

AUDIT SUMMARY

Our audit of the **Department of Transportation** for the year ended June 30, 1998, found:

- the financial statements are presented fairly in all material respects;
- internal control matters that we consider reportable conditions; however, we do not consider any of these to be material weaknesses;
- no material instances of noncompliance required to be reported under Government Auditing Standards; and
- adequate implementation of corrective action on prior audit findings.

Our audit findings include the following:

- Monitor and Comply With Accounting and Reporting Standards
- Perform Independent Physical Annual Inventory Counts and Compliance Reviews
- Properly Procure Consulting Contracts

These findings are explained in detail in the sections entitled "Internal Control Background, Findings, and Recommendations" and "Other Department Issues and Information."

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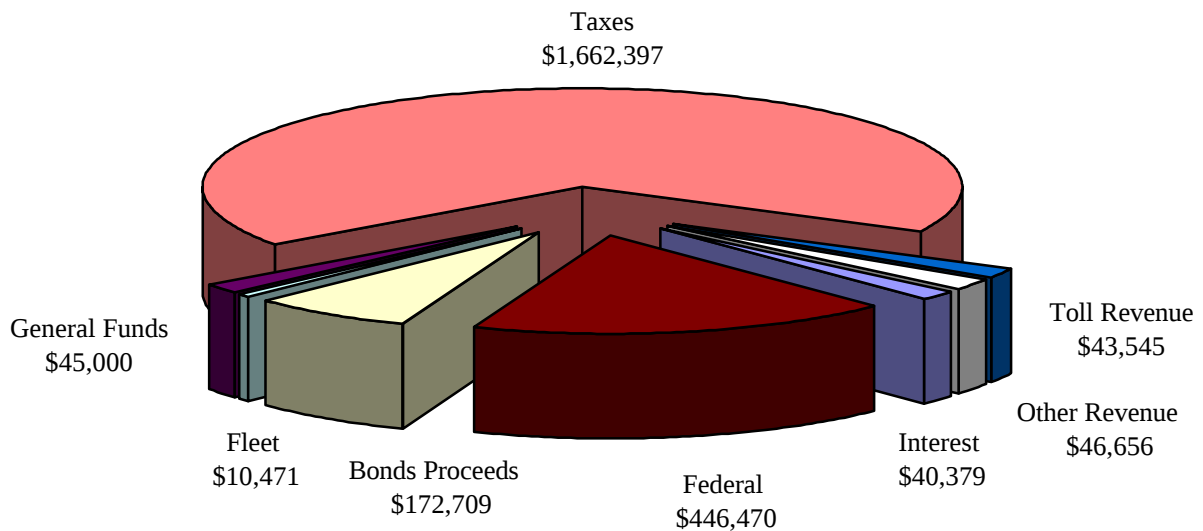
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AGENCY OVERVIEW

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. The Department not only maintains roads but also maintains more than 12,800 bridges, four underwater tunnels, two mountain tunnels, two toll roads, one toll bridge, four ferry services, 41 rest areas, and 98 commuter parking lots. The Department'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. The Department received 85 percent of the Transportation Trust Fund collections for construction, reconstruction, and improvement of highways; federal-aid matching funds for the interstate system; and paving of non-surface treated secondary roads for fiscal year 1998, which is included in the tax revenue in the chart below. However, due to changes in legislation during the 1998 General Assembly session, the allocation of the Transportation Trust Fund will change for the 1999 fiscal year with the Department's portion changing to 78.9 percent. The remaining portion of the Transportation Trust Fund provides funding for airports, seaports, and rail and public transportation. The Department receives funding from other sources as illustrated below.

