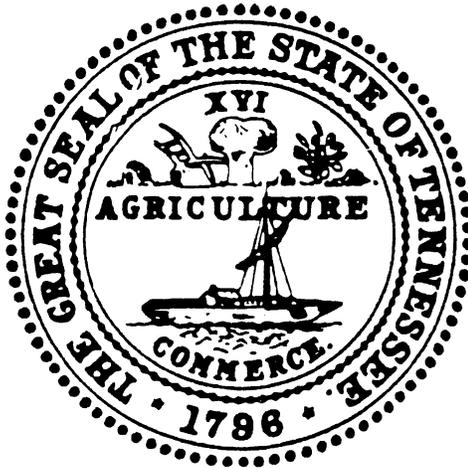


# AUDIT REPORT

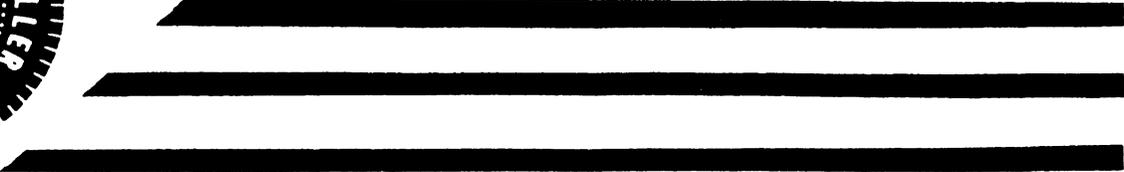
Department of Transportation

February 2007



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY

Department of Audit  
Division of State Audit



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STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**

State Capitol  
Nashville, Tennessee 37243-0260  
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John G. Morgan  
Comptroller

February 27, 2007

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 is the financial and compliance audit of the Department of Transportation for the period February 1, 2004, through February 28, 2006.

The review of internal control and compliance with laws and regulations resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

A handwritten signature in black ink that reads "John G. Morgan".

John G. Morgan  
Comptroller of the Treasury

JGM/ddm  
06/036



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

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March 31, 2006

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

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Transportation for the period February 1, 2004, through February 28, 2006.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of internal control significant to the audit objectives and that we design the audit to provide reasonable assurance of the Department of Transportation's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of Transportation is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's management has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the department's internal control and instances of noncompliance to the Department of Transportation's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA  
Director

AAH/ddm

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
**Department of Transportation**  
February 2007

## AUDIT SCOPE

We have audited the Department of Transportation for the period February 1, 2004, through February 28, 2006. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of railroad inspection fees, insurance claim settlements, Cumberland City Ferry service toll fees, sale or rental of excess property, vehicle fleet monitoring, regional and district garages, travel, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration, producing a compilation of subrecipient expenditure amounts, approving certain state contracts, and participating in the negotiation and procurement of services for the state.

## AUDIT FINDINGS

### **Management Has Not Assessed and Mitigated the Risks Associated With Inadequate Controls Over the Collection of Railroad Usage Fees, Which Increases the Risk of Not Collecting All Fees Due**

The department did not bill six railroad companies for the required usage fees. The department also failed to assess late payment fees to six of seven late railroad receipts tested. In addition, the department has not established written policies and procedures over these processes (page 4).

### **Management Has Not Assessed and Mitigated the Risks Associated With Incomplete Documentation of the Preventative Maintenance Performed on the Department of Transportation's Mobile Fleet Units, Which Increases the Risk of Improper Maintenance**

Departmental employees at the regional garages could not provide the preventative maintenance schedule forms for 6 of 25 state vehicles tested. Four of the missing forms were from the Clarksville garage. These forms are necessary to document that proper maintenance was performed on all state vehicles (page 9).

