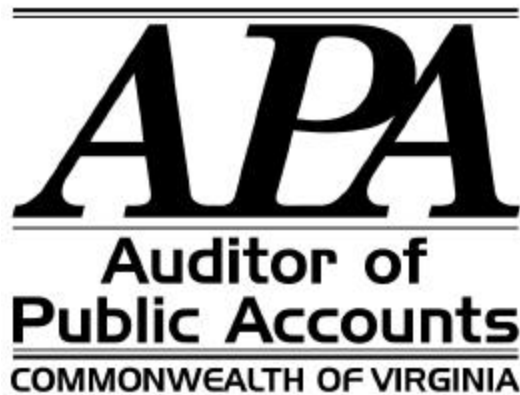


**DEPARTMENT OF TRANSPORTATION
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2000**



AUDIT SUMMARY

Our audit of the Department of Transportation for the year ended June 30, 2000, found:

- Internal control matters that we consider reportable conditions; however, we do not consider any of these to be material weaknesses;
- An issue of noncompliance with applicable laws and regulations tested; and
- Inadequate corrective action on prior year audit findings.

As reported in the previous audit, Transportation did not have adequate controls over inventory policies and procedures and did not properly manage inventory. Transportation addressed some of our concerns; however, we still found instances where policies were not enforced. Transportation did not ensure districts performed all inventory counts and reviews and did not establish procedures for District Administrators to monitor inventory until the end of fiscal year 2000. In addition, inventory turnover rates are extremely low, and district personnel continue to perform inconsistent and subjective compliance reviews.

We also found that Transportation does not properly assign contract administrators or maintain contract records for contracts procured and administered through the Administrative Services Division. We originally reported Transportation's failure to assign contract administrators in our fiscal year 1997 report. In addition, the most recent Department of General Services procurement review noted inadequate contract administrator assignment and incomplete contract files. Failure to properly assign contract administrators and maintain contract records could result in fraudulent activities and mismanagement of contracts.

Transportation has not updated, monitored, or complied with the small purchase charge card policies and procedures, which could result in mismanagement of the program, fraudulent activities, and failure to meet state requirements. The American Express Small Purchase Charge Card program is very decentralized within Transportation. Each district business administrator and division program managers are responsible for managing the program.

In the spring of 2000, the Information Technology Division began upgrading Oracle7 to Oracle8 for all Transportation systems. The Fiscal Division did not have the resources available to begin testing the PeopleSoft application until September 2000. The upgrade of an underlying database requires testing of the applications using it to determine compatibility. Without adequate time to plan, coordinate, and test the application against the upgrade, the Fiscal Division is unable to upgrade the PeopleSoft application on Oracle8 before losing vendor support for the Oracle database on December 31, 2000. Furthermore, Fiscal lost support for the PeopleSoft application in June 2000 and has not developed adequate plans for upgrading this application.

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Agency Highlights

The Virginia Department of Transportation builds, maintains, and operates the state's roads, bridges, and tunnels. Virginia is the third largest state-maintained highway system in the United States, just behind Texas and North Carolina. Transportation maintains over 56,000 miles of interstate, primary, and secondary roads and distributes state funds to help maintain over 10,000 miles of urban streets. Transportation not only maintains roads but also maintains more than 11,700 bridges, four underwater tunnels, two mountain tunnels, two toll roads, one toll bridge, four ferry services, 41 rest areas, and 107 commuter parking lots.

New Transportation Package

Transportation is facing several new challenges in the coming fiscal year and beyond. Transportation is receiving a substantial funding increase in fiscal 2001 as a result of both federal and state legislation. For the first time, the General Assembly developed a list of "priority" projects and designated where Transportation will spend the additional funding. These priority projects are included in legislation passed by the General Assembly during the 2000 session called the Virginia Transportation Act of 2000 (VTA). The Governor has also appointed a 21-member Commission on Transportation Policy to evaluate the policies and procedures that govern transportation in Virginia.

Virginia Transportation Act of 2000

The Virginia Transportation Act (VTA) creates the Priority Transportation Fund, commits General Fund revenues to transportation, and provides for the issuance of \$800 million in Federal Highway Revenue Anticipation Notes (FRANs). Transportation will use the collection of future federal funds to pay debt service on the FRANs. For fiscal 2001, VTA provides a \$3.2 billion Transportation budget.

The Priority Transportation Fund (the Fund) created by the VTA is a special, non-reverting fund and is a component of the Transportation Trust Fund. Any monies remaining in the Fund at the end of each fiscal year will not revert to the general fund but will remain in the Fund. Transportation shall use the monies in the Fund solely to facilitate the financing of priority transportation projects throughout the Commonwealth.