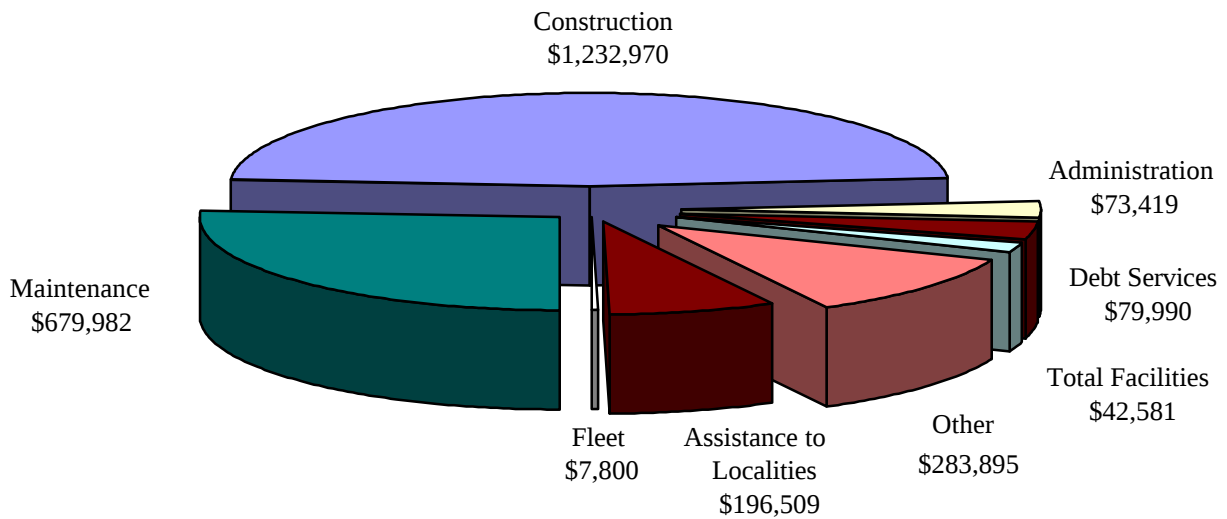
1998 Sources of Funds
(in thousands)



Since most of the Department's highway construction projects take several years to complete, the Department has unspent funds each year reserved for these projects. In addition, the Department maintains cash that is restricted by bond agreements. Due to a mild winter that allowed the Department to perform a greater amount of highway construction and the passage of the federal Transportation Equity Act of the 21st century in June 1998, the Department experienced a large increase in expenditures in fiscal year 1998. As a result, at the beginning and end of fiscal year 1998, the Department had a combined fund balance of \$878 million and \$749 million, respectively.

The Department's largest expense each year is highway construction. During 1998, the Department spent over \$1.2 billion on highway construction projects, as shown in the following chart. The Other expenses include the Transportation Board's allocation of \$122 million of the Transportation Trust Fund to the Department of Rail and Public Transportation, Virginia Port Authority, Department of Aviation as well as transfers to other State Agencies.

1998 Uses of Funds
(in thousands)



INTERNAL CONTROL BACKGROUND, FINDINGS, AND RECOMMENDATIONS

Financial Statement Preparation and Disclosures

The Department issues financial statements to satisfy bond requirements. With the act of issuing statements comes the responsibility of staying current with all of the accounting and reporting standards and ensuring the Department's financial statements comply with the standards. The Fiscal Division is comprised of several employees who collectively prepare the financial information. The new Financial Management System (FMSII) will compile the financial statements for next year but management will still need to investigate and implement any new accounting or reporting standards.

Monitor and Comply with Accounting and Reporting Standards

Management does not stay current with accounting and reporting standards and their changes. Management relies on other state agencies to provide this information to them. GASB has been issuing more standards recently and is refining a statement on the financial statement reporting model. This model will radically change the current method of financial statement presentation. If management does not monitor these changes as they evolve and determine how the Department will comply with them in the future, the Department's financial statements will not meet the standards.

Management must take responsibility for the Department's financial statements and ensure the statements comply with all applicable standards. To meet this responsibility, management should assign specific individuals the responsibility for staying current on new reporting standards and following and planning for the implementation of the new reporting model. Management should also ensure that personnel preparing the financial statements understand all financial statement reporting standards including any

applicable changes. In addition, personnel preparing the financial statements should take the initiative when complying with the new standards instead of relying on other state agencies to provide them with the necessary information. Management should also determine whether the Department's new Financial Management System will provide the information necessary to comply with the new financial reporting model.

