**

<u>CFDA Number</u>	<u>Program Name</u>	<u>Federal Disbursements</u>
20.205	Highway Planning and Construction	\$653,226

Source: State of Tennessee's Schedule of Federal Financial Assistance for the year ended June 30, 2005.

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The Honorable John G. Morgan  
December 20, 2005  
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We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards contained in Government Auditing Standards, issued by the Comptroller General of the United States.

We have issued an unqualified opinion, dated December 20, 2005, on the State of Tennessee's financial statements for the year ended June 30, 2005. We will issue, at a later date, the State of Tennessee *Single Audit Report* for the same period. In accordance with *Government Auditing Standards*, we will report on our consideration of the State of Tennessee's internal control over financial reporting and our tests of its compliance with certain laws, regulations, and provisions of contracts and grants in the *Single Audit Report*. That report will also contain our report on the State of Tennessee's compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our procedures, we identified an internal control and compliance issue related to the major federal program at the Department of Transportation. This issue, along with management's response, is described immediately following this letter. We have reported other less significant matters involving the department's internal control to the Department of Transportation's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA  
Director

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## FINDING AND RECOMMENDATION

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**DOT management did not ensure departmental policies and procedures and federal regulations were followed regarding the Davis-Bacon Act, increasing the risk of workers not receiving the prevailing wage rates**

### Finding

The Department of Transportation has established program policies and procedures to comply with the Davis-Bacon Act. However, as noted in 16 of the past 21 years (beginning with the year ending June 30, 1984), department personnel do not always adhere to these policies and procedures to monitor classifications and wage rates as required by the Davis-Bacon Act. In addition, the department is not always receiving contractor or subcontractor payrolls within the time frame required by the Copeland Act.

The Davis-Bacon Act requires laborers and mechanics employed by contractors or subcontractors on federal contracts to be paid no less than the prevailing wage rates established for that locale by the U.S. Department of Labor. To monitor compliance with this requirement, the department has established a system whereby designated personnel check contractor and subcontractor payrolls during each month of a project. Also, the project engineer or his representative is required to conduct a specific number of interviews with laborers and mechanics to verify the accuracy of payroll records examined. A separate interview form is completed and signed by the laborer or mechanic and the project engineer to document each interview. In response to prior findings, the department issued Circular Letter 1273-03 effective January 1, 2004, which, as amended, requires that the project engineer conduct one labor interview on each federal aid contract every month. The interviews are required to be documented on Form C-27. These interviews provide evidence of on-site visits to monitor classifications and wage rates. In addition, the department required project supervisors to certify that the required labor interviews for the month had been performed or if not, explain why.

For 4 of 46 construction contracts tested (8.70%), the project engineers had not always conducted a sufficient number of labor interviews. Two of the four problem contracts had no labor interviews that could be verified as performed for the applicable month being tested. However, the project supervisor certified the required interviews had been performed on the Engineers Estimate of Quantities report. For the other two problem contracts, a labor interview was performed, but the auditor could not confirm that the contractor was working on that particular day. The auditor cannot confirm whether this was a problem of insufficient recordkeeping, the incorrect contractor or date listed on the interview, or the daily journal not being located.

For 9 of 46 construction contracts tested (19.57%), there was no indication that the project engineer compared the labor interview to the applicable contractor or subcontractor payroll. For two of the interviews, the labor interview was signed as being reviewed before the

pay period was complete. Another two interviews had no labor interview performed for the applicable pay period being tested. For the remaining five interviews, a labor interview was performed, but there was no evidence that the interview was compared with the applicable payroll to ensure the prevailing wage was paid.

For 2 of 46 construction contracts tested (4.35%), the Copeland Act does not appear to have been followed. Under the *Code of Federal Regulations*, Title 29, Part 3, Section 4(a), contractors or subcontractors are required to submit certified payrolls, within seven days of the payroll pay date, to a representative of a federal or state agency at the site of the building or work. If no such representative is present, the certified payroll should be mailed to the federal or state agency within seven days. These two payrolls were received between 9 and 106 days late. For an additional 15 payrolls, the date payrolls were received could not be determined since the payrolls were not date stamped or the review date was not indicated. As a result, compliance with the Copeland Act could not be determined for these 15 contracts.

The Department of Transportation is required to comply with the Davis-Bacon Act and all other applicable federal regulations. Without sufficient compliance with Department of Transportation standards and federal regulations, material compliance with the Davis-Bacon Act cannot be assured.

### **Recommendation**

The Commissioner should ensure that departmental policies and procedures established to monitor compliance with the Davis-Bacon Act are followed for all projects, including performing timely labor interviews and comparing the labor interviews to payrolls. The Commissioner should also ensure that the Copeland Act is followed by requiring its contractors or subcontractors to submit certified payrolls when due and ensuring these are reviewed by project engineers in a timely manner. Management should consider adding appropriate language to contracts to comply with applicable provisions of the Copeland Act. In addition, the department should develop a policy to date stamp payrolls upon receipt to ensure contractors or subcontractors have submitted payrolls within the time frame required by the Copeland Act. Performing these procedures is important to ensure that workers are paid prevailing wage rates while projects are ongoing rather than discovering a problem when the projects are finished.

### **Management's Comment**

We concur that departmental policies and procedures were not followed. Federal regulations do not prescribe a number or a percentage of employee interviews, only that they be conducted. The frequency is set by the individual State DOT. Although we have not met the self-prescribed frequency, the department believes it has met the federal requirement of conducting employee interviews. However, we will develop a policy to address the frequency issue, cross checking the interview with the payroll, and dating the payrolls when received. This will include a tracking system where the interviews will be recorded.

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## STATUS OF PRIOR AUDIT FINDING

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### State of Tennessee *Single Audit Report* for the year ended June 30, 2004

An audit finding pertaining to the Department of Transportation was included in the *Single Audit Report*. The updated status of this finding as determined by our audit procedures is described below.

#### **Resolved Audit Finding**

The current audit disclosed that the Department of Transportation has corrected the previous audit finding concerning system administrative and security controls.

### Most Recent Financial and Compliance Audit

Audit report number 03/100 for the Department of Transportation, issued in May 2004, contained no audit findings.

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## OBSERVATIONS AND COMMENTS

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### **Management's Responsibility for Risk Assessment**

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during

the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumstances that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the commissioner.

### **Fraud Considerations**

Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, and not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.