The VTA provides for the following new funding sources over the next six years:

<u>Funding Source</u>	<u>Estimated Amount</u>
General Fund (GF) Appropriations	\$545.8 million
Insurance Premium Tax	\$416.0 million
FRANs (Federal Highway Revenue Anticipation Notes)	\$1,100.0 million
Electronic Fuels Tax Collection	\$228.0 million: State Revenues: \$135.5 million Federal Revenues: \$92.5 million

The Virginia Transportation Development Plan (formerly known as the Six-Year Improvement Program) allocates \$3.06 billion in funding for fiscal 2001 as follows:

<u>Designated Projects</u>	<u>Allocated Funding</u>
Priority Transportation Fund District projects	\$1,200.0 million
Priority Transportation Fund Statewide projects	\$744.0 million
General Fund for existing projects	\$473.2 million
General Fund for Priority Transportation Fund projects	\$416.3 million
Debt Service on bonds for Route 58 and Northern Virginia projects	\$96.0 million
Buses and vans	\$52.0 million
Airports	\$30.0 million
Other projects	\$48.5 million

Federal Highway Revenue Anticipation Notes – FRANs

VTA authorized the Commonwealth Transportation Board to issue FRANs and limits the amount outstanding to no more than \$800 million at any one time. On November 1, 2000, Transportation received \$375 million in proceeds from the first issue of FRANs.

FRANs are a type of Grant Anticipation Revenue Vehicle (GARVEE). These are debt-financing instruments that permit issuers (states) to pledge future federal highway funds to repay investors. Section 311 of the *National Highway System Designation Act of 1995* authorized their issuance and allows a state to use future obligations of federal-aid funds to reimburse the retirement of principal and interest and pay issuance, insurance, and other costs incidental to the sale of eligible debt financing instruments.

Unlike other bonds, these bonds do not finance any specific project or projects. Instead, the proceeds from any FRAN sale may fund all or part of the project cost on any of the projects specified in the VTA as priority projects. While all these projects are eligible to receive FRAN funding, not all of these projects will or should receive such funding.

FRANs have a ten-year term, which provides for the pay-down of bond principal and allows periodic bond re-issuance. Within the next six years, Transportation intends to issue up to \$1.1 billion of these bonds. Up to \$800 million may be outstanding at any time; as existing bonds are retired, the Commonwealth can issue new notes as long as the outstanding principal is less than or equal to \$800 million. Principal repayment is from federal allocations made to each district based on the proportion of bond proceeds used in each district. Interest payment is from Commonwealth Transportation Board statewide allocations.

The planned sales of these bonds are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2001	\$375,000,000
2003	\$350,000,000
2006	\$375,000,000

Transportation Equity Act for the 21st Century - TEA 21

The Transportation Equity Act for the 21st Century (TEA 21) is a federal six-year bill that began in fiscal year 1998 and goes through 2003. It authorized federal funding for the highway, safety, and transit programs. Overall, the legislation provided for an annual highway program funding level increase of 44 percent nationally. It represents a dollar increase of almost 62 percent for the Commonwealth, as well as a 13 percent increase in the state's share of overall federal highway funding.

Commission on Transportation Policy

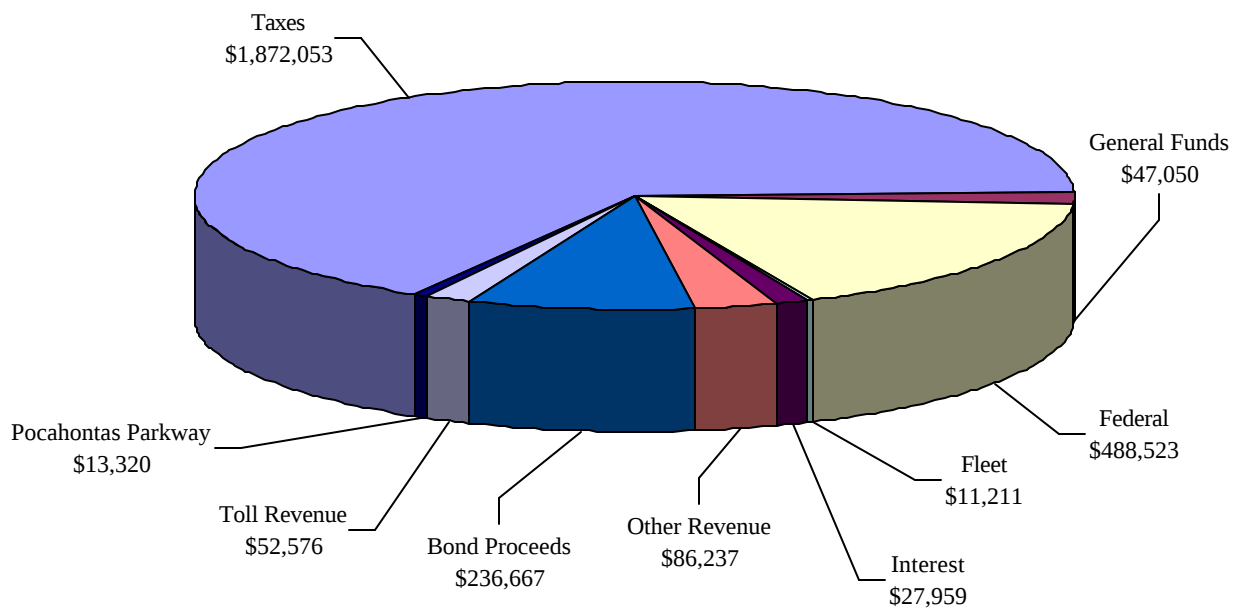
In May 1999, the Governor appointed a 21-member commission to evaluate transportation policies and procedures and to seek new and innovative ways to plan, design, fund, and build transportation infrastructure. The Commission has presented two interim progress reports to the Governor since its inception. The recommendations from these first two reports are reflected in the Virginia Transportation Development Plan and include the use of an inflation factor in project cost projections, and the use of project phases to distinguish between feasibility and capital improvement phases. The Commission's final report was due December 1, 2000.