# Financial and Compliance Audit Department of Transportation

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# Financial and Compliance Audit Department of Transportation

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## INTRODUCTION

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### POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Transportation. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which requires the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

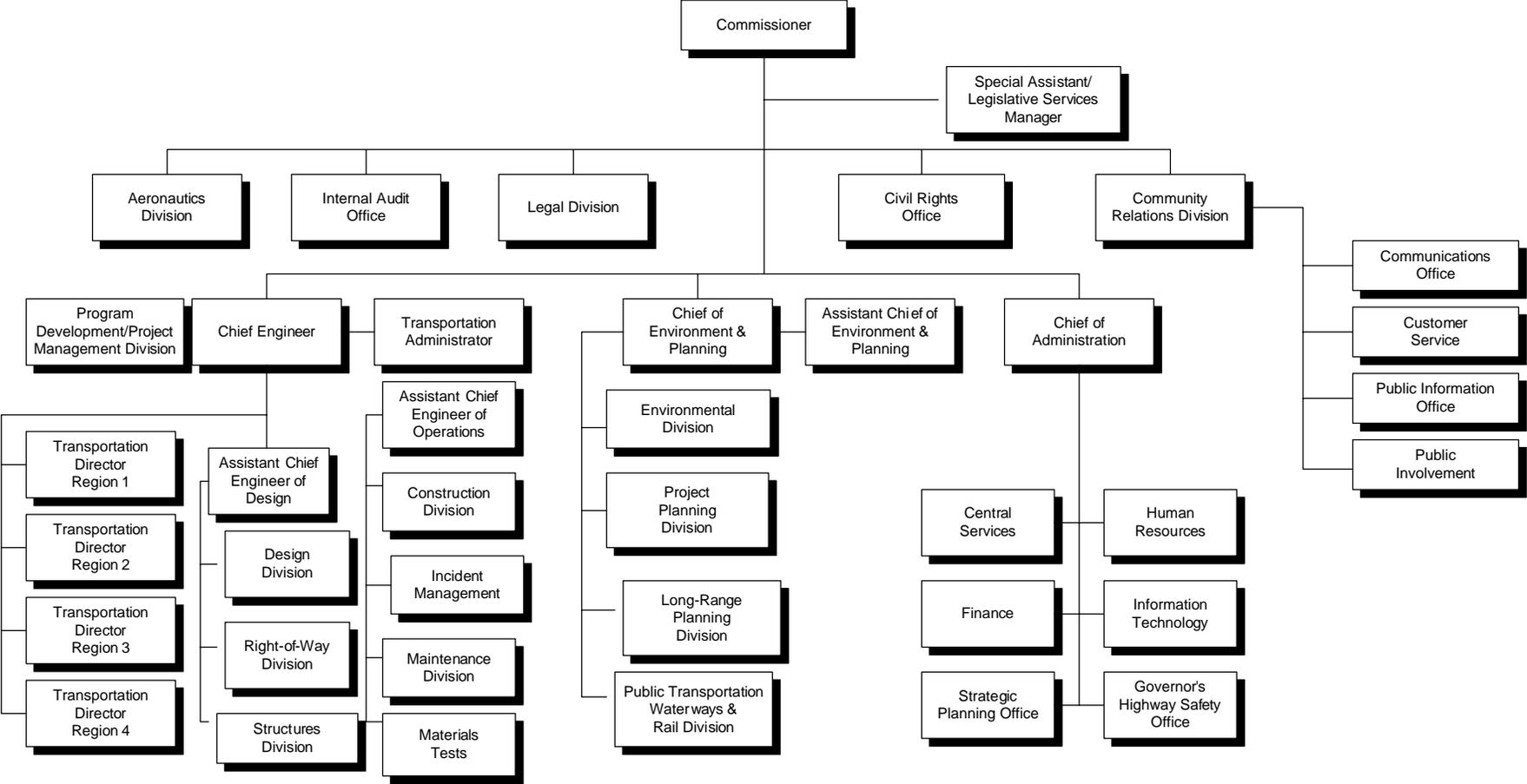
### BACKGROUND

The mission of the Department of Transportation is to plan, implement, maintain, and manage an integrated transportation system for moving people and products, with emphasis on quality, safety, efficiency, and the environment. In order to fulfill this mission, the department has a Bureau of Engineering that administers all phases of transportation programs from planning, constructing, and maintaining of highways to administering field work.

Along with its roadway activities, other duties for the bureau include planning and developing rail transportation, providing aerial photography and mapping services, maintaining and operating state-owned aircraft, issuing permits for overdimensional vehicles, funding assisting publicly owned airports, and controlling outdoor advertising on state highways. The department also provides maintenance on the department’s general vehicle fleet and technical and funding assistance to over 300 public transportation agencies.

