

DEPARTMENT OF TRANSPORTATION

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2004**



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General Information

The Department of Transportation maintains and reports a majority of the Commonwealth's infrastructure, which consists of highways, bridges, tunnels, and right-of-way land, as well as a substantial portion of the Commonwealth's capital assets, including buildings and equipment. For fiscal year 2004, Transportation's infrastructure and other capital assets totaled \$12 billion net of accumulated depreciation. Transportation reports financial information, including asset values and depreciation, related to all of its capital assets for inclusion in the Commonwealth's Annual Financial Report (CAFR).

As a result of the recommendations in the fiscal year 2003 audit, Transportation began improving its capital asset internal controls and financial reporting processes. There has been a proactive attitude and an increase in accountability within Transportation to ensure accurate financial reporting of capital assets for fiscal year 2004.

Transportation has improved its capital asset and financial reporting processes; however, there are several areas that Transportation should continue to improve. Transportation should continue its establishment and definition of roles and responsibilities within the new Capital Asset and Inventory Control Division. This definition will help enhance communication between individuals, divisions, and districts, which still needs improvement specifically relating to the Asset Management Division. In addition, Transportation does not have a reconciliation process for reclassifying assets from one category to another. Transportation did not monitor asset acquisitions to ensure proper capitalization during fiscal year 2004. Although the Asset Management Division performed fuel and equipment inventories, the Capital Asset and Inventory Control Division did not include the Asset Management Division in its asset inventory efforts because Transportation has not yet defined the relationship between the two divisions.

Overall, the adjustments made during this audit were minimal in comparison to the prior years. The net effect of all capital asset audit adjustments totaled \$1.7 million. This was a major improvement from the prior year.

Improve Capital Asset Management and Reporting

Changes from the Prior Year

Transportation hired a Financial Reporting Unit Manager within the Controller's Office to be responsible for the capital asset reporting function. In addition, Transportation is creating a Capital Asset and Inventory Control Division, which will exist directly under the Chief Financial Officer and hired district inventory managers to aid in implementing and executing the new policies and procedures. This Division became effective December 2004 with an Acting Division Administrator. Within this Division, there will be three distinct areas: inventory, capital assets, and compliance. Due to its recent creation, the Division has established responsibility for some, but not all, statewide policies, methodologies, controls, and reporting of assets, but the Division is in the process of defining these functions.

We recommend the Capital Asset and Inventory Control Division have central oversight for each asset area, district, and the Central Office with authoritative control. This oversight should include monitoring, coordinating, and managing the inventory of Transportation's assets during the year, as well as compiling financial reporting information at year end. Transportation should continue to define the responsibilities and functions of the Capital Asset and Inventory Control Division.

Issues

During the fiscal year 2003 audit, we noted the Asset Management Division did not properly capitalize fuel terminals. In response to this finding, in fiscal year 2004, Transportation determined that it had improperly recorded its fuel facilities on the Fixed Asset Accounting and Control System (FAACS) by including the building and the fuel equipment all in one asset. In order to separate the costs between the building and the equipment, the Capital Outlay Division deleted these assets from FAACS and added the fuel canopies as “new assets” to FAACS. Transportation also added the equipment portion of the fuel facilities, including terminals, dispensers, underground storage tanks, and automatic gauging systems to the major equipment database. The assets involved in this process totaled approximately \$24 million.

The process the Capital Outlay and Asset Management Divisions used to record these assets did not provide an adequate audit trail. Although the Asset Management Division instructed the districts on how to make these changes, the districts did not use consistent salvage values for similar assets. The differences resulting from the inconsistent data are immaterial for financial reporting purposes. However, Transportation should review these assets, determine the appropriate useful lives, and adjust the database as needed.

As a result of a complete inventory of buildings and improvements, Capital Outlay deleted and added “new assets” for older buildings, as well as those that had renovations or improvements. Transportation improperly included these changes as new acquisitions rather than prior period adjustments for financial reporting purposes. This error and the errors from the reclassification of the fuel terminals above resulted in a \$2.6 million audit adjustment.

The Commonwealth Accounting Policies and Procedures (CAPP) manual directs agencies not to delete assets from FAACS because it eliminates the audit trail. Transportation should complete a full reconciliation of all differences within FAACS for fiscal years 2003 and 2004 to determine the most appropriate way to report the assets.