Financial Information

Transportation's main source of funding is its allocation from the Transportation Trust Fund. Revenues collected by the Departments of Motor Vehicles and Taxation from taxes, licenses, and vehicle registrations fund the Transportation Trust Fund. Transportation received 78.7 percent of Trust Fund revenues collected, which is further allocated within Transportation to the paving of non-surface treated secondary roads and constructing, reconstructing, maintaining, and improving the primary, secondary, and urban road systems. The remaining 21.3 percent of Transportation Trust Fund revenue goes to the Mass Transit, Port, and Airport Funds. The chart below illustrates Transportation's funding sources, including its Transportation Trust Fund allocation.

Sources of Revenue - Fiscal Year 2000

(in thousands)



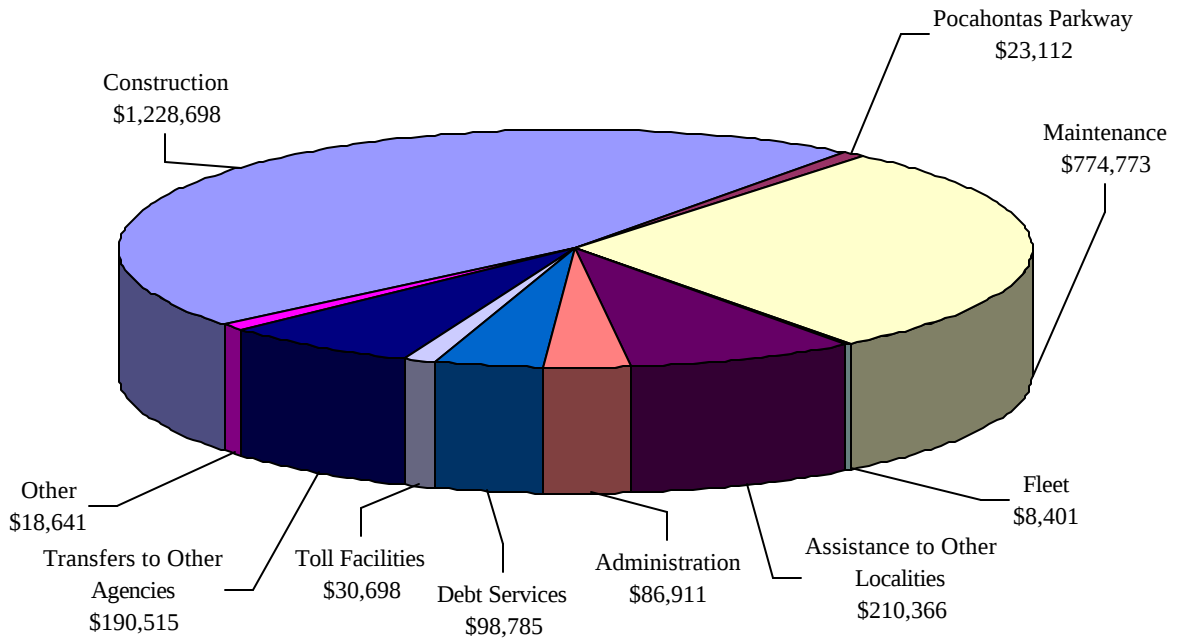
(Source: Cash basis statement of revenues and expenditures for Special Revenue, Internal Service, and Debt Service. Pocahontas Parkway revenues were obtained from the component unit's financial statements that were audited by other auditors.)

VTA requires the Commonwealth Transportation Board to transfer any excess revenues over official revenue estimates in the Transportation Trust Fund (TTF) to the Priority Transportation Fund. VTA states revenues exceeding official forecasts for the TTF should reduce the amounts allocated for highway and mass transit improvements only. At the end of fiscal year 2000, the Commonwealth Transportation Board transferred approximately \$23 million of excess revenues to the Priority Transportation Fund.