With approximately 4,500 employees and a budget over 1.8 billion dollars, the department is one of the largest agencies in state government. An organization chart of the department is on the following page.

# Tennessee Department of Transportation Organization Chart



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## AUDIT SCOPE

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We have audited the Department of Transportation for the period February 1, 2004, through February 28, 2006. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of railroad inspection fees, insurance claim settlements, Cumberland City Ferry service toll fees, sale or rental of excess property, vehicle fleet monitoring, regional and district garages, travel, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration, producing a compilation of subrecipient expenditures amounts, approving certain state contracts, and participating in the negotiation and procurement of services for the state.

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## PRIOR AUDIT FINDINGS

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There were no findings in the prior audit report.

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## OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

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### RAILROAD INSPECTION FEES

The Tennessee Department of Transportation is responsible for collecting fees from railroads doing business in the state. The railroads are required by Section 65-3-201, *Tennessee Code Annotated*, to pay to the state on or before July 1 of each year a fee for the inspection, control, and supervision of the business, service, and rates of such railroads. The amount of the fee is self-assessed based upon the lesser of ton miles operated annually in the state or a formula computed based on ton mileage from the 1990s. The Railroad Regulatory Section of the Public Transportation, Waterways and Rail Division of the department oversees track inspections, signal and train control inspections, and railroad operating and safety programs and procedures.

The objectives of our review of the controls and procedures relating to railroad inspection fees were to determine whether

- the policies and procedures were adequate and based on current state law;

- controls over funds collected for inspection fees were adequate;
- receipts were correctly recorded in the accounting system; and
- all railroads were billed appropriately.

We reviewed applicable laws and regulations relating to railroad inspection fees. We interviewed key personnel to gain an understanding of policies, procedures, and controls. We performed testwork on a nonstatistical sample of receipts from February 1, 2004, through December 31, 2005, to determine whether the receipts were adequately recorded in the accounting system. We reviewed railroads doing business in the state and compared them to railroad fees billed and collected.

Based on our testwork, we determined that receipts were correctly recorded in the accounting system. However, our interviews, review of supporting documentation, and testwork indicated that policies, procedures, and controls for railroad inspection fees were not adequate based on current state law and that railroads were not billed appropriately. These problems are noted below in finding 1.

**1. Management has not assessed and mitigated the risks associated with inadequate controls over the collection of railroad usage fees, which increases the risk of not collecting all fees due**

**Finding**

The Department of Transportation has not established policies and procedures governing the collection of railroad usage fees and the assessment of penalties for railroads who fail to pay fees. Furthermore, the Department of Transportation did not always bill railroad companies for the annual fees or assess penalties for late payments.

Section 65-3-201, *Tennessee Code Annotated*, requires every railroad doing business in Tennessee to pay an annual fee for the inspection, control, and supervision of the railroad companies. In addition, Section 65-3-203, *Tennessee Code Annotated*, establishes a penalty charge for railroad companies that fail to pay the annual fees.

Based on testwork performed, management has not billed six railroad companies the required usage fees even though these companies have operated in Tennessee since 2003. According to management, required annual statements are used to bill the railroad companies. Section 65-3-206, *Tennessee Code Annotated*, requires every railroad doing business in the state to file an annual statement with the department providing certain railroad use information. Management stated that these railroad companies did not file the required annual statements, and no action was taken to obtain the statements or to bill the railroad companies. Furthermore, there appears to be a lack of communication between the Railroad and Finance Divisions of the department. The Finance Division prepares the bills and receives payments from the railroad companies. However, both the Railroad and Finance Divisions were receiving the annual

statements. As a result, no one was checking to be sure that all railroad companies had filed the annual statement and that bills were sent to all the railroad companies.

Testwork also revealed that for six of seven late railroad receipts tested (86%), management failed to assess the late payment fees to the railroad companies. An examination of all receipts received from railroad companies revealed that the department had not collected approximately \$28,775.79 in late fees due for the period February 2004 through December 2005.