Capital Acquisitions

Transportation did not monitor asset acquisitions to ensure proper capitalization prior to June 2004. We found that Transportation did not capitalize 14 percent of asset purchases tested. This is due to the divisions not knowing into “which asset system” they should record the assets. Transportation also does not have documented policies and procedures for purchasing and capitalizing electronic or data processing equipment to distinguish between Transportation and Virginia Information Technologies Agency owned assets. Transportation began monitoring potential asset purchases in June 2004; however, we were unable to determine the effectiveness of this procedure given the short time it was in effect during the fiscal year under audit. The new Capital Asset and Inventory Control Division should continue monitoring asset acquisitions and develop policies for electronic and data processing equipment.

The fiscal year 2003 audit noted that Transportation needed to develop a method to capture and capitalize the cost of improvements other than buildings for existing assets, so that they can capitalize this information by 2006 to comply with Governmental Accounting Standards Board Statement No. 34. Transportation began developing a process to capitalize these costs; however, as of the end of our audit, this methodology was not available for review. Transportation should finalize this methodology, so that it is available for audit and review for fiscal year 2006 financial reporting.

Equipment Management System

Transportation records and tracks the different categories of capital assets using several different systems and an Access database. Transportation’s use of multiple systems and schedules makes tracking

capital assets difficult. One of these multiple systems is the Equipment Management System (EMS) used by the Asset Management Division. Transportation originally developed EMS as an equipment asset maintenance and management system. EMS is an old system and Transportation cannot easily query information out of the system. As reported during the fiscal year 2003 audit, Transportation experienced difficulty implementing financial reporting changes due to the system constraints.

During fiscal year 2004, the Financial Reporting Unit Manager reviewed EMS to improve the quality of the information maintained in the system for financial reporting purposes. As a result, Transportation was able to evaluate and modify EMS so that it could calculate depreciation for the assets and provide the users with a more efficient method of obtaining capital asset information from the system. However, we recommend Transportation continue to evaluate EMS and consider implementing a new asset management system. Transportation should consider incorporating all of its other capital asset systems into a new system.

Asset Inventory Counts

Transportation completed a comprehensive inventory of all asset categories during fiscal year 2004. During this process, Transportation emphasized the importance of performing and certifying asset inventories. The Central Office coordinated and developed an inventory certification process for major equipment, buildings, infrastructure, and data processing equipment. However, the Capital Asset and Inventory Control Division did not include the Asset Management Division in its asset inventory efforts because Transportation has not yet defined the relationship between the two divisions. Not coordinating the scheduling of asset inventory counts among these asset areas can result in inefficiencies in the districts.

We recommend the Capital Asset and Inventory Control Division coordinate the asset inventory efforts for all asset categories to meet the Commonwealth's accounting policy requirement of having inventory counts every two years.

Other Adjustments

Transportation's internal audit performed a review of infrastructure and found that Transportation had not adjusted for highway and road abandonments and discontinuances when capitalizing infrastructure each year. Abandonments and discontinuances represent roadways removed from state service or turned over to the locality. Since the abandoned and discontinued highways and roads are old roads and fully depreciated, there is no effect on the Commonwealth's financial statements. Transportation has identified all discontinuances associated with the primary roadway system, but still needs to adjust the infrastructure amounts for 2006.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

February 1, 2005

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited selected financial records and operations of the Department of Transportation (Transportation) for the year ended June 30, 2004, in support of the Comprehensive Annual Financial Report for the Commonwealth of Virginia.

Audit Objectives, Scope, and Methodology

Our audit's primary objective was to evaluate the accuracy of Transportation's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2004. In support of this objective, we evaluated the accuracy of recording financial transactions in Transportation's accounting records, reviewed the adequacy of Transportation's internal control, tested for compliance with applicable laws and regulations, and reviewed corrective actions of audit findings from prior year reports. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

- Depreciable and Non-Depreciable Capital Assets, including Infrastructure
- Supplies and Materials Inventory
- Operating and Capital Leases
- Installment Purchases

We reviewed and gained an understanding of the overall internal controls, both automated and manual, including controls for administering compliance with applicable laws and regulations, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the following operations:

- Capital Asset, Inventory, Installment Purchase, and Lease Expenditures
- Financial Reporting

Management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and

compliance with applicable laws and regulations. We tested transactions and controls and performed other audit tests we deemed necessary to determine whether Transportation's controls were adequate, had been placed in operation, and were being followed.