Transportation spent over \$2.4 billion in fiscal year 2000 and transferred an additional \$190 million to other agencies. Of the \$2.4 billion in expenses, 90 percent was for construction, maintenance, and assistance to localities and the remaining 10 percent supported administration, toll facilities, debt service, and other expenses. The following chart summarizes expenses and transfers for fiscal year 2000:

Uses of Funds - Fiscal Year 2000

(in thousands)



(Source: Cash basis statement of revenues and expenditures for Special Revenue, Internal Service, and Debt Service. Pocahontas Parkway revenues were obtained from the component unit's financial statements that were audited by other auditors).

Internal Control Background, Findings, and Recommendations

Inventory Management

Transportation uses the Financial Management System (FMSII) to purchase inventory and the Inventory Management System (IMS) (formerly PIMS - Purchasing and Inventory Management System) to track inventory.

IMS is a computerized perpetual inventory network system that links all inventory locations statewide. The Administrative Services Division (ASD) is responsible for the establishment, maintenance, and statewide monitoring of IMS policies and procedures. The District Administrator, under the operational purview of the District Business Administrator (DBA), is responsible for the district-wide adherence to IMS policies and procedures for each of the nine Districts. The DBA's responsibilities include ensuring the performance of monthly sample inventory counts, annual independent physical inventory counts, and compliance reviews at the district.

Continue to Improve Inventory Management and Relevant Inventory Policies and Procedures

To correct the inconsistencies and inaccuracies in IMS noted during the fiscal 1999 audit, Transportation's management agreed to systematically validate its inventory balances before the end of fiscal 2000, perform counts and reviews, and reconcile inventory balances. In addition, during the fiscal 1999 audit, we suggested reviewing and changing several procedures that appear to complicate the maintenance of accurate inventory records and are outdated, unrealistic, or imprecise. Transportation accomplished some, but not all, of these goals during fiscal 2000.

- Transportation performed a statistical inventory count in April 2000, verifying the validity of balances in IMS and bringing IMS and FMSII into agreement. However, the Administrative Services Division (ASD) did not ensure that the districts performed all inventory counts and reviews after the statistical count in April 2000 and did not establish procedures for District Administrators to monitor inventory until June 13, 2000. Consequently, there was no reliable process in place to track and ensure the completeness of the monthly counts. Based on our review, many locations did not perform the monthly counts in May and June 2000. Although IMS automatically generates the required monthly sample inventory counts, several locations are not generating any sample counts. Instead IMS generates reports stating that no items met the sample criteria when in fact they did have items that required counting. One location has not generated a sample count report since July 1999. ASD was not aware of this problem until the auditors brought it to their attention.
- District personnel continue to perform inconsistent and subjective compliance reviews. Different districts use different versions of the forms, resulting in incomparable reviews. Some personnel did not complete the forms or answer all questions, and in some cases, omitted entire pages of information.
- The compliance reviews tested continue to cite an inventory turnover rate of less than 3.0, evidence of obsolete, surplus, or slow-moving stock on hand, and a high overstock percentage (over 30 percent).
- Internal Audit's Unit Cost Testing listed 12 out of 49 items (29 percent) with no activity during fiscal 2000. The date of last activity for two of the items was 1995.
- Districts maintain emergency inventory items. The districts use most of this material only during emergencies (such as snow removal), but must apply all the same policies and procedures monthly to these items as they do to the rest of the inventory, which is inefficient. In addition, the inclusion of these items contributes greatly to both the low inventory turnover rate and the slow moving stock.
- District personnel record unused project inventory items back in the system with a zero dollar value. District personnel also inconsistently assign values to 'found' items and often record them as new items with no value. Found items occur when district personnel return items to inventory stock locations but do not re-enter the items into IMS or they find the items during sample inventory counts. This may have contributed to the lack of system-generated inventory count reports at several district stock locations.

The observations above highlight a need for Transportation to reconsider its policies and procedures over the inventory system and the cost and resources necessary to gather and maintain information. Transportation, in reexamining these policies and procedures, needs to determine that the cost of the internal controls does not exceed the cost of the assets under control.

Specifically, we recommend that ASD should:

- Perform a comprehensive review of IMS and the actual inventory on hand to determine how to eliminate or reduce the amount of obsolete, surplus, and slow-moving stock.

- Establish specific policies on recording items at a zero dollar cost.
- Develop procedures on how to perform compliance reviews consistently throughout the districts.
- Continue the new process for District Administrators to monitor monthly inventory counts and investigate the system issue of not properly generating monthly counts.
- Review the daily reconciliation process and consider whether a monthly, automated process would be more beneficial and efficient.
- Work with district personnel and Financial Accounting and Reporting to review its inventory policies and procedures. During this review, they should address not only the effects of the problems above, but also the source of these problems. By doing this, the Department can re-examine those policies and procedures so that they maintain and improve inventory management.

These are only some examples of changes that could assist district personnel in maintaining accurate inventory information. Since ASD has not done a comprehensive update to the IMS policies and procedures manual since 1992, they have the opportunity to implement a number of similar changes that could streamline the maintenance of record keeping and reduce resources needed to keep inventory records current.