Without proper policies and procedures and controls over billing and collecting the usage fees and assessment of penalties, the risk of uncollected fees and understatement of revenues is increased.

### **Recommendation**

Management should ensure that the risks noted in this finding, including the risk of railroad companies operating in Tennessee which have failed to file annual statements, are adequately identified and assessed in management's documented risk assessment activities. Among the risks management should identify and mitigate is the risk that staff could improperly waive fees and penalties. Management should assign specific personnel to ensure the development of formal policies and procedures for the billing and collecting of railroads usage fees. These policies and procedures should include the guidelines for the assessment of late fees. Management should ensure that adequate measures are in place to assure that all railroad companies operating in Tennessee have filed the required annual statements, to promptly determine which railroads should be charged the annual usage fees and applicable late fees, and to bill railroad companies accordingly. Management needs to identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur. All controls and control activities, including monitoring, should be adequately documented in management's formal risk assessment.

### **Management's Comment**

We concur. The following procedure has been developed to address the finding. In order to ensure all railroads operating in the state are billed, the Finance Office shall prepare a schedule of railroads to be billed. The schedule shall include the name, address, and contact person for each railroad. This schedule shall be verified by the Public Transportation Division, Waterways and Rail Office, and corrected as appropriate.

The Statement of Ton Miles and Computation of Inspection Fee Form is used by the railroads to calculate the Ton Mile Tax. This form shall be mailed to all railroads listed on the amended schedule no later than April 1 of each year. Payments received shall be recorded and deposited in a separate account known as the Railroad Account. By June 5 of each year, a reminder shall be sent to all railroads that have not paid the Ton Mile Tax for the previous calendar year as of May 31. This reminder shall clearly state the penalty imposed by TCA 65-3-

203 is 10% of the Ton Mile Tax for each month or fraction thereof that the payment is late. If any railroad does not pay the Ton Mile Tax on or before July 1, a letter shall be sent instructing them to remit the tax amount plus 10% of that amount for each month or fraction thereof that the tax payment is late.

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## **INSURANCE CLAIM SETTLEMENTS**

The Department of Transportation is responsible for the collection of insurance claim settlements. Insurance claims stem from damage to department property through auto accidents or damages to department vehicles. Traffic reports are received and damages to state property are billed to the responsible parties.

The objectives of our review of the controls and procedures relating to insurance claim settlements were to determine whether

- the policies and procedures were adequate and were followed;
- controls over funds collected for claims were adequate;
- receipts were correctly recorded in the accounting system; and
- receipts agreed to property damage reports.

We interviewed key personnel to gain an understanding of policies, procedures, and controls over insurance claim settlements. We performed testwork on a nonstatistical sample of receipts from February 1, 2004, through November 4, 2005, to determine whether the receipts were adequately recorded in the accounting system. We compared receipts to property damage reports to determine if the receipts and reports agreed.

Based on our interviews, review of supporting documentation, and testwork, we found that policies and procedures for insurance claim settlements were adequate and were followed, controls over funds collected were adequate, receipts were correctly recorded in the accounting system, and receipts agreed to property damage reports.

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## **CUMBERLAND CITY FERRY SERVICE TOLL FEES**

The Tennessee Department of Transportation is responsible for the operation of a ferry boat across the Cumberland River in Cumberland City, Tennessee. The ferry service provided by the Cumberland City Ferry is required by Section 54-11-308, *Tennessee Code Annotated*, and the department has contracted for this service for several years. The contractor is responsible for the collection of the ferry service toll fees.

The primary objectives of our review of the Cumberland City Ferry service toll fees were to determine whether

- the department's controls over ferry service toll fees were adequately designed;
- ferry service toll fees were charged in accordance with state law;
- fee receipts were deposited timely;
- fee receipts agreed to the ticket sales for the corresponding day; and
- fee receipts were correctly recorded in the accounting system.

To accomplish our objectives, we interviewed key personnel to gain an understanding of procedures and controls. This included a visit to the Cumberland City Ferry on January 12, 2006, where controls over fee receipts were observed. We tested a nonstatistical sample of ferry service toll fee receipts from February 1, 2004, through November 4, 2005, to determine if fees were charged in accordance with state law, fee receipts were deposited timely, fee receipts agreed to the ticket sales for the corresponding day, and fee receipts were correctly recorded in the accounting system.