Purchasing and Inventory Management System Control Procedures

The Department uses its Purchasing and Inventory Management System (PIMS) to track inventory. This system, installed in 1989, is a computerized perpetual inventory network system that links all of the Department's inventory locations statewide. Personnel use terminals throughout the state to update the computer system when these locations receive, transfer, and issue stock items. This network enables any PIMS data inquiry personnel to access inventory data located anywhere in the state.

The Administrative Services Division has responsibility for the establishment, maintenance, and statewide monitoring of the PIMS policies and procedures. For each of the nine Districts, the District Administrator determines the district-wide adherence to PIMS policies and procedures through the operational purview of the District Administrative Manager (DAM). The DAM ensures that the districts perform annual independent physical inventory counts and compliance reviews.

Perform Independent Physical Annual Inventory Counts and Compliance Reviews

District personnel did not perform a complete annual inventory count or compliance review in six of the nine Districts, which carry a combined inventory value of \$21,009,257. Two of the six districts have not completed an inventory count or compliance review in three years. There is also no documentation to indicate corrective action of deficiencies identified during compliance reviews. Not performing an annual physical inventory count and not conducting compliance reviews can lead to an inadequate safeguarding of assets and incorrect inventory records.

Management should ensure that all Districts complete an annual independent physical inventory, perform compliance reviews, and take immediate corrective action in response to review findings. District personnel must perform these procedures to ensure the adequacy of internal controls in safeguarding assets and for the proper accounting for inventory.

OTHER DEPARTMENT ISSUES AND INFORMATION

Information System Update

The Department's management developed and approved a five-year plan covering 1995 through 2000. The plan provides management with a long-term vision for the future of the Department's information systems. The plan addresses external pressures such as the federal government's requirement for new information systems. The plan also addresses management's need for information systems to do more with fewer employees since they lost 1,200 employees in workforce reductions in 1995. The Department is currently in the process of rewriting and updating the plan and expects to complete a revised plan in the summer of 1999.

The centerpiece of management's plan is a new information architecture. This new architecture features information resource sharing by work groups, decision support tools, integrated business applications, integrated distributed database structures, and a data warehouse. Management provides oversight to this plan with the Management Information Systems (MIS) 2000 committee.

The MIS 2000 committee also set up a joint venture with a consultant to establish a project management office for the information systems projects. Department employees and contract project managers staff the office. In the fall of 1998, the consultants were no longer staffing the office but were only there for assistance. Currently, the office provides support to the individual projects and the MIS 2000 committee. The office developed the new systems development methodology approved by the MIS 2000 committee and provides formal project leader management training. This new methodology also includes structures on how to review and evaluate projects and how to coordinate delays or project cancellations with other projects.

Year 2000 Plans

The Department has a formal project structure in place to implement necessary changes to its various computer systems and other electronic hardware that are dependent upon date-sensitive coding. The estimated cost of the year 2000 project is approximately \$6.5 million, and the actual costs incurred as of June 30, 1998 were approximately \$400,000. The Department identified its mission critical information technology systems, and they are in various stages of remediation, validation and testing.

The Department is also working with its business partners to validate supporting infrastructure to all its information technology applications and electronic data exchanges with other state and federal government agencies, including IBM mainframe computing services provided by the Department of Information Technology.

The Department has inventoried and assessed other non-traditional electronic devices including telecommunications, major infrastructure, traffic signals, physical plant, and technical and office equipment. The Department is actively working with equipment vendors and manufacturers to obtain compliance and testing information. In addition, the Department is coordinating with suppliers critical to their operations to assess the progress vendors are making with their own year 2000 projects.

New Financial Accounting System

The Department implemented a new accounting system, Financial Management System (FMS II), on September 1, 1998. This system is equipped with six modules including project accounting, general ledger, accounts receivable, accounts payable, purchasing, and time entry and leave, and will manage all financial operations. The Department is currently modifying the time entry and leave module to include the Commonwealth's new disability and leave program.

The original implementation date was July 1, 1997. Management delayed the project six months to use an enhanced version of the software. In the fall of 1997, project management delayed the project an additional four months due to hardware problems and testing delays. The Department planned to go live on April 1, 1998. Weeks before implementation, the project was delayed an additional three months when the contractor did not finish the system testing to the satisfaction of the project leader. Management planned to start the new accounting system in July 1998 without running parallel with the old accounting system. Management felt that the in-depth testing planned before implementation would adequately test the new system. Because they did not

accomplish all planned testing prior to the July 1998 implementation date, the Department pushed the date of implementation back to September 1, 1998.