Contract Management

Transportation purchased over \$113 million of goods and services through the use of more than 66,000 contracts procured and administered through the Administrative Services Division (ASD). Contract Administrators use the Financial Management System (FMSII) to track contract expenses and monitor contract budgets. ASD contracts for goods and professional and non-professional services not purchased by districts and divisions and provides procurement training, advice, and guidance to districts and divisions. As of November 2000, the procurement section has added two positions to conduct reviews of district and division procurement activities.

Improve Contract Administration

Transportation does not adequately assign contract administrators and maintain contract records, according to our audit and a review done by the Department of General Services' Division of Purchase and Supply (DGS/DPS) dated August 23, 2000.

Transportation does not properly assign contract administrators in writing. The contract officer did not properly assign a contract administrator to one of three contracts tested during our audit. The Administrative Services Division (ASD) procured this contract centrally; however, multiple districts purchase services from the contract. We noted the lack of an assigned contract administrator for this contract in our fiscal 1997 audit. When ASD renewed the contract in September 2000, the Contract Officer assigned multiple individuals contract administration duties through an assignment letter addressed to "All Contract Administrators Named in the (09/18/2000) E-mail." This form of contract administration assignment is not an adequate method of assignment. Without the related e-mail, the assignment letter has no authority. The DGS/DPS review also noted instances where there was no documentation of assignment of a contract administrator.

Transportation does not adequately maintain contract records. Two of three contract files reviewed were missing required documentation. The DGS/DPS review also noted an extensive lack of documentation throughout the contract files in the Central Office and in each district and residency visited. Missing documents included notice of sole source awards, notice of emergency awards, proper solicitation or competition, emergency procurement justification, price reasonableness determinations, and solicitation of small, women-owned, and minority businesses. Management should ensure that contract files contain all required documentation.

The Agency Procurement and Surplus Property Manual (Manual) requires an agency to assign a contract administrator in writing by designating either a specific individual or position. ASD contract officers should properly assign contract administrators. The assignment should include restrictions on the contract's use, specific responsibilities of the contract administrator, and responsibilities the administrator cannot assume. Contract officers should assign contract administration duties to specific individuals or positions for each district and should assign contract administrators separately, if the contract requires multiple administrators. ASD should also require recipients to respond acknowledging receipt and accepting responsibilities. Assigning responsibility for contract administration is especially important as Transportation continues to decentralize more of its business functions. By moving more business functions out to the employees making the business decisions, it becomes more difficult and more important for management to exercise adequate oversight over these transactions.

Failure to properly assign contract administrators and maintain contract records could result in fraudulent activities and mismanagement of contracts. Management should ensure contract officers and administrators follow all procurement guidelines as outlined in the Manual.

Small Purchase Charge Card Program

State agencies across the Commonwealth use the American Express Small Purchase Charge Card. The Commonwealth encourages use of the card since it offers State agencies an alternative when purchasing low dollar items. The use of the card also eliminates multiple vendor payments and reduces the volume of accounts payable transactions. Transportation purchased over \$19 million in fiscal year 2000 through the use of more than 1,200 American Express Small Purchase Charge Cards.

Update, Monitor, and Comply with Small Purchase Charge Card Procedures

Transportation has not updated, monitored, or complied with the small purchase charge card policies and procedures. Through our review of Transportation's Small Purchase Charge Card Program, we found the following:

- Small purchase charge card procedures are outdated and do not address policy and procedure changes resulting from the implementation of FMSII, small purchase limit increases, monthly transaction limit increases, billing date changes, and program card manager changes in the Central Office divisions.
- Transportation does not maintain cardholder agreements. Two of the twenty-five employees tested did not have cardholder agreements.
- Transportation does not provide adequate training to new cardholders or supervisors.

- Policies and procedures do not address how and when to deactivate a card. Transportation did not deactivate one terminated employee's purchase card until three months after termination. Transportation's policies and procedures state that it is the responsibility of the cardholder to promptly return the purchasing card to their supervisor upon employment termination; however, proper collection of the charge card does not prevent usage of the charge card number.
- Transportation's policies and procedures do not require cardholders to provide a certification of receipt of goods or a supervisor's signature on the charge card statement. Lack of policies and procedures requiring a certification of receipt of goods could result in payments for outstanding goods. The supervisor should approve this certification verifying the receipt of the goods. The certification and supervisory approval ensures all parties are aware of outstanding goods. The supervisor should sign the cardholder charge card statement to provide adequate documentation of the review and that the supervisor knows that cardholder has reconciled the charge card statement to the purchasing log.
- Transportation does not adequately monitor transaction and monthly purchase limits. Transportation relies on the controls in place at American Express to deny charges when employees reach their card limit. Two of the nine districts tested stated they relied on American Express to monitor limits and would increase a cardholder's limit if a charge is denied as a result of reaching the limit.