Our audit was more limited than would be necessary to provide an opinion on internal controls or on overall compliance with laws and regulations. Because of inherent limitations in internal controls, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Results

We noted a certain matter involving internal control and its operation that we consider to be a reportable condition relative to the Comprehensive Annual Financial Report for the Commonwealth. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect Transportation's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. The reportable condition, entitled "Improve Capital Asset Management and Reporting," is described in the section entitled, "Audit Issues." It will be included in the Commonwealth of Virginia Single Audit Report for the year ended June 30, 2004. We believe that the reportable condition is not a material weakness.

Transportation has taken adequate corrective action to begin addressing the prior year findings, "Improve Capital Asset Management and Reporting," "Improve Internal Controls Over Capital Assets," "Evaluate and Improve the Equipment Management System," and "Improve Controls Over Major Equipment Inventory." However, the size and scope of the issues facing Transportation, will require several years to fully correct. Accordingly, we included these findings in the finding "Improve Capital Asset Management and Reporting" in the section entitled "Audit Issues." Additionally, Transportation has corrected a number of prior year audit findings, which are not repeated in this letter.

We have included management's views concerning this finding and recommendation, as well as their planned corrective actions, at the end of this letter.

We discussed this letter with management on February 10, 2005.

AUDITOR OF PUBLIC ACCOUNTS

DBC/kva
kva:



COMMONWEALTH of VIRGINIA

DEPARTMENT OF TRANSPORTATION

1401 EAST BROAD STREET
RICHMOND, VIRGINIA 23219-2000

PHILIP A. SHUCET
COMMISSIONER

February 11, 2005

Mr. Walter J. Kucharski
Auditor of Public Accounts
P.O. Box 1295
Richmond, VA 23218

Dear Mr. Kucharski,

Thank you for this opportunity to respond to your latest audit of the Department of Transportation's Capital Assets, Leases and Inventory for the fiscal year ended June 30, 2004. We have accomplished much in this area since the Fiscal Year 2003 audit, and I appreciate your recognition of our progress in the report.

The improvements mentioned in the report underscore the commitment we have made to the financial management of the capital asset program. Further improvements will be made to fully address all issues reported. The Chief Financial Officer's recent establishment of the Capital Assets and Inventory Control Division, with its focus on the oversight of the Department's capital asset inventories and valuation methodologies under one umbrella, will bring the necessary accountability and internal control to this area.

I also want to thank your staff for all their work, assistance and guidance during this review.

Sincerely,

A handwritten signature in black ink, appearing to read "Philip A. Shucet", written over a horizontal line.

Philip A. Shucet

Attachment

Virginia Department of Transportation
Action Plan for APA Audit
Fiscal Year 2004

	APA Finding	Actions	Responsible Position	Estimated Completion Date
MP#1	Capital Asset Management and Reporting	1. Define roles and responsibilities of the Capital Assets & Inventory Control Division.	Director of Capital Assets & Inventory Control	June 1, 2005
		2. Develop an action plan to include assets currently controlled by the Asset Management Division under the oversight and direction of the Capital Assets & Inventory Control Division.	Director of Capital Assets & Inventory Control	June 1, 2005
		3. Review the equipment portion of fuel facilities and their appropriate useful lives and salvage values.	Director of Capital Assets & Inventory Control	June 1, 2005
		4. Perform reconciliation of differences within FAACS for FY 2003 and 2004.	Assets & Inventory Control	June 1, 2005
		5. Review and refine as necessary the methodology for monitoring asset acquisitions	Director of Capital Assets & Inventory Control	June 1, 2005
		6. Document and refine procedures for capitalizing electronic or data processing equipment to distinguish between VDOT and VITA owned assets.	Director of Capital Assets & Inventory Control	June 1, 2005
		7. Finalize the methodology for capturing and capitalizing the cost of improvements other than buildings for existing assets.	Director of Capital Assets & Inventory Control	June 15, 2005
		8. Evaluate current systems for reporting assets, including EMS, and consider incorporating all capital assets into a new system.	Director of Capital Assets & Inventory Control	June 15, 2005
		9. Adjust infrastructure amounts, starting with FY 2005, for primary roadway discontinuances and abandonments.	Controller	July 31, 2005