As a result of interviews, observations, and testwork performed, we determined that

- in all material respects, the department's controls over ferry service toll fees were adequately designed;
- ferry service toll fees were charged in accordance with state law;
- fee receipts were deposited timely;
- fee receipts agreed to the ticket sales for the corresponding day in all material respects; and
- fee receipts were correctly recorded in the accounting system.

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## **SALE OR RENTAL OF EXCESS PROPERTY**

The Tennessee Department of Transportation obtains parcels of land, called right-of-way, for use in road construction. If the department will not need the purchased land in the immediate future, the land can be rented until needed. When the construction project has been finished, or the finalized routes or exact locations have been determined, many times the right-of-way is not used when the project is complete. Excess lands not used during construction may be sold.

Our objectives were to determine whether

- the department's procedures and related controls over the sale or rental of excess property were adequate;

- property appraisals were obtained when required for sales of excess property;
- departmental requirements were followed for declaring right-of-way property as excess property;
- bids were obtained when required for the sale of excess property;
- sales of excess property were properly approved;
- fair value estimates were prepared when required by departmental personnel for the rental of excess property; and
- signed agreements were obtained for the rental of excess property and the property was included on the departmental listing of rental agreements.

To accomplish our objectives, we interviewed key agency personnel to gain an understanding of procedures and controls over the sale or rental of excess property. We also reviewed written procedures. We tested a nonstatistical sample of revenue transactions for property sales and rentals from February 1, 2004, through November 4, 2005, to determine that appraisals, bids, and fair value estimates were obtained or prepared when required, departmental requirements were followed for declaring right-of-way property as excess property, sales of excess property were properly approved, and signed agreements were obtained for the rental of excess property. We also obtained the departmental listing of rental agreements and verified all rental agreements tested in the above sample were included on this listing.

As a result of interviews and testwork performed, we determined that

- procedures and controls over the sale or rental of excess property were adequate;
- appraisals were obtained when required for sales of excess property;
- departmental requirements were followed for declaring right-of-way property as excess property;
- bids were obtained when required for the sale of excess property;
- sales of excess property were properly approved;
- fair value estimates were prepared when required by departmental personnel for the rental of excess property; and
- signed agreements were obtained for the rental of excess property and the property was included on the departmental listing of rental agreements.

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## **VEHICLE FLEET MONITORING**

The department manages a fleet of approximately 1,700 light-duty passenger vehicles. The department performs preventative maintenance on these vehicles and also other state vehicles as necessary. The department provides vehicle operators with Fuelman fleet cards. The

Fuelman program provides the department with data on the amount and grade of fuel purchased for each vehicle to help the department better track fuel expenses.

The objectives of our review of vehicle fleet monitoring were to determine whether

- the department's policies and procedures over vehicle fleet monitoring were adequate;
- the required preventative maintenance was performed in a timely manner and according to departmental policies; and
- gasoline purchases made with Fuelman cards were proper.

To accomplish our objectives, we interviewed key personnel to gain an understanding of department policies and procedures over vehicle fleet monitoring. We performed testwork on a sample of garage work orders to determine if the required preventative maintenance on the department's vehicles was performed timely and in accordance with departmental policies. We also selected a sample of department vehicles and tested the vehicles' gasoline purchases for randomly selected one-month periods to determine if gasoline purchases made with Fuelman cards were proper.

Based on our interviews, review of supporting documentation, and testwork, we found the department's policies and procedures over vehicle fleet monitoring were adequate and gasoline purchases made with Fuelman cards were properly made, in all material respects. We also found that preventative maintenance on the department's vehicles was performed timely. However, we found that preventative maintenance on the department's vehicles was not performed according to departmental policies. This is discussed below in finding 2.