Failure of Transportation to update, monitor, or comply with small purchase charge card policies and procedures could result in mismanagement of the program, fraudulent activities, and failure to meet state requirements. Management should review their current policies and procedures and update them to reflect the above changes and any additional changes noted during the updating process. Management should also ensure that an individual is responsible for updating the policies and procedures regularly or when there has been a change. Assignment of this responsibility will help ensure agency policies and procedures reflect current state requirements, as well as agency procedural changes.

The American Express Small Purchase Charge Card program is very decentralized within Transportation. Each district business administrator and division program managers are responsible for managing the program. Central Office should ensure each district and division properly follows all policies and procedures established by the agency and the State. Management should also ensure that Central Office periodically reviews the Small Purchase Charge Card program in each district and division to ensure compliance with agency policies and procedures. During our audit, Transportation began a review of its small purchase charge card program, identifying many of the same issues noted above. We encourage Transportation to continue this review and implement corrective action quickly.

Receivables Management

During fiscal 1999, Transportation implemented a new accounting system, Financial Management System (FMSII). The system has six modules that include project accounting, general ledger, accounts receivable, accounts payable, purchasing, and time entry and leave. The implementation of FMSII affected many operational processes, including accounting for receivables.

Develop a System to Adequately Account for and Report Accounts Receivable

As a result of the Financial Management System's (FMSII) inability to properly age accounts receivables, Transportation is not applying proper collection procedures on approximately 70 percent of its receivables, excluding federal accounts. In addition, the system does not automatically generate notices for past due amounts and receivable balances are increasing. If the problem is not corrected, it could result in substantial past due receivables.

Management needs to develop a system and implement internal control procedures to properly and accurately record, age, and account for all receivable transactions. Uncollected accounts should be periodically reviewed and collection actions taken in accordance with Commonwealth accounting policies and procedures and legal requirements. A member of management not involved in cash receipts and disbursements should periodically review aged account balances.

Other Department Issues and Information

Financial Management System

Transportation's new financial management system, FMSII, is a client/server-based system that consists of a PeopleSoft Financial and Human Resources application, an Oracle Database, and a Windows NT FMS Panel Server all running on a Unix operating system. Transportation networks the system over the Commonwealth Telecommunications Network and various local frame relay networks to all Transportation districts, area headquarters, and residencies. There are over 5,000 users of FMSII throughout the Commonwealth.

The FMSII database is running Oracle7, Server Release 7.3.4.3.0, and PL/SQL Release 2.3.4.3.0. The PeopleSoft application is release 6.11 and consists of modules for Accounts Payable (AP), Accounts Receivable (AR), General Ledger (GL), and Purchasing (PO), and Transportation has customized it to include a Project Accounting module and a Time Entry module for employee timesheets. Transportation began implementation of the system in fiscal year 1996 and by the time the system went live in fiscal year 1999, the Fiscal Division understood that the application was close to losing support. Furthermore, the amount of customization to this application has made the process of upgrading very difficult.

Maintain Support for Mission Critical Systems

While the Fiscal Division is responsible for the PeopleSoft application, the Information Technology Division (ITD) is responsible for the Oracle database, the Windows NT server, and the Unix Operating system. In the spring of 2000, ITD began upgrading Oracle7 to Oracle8 for all Transportation systems. However, the Fiscal Division did not have the resources available to begin testing the PeopleSoft application until September 2000. The upgrade of an underlying database requires testing of the applications using it to determine compatibility. Without adequate time to plan, coordinate, and test the application against the upgrade, the Fiscal Division will be unable to upgrade the PeopleSoft application on Oracle8 before losing vendor support for the Oracle database on December 31, 2000. Furthermore, the Fiscal Division lost support for the PeopleSoft application in June 2000 and has not developed adequate plans for upgrading this application.

Management should develop policies and procedures that define the responsibilities of the Fiscal Division and ITD in relation to FMSII and its supporting database, server, and operating system. Furthermore, management should develop plans to address system upgrades and the coordination between divisions. These plans should address the procedures for evaluating and determining the need to upgrade the FMSII system and the best methodology to do so.

Without policies and procedures defining the responsibilities of the Fiscal Division and ITD, Transportation has put the mission critical FMSII system at risk. Furthermore, Transportation has already spent over \$26 million dollars to get FMSII up and running at a mature state and now faces the task of upgrading the customized application. Without a well-documented plan, this upgrade could become very expensive and time consuming.

Highway Construction

During fiscal 2000, Transportation spent over \$1.2 billion on highway construction projects. Building a road is a lengthy process that includes years of research, planning, design, engineering, and budgeting. Project monies come from federal and state revenues.

Construction projects occur in three major phases: Preliminary Engineering, Right of Way, and Construction. The Commonwealth Transportation Board (Board) must approve all construction projects before any activity may occur. The Virginia Transportation Development Plan (Plan) includes the approved construction projects and funding sources. Based on the allocations made in the Plan, Transportation authorizes construction project expenditures. The authorizations represent the total dollar amount approved for each construction phase using estimated costs, which Transportation revises each year when the Board updates the Plan.

Even though authorizations are the approved spending limits, Transportation exceeds these limits on some projects because authorizations use estimated costs. These original project estimates often underestimate the final cost of road construction projects due to several factors such as expanding the project beyond its original scope, not including an inflation factor, the occurrence of design errors and omissions, and not including adequate contingencies for unforeseen circumstances and incidentals. Exceeding authorized amounts will affect subsequent project phases and other projects. In general, a cost increase or authorization overrun may prevent the addition of other projects to the Plan, or may delay a project. Physical development problems can also delay a project. When this occurs, Transportation can transfer funds in one year and replace them in a later year. In this case, switching the funding would not further delay the project. Once the project is under contract, Transportation must pay the total cost and, if necessary, may have to delay other projects in order to meet their contractual obligations.

Generally, when the Board updates the Plan, they give estimated cost increases priority over new additions to the plan. The Board may have to delay subsequent phases if there is no funding available to pay for the increase. However, the most recent Plan, issued November 1, covering fiscal 2001 now includes an inflation factor. In addition, Transportation is working on improving construction estimates as a result of Transportation initiatives. This should reduce the effect of cost increases on future projects. However, it may take several years before Transportation can assess the impact of these changes on the Plan.

Transportation has three major construction projects: the Springfield Interchange, the Pocahontas Parkway, and the Coalfields Expressway. The Springfield Interchange and the Pocahontas Parkway are both under construction, and the Coalfields Expressway is in the planning phase.

Springfield Interchange

The Springfield Interchange project is the highest dollar, non-bridge or tunnel project Transportation has ever undertaken. The project is anticipated to last up to eight years, affecting thousands of commuters. Transportation identified the Springfield Interchange as one of the busiest interchanges in the country and the most dangerous spot on the Capital Beltway. Because of this, Transportation embarked on a massive construction project to make the interchange safer, less congested, and more manageable. The new and

improved interchange will separate local traffic, making it easier for commuters to get to work and for travelers to pass through the area.

During calendar year 2000 Transportation revised the project's estimated costs, and as of November 1, 2000, the estimated cost is \$567.4 million. This is an increase of over \$27.4 million from the estimated cost reported in September 2000. Total estimated cost is comprised of the following:

<u>Project Phase</u>	<u>Estimated Cost</u>
Preliminary Engineering	\$ 42,649,000
Real Estate (Right of Way)	68,909,000
Spring Mall Drive Ramps	2,040,000
Beltway Ramps (future project)	689,000
Phase 1	2,778,000
Phases 2 and 3	116,603,000
Phase 4	139,270,000
Phase 5	55,700,000
Phases 6 and 7	107,608,000
Congestion Management Programs	28,000,000
Springfield Interchange Information Center	<u>3,170,000</u>
Total	<u>\$567,413,000</u>

(Source: Springfield Interchange Fact Sheet obtained from www.springfieldinterchange.com)

Pocahontas Parkway (Route 895)

The Route 895 connector is a project under the Public Private Transportation Act (PPTA), which enables the Commonwealth and local governments to enter into agreements authorizing private entities to acquire, construct, improve, maintain, or operate qualifying transportation facilities. The PPTA provides the private entity the ability to issue tax-exempt bonds to finance the projects. Transportation entered into a comprehensive agreement in June 1998 for the private development of the Route 895 connector with FD/MK Limited Liability Company. FD/MK created the Pocahontas Parkway Association to assist with the financing of the project.

Financed and constructed by the private entity, Pocahontas Parkway Association, the Route 895 connector will be a nine mile, four lane limited access toll road extending from the current eastern terminus of Chippenham Parkway at Interstate 95 to a connection with Interstate 295, southwest of Richmond International Airport. Construction began during fiscal year 2000. Various agreement provisions outline Transportation's responsibilities such as the approval of project budgets, toll rates, and debt issuance. The \$354 million in bonds issued in July 1998 to finance the project are tax-exempt and are not a debt of the Commonwealth, Transportation, or any other agency. The road will become operational during 2002.

Coalfields Expressway

In November 1995, Congress enacted the National Highway System Designation Act of 1995, which extended the Coalfields Expressway from the West Virginia State line into Virginia. The proposed roadway is defined in the legislation as going to Pound, Virginia, and generally following State Route 83 through Buchanan, Dickenson, and Wise counties. The new legislation identified the Coalfields Expressway as a "Congressional High Priority Corridor" and included it as part of the National Highway System (NHS).

The 2000 Session of the General Assembly created the Virginia Coalfields Coalition Authority with powers solely to provide for the construction of the Coalfields Expressway highway system. No other

agency, authority, board, state, or local entity may provide for the construction of the program. The Board will have eleven appointed members and the chairman shall sign and execute all vouchers for the disbursements of funds belonging to the Authority upon authorization by the Board. The Board may employ or retain such employees, agents, financial advisers, and attorneys as it may deem necessary and fix their compensation.