**2. Management has not assessed and mitigated the risks associated with incomplete documentation of the preventative maintenance performed on the Department of Transportation's mobile fleet units, which increases the risk of improper maintenance**

**Finding**

Management of the Department of Transportation (DOT) has not ensured that DOT employees always complete the preventative maintenance inspection forms for preventative maintenance performed on its mobile fleet units as required by their own policy. The DOT *Garage Operations Manual* states that the purpose of the Programmed Preventative Maintenance program (PPM) is to provide cost-effective maintenance and repairs for safe and efficient operation of the state's mobile fleet units (state vehicles). The mobile fleet units are scheduled for preventative maintenance at their home base garages, and the services are performed by DOT employees. The DOT *Garage Operations Manual* requires employees to document the preventative maintenance they have performed on the mobile fleet units by placing a check next to the activities outlined on the preventative maintenance inspection form. DOT employees also document preventative vehicle maintenance, along with all other vehicle work, on garage work order forms. The department uses these garage work order forms to update the department's

system which tracks vehicle maintenance to ensure all vehicles receive the required preventative maintenance. The garage work order forms are not designed to provide as much detail as the preventative maintenance inspections forms.

We reviewed a sample of 25 vehicles selected from four DOT garages (Nashville, Gallatin, Clarksville, and Cookeville). Our testwork revealed that DOT management could not provide the preventative maintenance inspection forms for 6 of 25 vehicles tested (24%). However, management did provide the corresponding garage work order forms for these six vehicles. The Clarksville garage could not provide four of the six missing preventative maintenance inspection forms. In addition, a DOT mechanic did not sign the garage work order form for one of the four vehicles. The Clarksville garage supervisor stated he was unaware of this widespread problem when we notified him. The Clarksville garage supervisor later stated that laziness seemed to be the main reason employees did not fill out the preventative maintenance inspection forms. However, the Clarksville garage supervisor also stated that he is now monitoring the employees to ensure the preventative maintenance inspection forms are completed. The supervisor over the regional garages also stated he was unaware of the problem.

The Gallatin and Nashville garages were unable to provide the remaining two preventative maintenance inspection forms and did not know the forms were missing until we requested them. Although only one form was not located at each of these garages, it is important that all preventative maintenance inspection forms are properly completed and retained to thoroughly document that proper maintenance was performed and identify any vehicle parts needing replacement or repair. Providing this preventative maintenance is a primary purpose of the regional garages.

### **Recommendation**

The Commissioner and Chief Engineer should ensure that all garages are using the required preventative maintenance inspection forms as a guideline when performing preventative maintenance and that the forms are properly completed and filed in the mobile fleet unit file folders.

The Commissioner and Chief Engineer should ensure that the risks noted in this finding are adequately identified and assessed in management's documented risk assessment activities. Management should identify specific staff at the appropriate level to be responsible for the design and implementation of internal controls to adequately mitigate the risk of inadequate documentation of preventative maintenance performed on vehicles. Management should also identify staff to be responsible for ongoing monitoring for compliance with preventative maintenance requirements and take prompt action should exceptions occur. All controls and control activities, including monitoring, should be adequately documented in the formal risk assessments.

The Commissioner and Chief Engineer should ensure that fundamental activities such as the preventative maintenance of vehicles and preparation of preventative maintenance inspection

forms are included in any identification of key activities to be performed by the department. The performance or lack of performance of such responsibilities by assigned staff should be adequately documented in performance evaluations, and appropriate personnel actions should ensue to better ensure personal accountability and oversight by responsible staff.

### **Management's Comment**

We concur. To aid compliance in properly filling out preventative maintenance inspection checklists, the TDOT Fleet Manager will draft a memorandum to each Regional Director noting the deficiencies found in completing preventative maintenance forms. Garage Supervisors will be requested to check all garage work orders being closed out to ensure that the appropriate PPM inspection form is attached. Furthermore, it will be recommended that the performance or lack of performance of such responsibilities by assigned staff be included in performance evaluations.

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### **REGIONAL AND DISTRICT GARAGES**

The Tennessee Department of Transportation has four regional garages, along with 33 district garages which keep various forms of supplies and parts at their respective locations. The regional garages keep a larger variety of parts and supplies than the smaller district garages. The garages perform maintenance and repair work on vehicles including dump trucks and tractors. All garages are required to abide by established purchasing policies and procedures when buying items for stock or for direct application.