Transportation is conducting a five-step process for the Coalfields Expressway. The five major steps are:

- Concept
- Feasibility Study
- Location Study/Preliminary Engineering
- Final Engineering
- Construction

Transportation has completed the first two steps and is working on the third step. The Location Study will identify several possible locations, including alternatives, for the Expressway. This step's original completion date was summer of 1999; however, a recent change in federal regulation required additional evaluations and has extended the process. The Board will select a single location for study in detail during the fourth step, Final Engineering. Specific construction detail, including right of way requirements, will be determined during Final Engineering. As of November 2000, the Transportation Board has not identified funding for the fifth step, although the Transportation Board has allotted planning funds. Federal and state requirements mandate that Transportation follow this five-step process to build a road.

GASB 34 Infrastructure

Generally accepted accounting principles have undergone a number of changes in the past several years, the most significant of which is the Governmental Accounting Standards Board (GASB) Statement 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The most dramatic change that GASB 34 imposes is the capitalization of infrastructure assets. Infrastructure assets are long-lived, stationary capital assets that have a significantly greater number of years use than most capital assets. Examples include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. GASB 34 requires presentation of these assets for the first time in the Comprehensive Annual Financial Report of the Commonwealth beginning in fiscal 2002.

GASB 34 permits a choice for infrastructure presentation of either depreciating infrastructure assets or using a "modified approach." The modified approach allows governments to use a "preservation" system to maintain infrastructure at a certain level, rather than depreciating the assets. Transportation and the Commonwealth have chosen to use the depreciation method.

Transportation has the task of gathering all of the information for the capitalization of infrastructure assets under GASB 34. Transportation's goals, in conjunction with the Office of the Comptroller and the Auditor of Public Accounts, include the determination of the following for infrastructure:

- Capitalization Policy: the dollar amount above which Transportation will capitalize
- Inventory: what assets should be included in infrastructure
- Asset Ownership: who owns the asset, the Commonwealth or a locality
- Dollar value of the inventory: amount initially capitalized
- Depreciation Method
- Infrastructure Networks and Sub-systems

Transportation has made significant progress towards reaching these goals and has drafted a plan outlining networks, subsystems, ownership, initial capitalizable inventory values, and depreciation methods. They are in the process of determining a suitable capitalization policy.

Transportation has devoted substantial time and resources to this critical project and should continue to do so in the future. The proper presentation of the Commonwealth's financial statements is crucial to the state's ability to issue debt and maintain bond ratings. The capitalization of infrastructure is a vital part of the new GASB 34 Reporting Model.

December 15, 2000

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON
INTERNAL CONTROL OVER FINANCIAL REPORTING

We have audited the general purpose financial statements of the **Department of Transportation** as of and for the year ended June 30, 2000, issued our report dated December 15, 2000, and included it in the Financial Report issued by the Department of Transportation. We submit herewith our report on compliance and internal control over financial reporting.

In planning and performing our audit of the financial statements of Transportation as of and for the year ended June 30, 2000, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, contracts, and grants in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. We did not audit the financial statements of the Pocahontas Parkway Association, a blended component unit. The Association's financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion, insofar as it relates to the Association's financial statements, is based solely upon the report of the other auditors.

Compliance

As part of obtaining reasonable assurance about whether Transportation's statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under Government Auditing Standards. The instance of noncompliance, entitled "Improve Contract Administration," is described in the section titled, "Internal Control Background, Findings and Recommendations."

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Transportation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting 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 statements. Reportable conditions are described in the sections titled, "Internal Control Background, Findings, and Recommendations" and "Other Department Issues and Information."

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Status of Prior Findings

Transportation has not taken adequate corrective action with respect to the previously reported findings, "Improve Controls over Inventory Policies and Procedures to Prevent a Qualified Financial Statement Opinion" and "Properly Manage Inventory." Accordingly, we included these issues in the finding entitled "Continue to Improve Inventory Management and Relevant Inventory Policies and Procedures" in the section, entitled "Internal Control Background, Findings, and Recommendations." Transportation has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

Report Distribution and Exit Conference

The "Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting" is intended solely for the information and use of the Governor and General Assembly of Virginia, the Transportation Board 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 and its distribution is not limited.

We discussed this report with management at an exit conference held on January 23, 2001.

AUDITOR OF PUBLIC ACCOUNTS

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kva:47

DEPARTMENT OF TRANSPORTATION

Richmond, Virginia

As of June 30, 2000

Shirley J. Ybarra, Secretary of Transportation

Charles D. Nottingham, Commissioner

Thomas F. Boyd, Assistant Commissioner for Finance

Gregory A. Whirley, Sr., Controller

COMMONWEALTH TRANSPORTATION BOARD

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