The objectives of our review were to determine whether

- the department's procedures and related controls over regional and district garages were adequate;
- Tennessee Occupational Safety and Health Act (TOSHA) reports indicated there were specific garages which may be prone to problems;
- work orders were properly prepared for vehicles brought to a garage for repairs; and
- purchases for vehicle repairs were supported and allowable, and bids were obtained when necessary.

To accomplish our objectives, we interviewed key personnel to gain an understanding of procedures and controls over regional and district garages. We reviewed TOSHA reports to acquaint ourselves with any particular problems. We visited five garages (Nashville, Chattanooga, Knoxville, Cookeville, and Crossville) and tested 35 work orders to determine if they were properly prepared. We also reviewed purchases for vehicles repairs to determine if purchases were supported and allowable, and bids were obtained when necessary.

Based on our interviews, review of supporting documentation, and testwork, we determined that procedures and controls over district and regional garages were adequate. We did not identify any specific garages that required additional audit work based on our review of the TOSHA reports. Also, garage work orders were properly prepared, purchases for vehicle repairs were supported and allowable, and bids were obtained when necessary.

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## TRAVEL

The department follows the Comprehensive Travel Regulations issued by the state's Department of Finance and Administration. Our objective was to determine if payments for travel were reasonable, valid, and paid in accordance with the Comprehensive Travel Regulations for the Commissioner and four other employees reporting directly to the Commissioner.

To accomplish our objective, we reviewed the Comprehensive Travel Regulations, interviewed key department personnel responsible for travel, and reviewed supporting documentation to gain an understanding of the controls and procedures over travel. We obtained a listing of all travel claims from February 1, 2004, to December 1, 2005, for the Commissioner and four other employees who report to the Commissioner. We tested the five highest dollar travel claims for each of the five employees to determine if the travel claims and supporting documentation complied with the Comprehensive Travel Regulations and that the travel reimbursements were reasonable and valid.

Based on our interviews, reviews of travel claims and supporting documentation, and testwork, we determined that the travel reimbursements to the Commissioner and four other employees tested were reasonable, valid, and paid in accordance with the Comprehensive Travel Regulations.

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## FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30 each year. In addition, the head of each executive agency is required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objectives were to determine whether

- the department's June 30, 2005, and June 30, 2004, responsibility letters and December 31, 2003, internal accounting and administrative control report were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*;

- documentation to support the department's evaluation of its internal accounting and administrative control was properly maintained; and
- procedures used in compiling information for the internal accounting and administrative control report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*.

We reviewed the June 30, 2005, and June 30, 2004, responsibility letters and the December 31, 2003, internal accounting and administrative control report to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and Administration. We reviewed the supporting documentation for the department's evaluation of its internal accounting and administrative controls. We also interviewed key employees responsible for compiling information for the internal accounting and administrative control report to gain an understanding of the department's procedures.

We determined that the Financial Integrity Act responsibility letters and internal accounting and administrative control report were submitted on time, support for the internal accounting and administrative control report was properly maintained, and procedures used were in compliance with *Tennessee Code Annotated*.

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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 circumventions 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 head of the entity.

## **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, 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.

## **TITLE VI OF THE CIVIL RIGHTS ACT OF 1964**

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30 each year. The Department of Transportation filed its compliance reports and implementation plans on June 30, 2005, and June 30, 2004.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The

Tennessee Title VI Compliance Commission is responsible for monitoring and enforcement of Title VI.

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## APPENDIX

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### ALLOTMENT CODES

Department of Transportation allotment codes:

- 401 Transportation Headquarters
- 402 Bureau of Administration
- 403 Planning and Programming
- 405 Environment and Planning
- 411 Bureau of Operations
- 412 Engineering Administration
- 414 Claims for Injury and Damage
- 416 Area Mass Transit
- 418 Field Construction Operations
- 419 Field Maintenance Operations
- 430 Equipment Administration
- 440 Planning and Research
- 451 Maintenance and Marking
- 453 Betterments
- 455 State Aid
- 470 State Industrial Access
- 472 Interstate Construction
- 475 Forest Highway Construction
- 478 Local Interstate Connectors
- 480 State Highway Construction
- 481 Capital Improvements
- 488 Bridge Replacement
- 494 Transportation Equity Fund