The Department is currently evaluating interim and long-term options to properly run the system. Among these options is the acquisition of a new server for FMS II because the current server does not have the capacity necessary to properly run the system. A new server will greatly enhance system response time and provide additional space for the implementation and future development of other modules. The Department expects to install the new server by the spring of 1999.

The total budgeted cost of the system development is \$13,206,510. As of December 1, 1998, the Department has spent \$9,453,534 or 71 percent of the budget. The remaining portion of the budget will cover system maintenance, modifications of existing modules such as the time and entry module, development of new modules, and implementation of new software versions.

Statewide SMART TAG

The Department implemented SMART TAG (formerly known as FASTOLL) on April 15, 1996 and it is accounting for approximately 110,000 transactions per day. SMART TAG is an electronic toll collection system that lets customers pay without stopping at tollbooths. As the vehicle approaches the tollbooth, the system electronically reads a transponder on the inside of the vehicle and automatically deducts the toll from a pre-paid account. Currently, the system is available for use on the Hirst-Brault Expressway, the George P. Coleman Bridge, and the Dulles Greenway Toll Road (privately owned and operated). The Department also anticipates that SMART TAG will be ready for use on the Powhite Extension and all toll facilities maintained by the Richmond Metropolitan Authority (RMA) in the summer of 1999.

The Department has worked with several contractors in the construction and implementation of the SMART TAG system. The initial contractor for the Hirst-Brault Expressway defaulted, forcing the Department to re-solicit and award the new contract to TRANSCORE. In February 1998, the Department signed another contract with TRANSCORE to develop and implement a SMART TAG system at the Powhite Parkway Extension. As of December 1, 1998 the system is still in the preliminary stages. The Department is attempting to coordinate the timing of implementation at the Powhite Extension with RMA's implementation of the same system for the RMA facilities (Powhite Parkway, Downtown Expressway, and Boulevard Bridge). This coordination will allow customers to use the SMART TAG transponders at all Richmond-area toll facilities.

The SMART TAG customer service centers process applications for credit, sell the transponders to the customer, collect all payments, maintain customer accounts, and transfer revenues to the appropriate toll roads. The Department selected a single vendor, Castle Rock, to run all customer service centers throughout the state to ensure maximum customer satisfaction and prevent potential accounting problems. This will also allow customers to use the same SMART TAG transponder at all toll facilities throughout the state. The Department's original agreement was with Castle Rock to run the customer service center for the Hirst-Brault Expressway. This agreement allows the Department to add additional satellite locations for other roadways throughout the state as needed. In addition to the Hirst-Brault Expressway, Castle Rock is maintaining customer service centers for the Coleman Bridge. The Department plans to add additional satellite locations upon system implementation at the Powhite Extension and RMA facilities.

Contracting

Management continued its efforts to provide services through contracts with private vendors. The following are highlights of the contracting to date:

- Approximately two years ago, the Department began the process of determining the cost effectiveness of contracting personal computer services. Management formed a committee and their preliminary cost benefit analysis identified the possibility of significant cost savings. The current proposals include leasing services, configuration services, maintenance, swaps, and disposal. Under this proposal, the vendor would eventually replace and upgrade all of the Department's 7,000 personal computers.

The committee awarded the pilot contract in August 1998, and will reevaluate the cost effectiveness of the contract in 9 to 12 months. At that time, the Department will determine whether or not to fully implement the services.

- The Department continues to contract toll and maintenance operations at the Coleman Bridge.
- The Department contracted the management and operation of 11 of 13 drawbridge span operations during the 1997 fiscal year. Management moved 33 employees to other areas and have not moved or reassigned any additional employees.
- Due to drier weather and availability of in-house employees, the Department was able to use more of its own staff for mowing services. As a result, the Department decreased the amount of mowing contracts from 43 percent in 1997 to 37 percent in 1998 and increased in-house mowing services from 57 percent in 1997 to 63 percent in 1998.
- The Department awarded total maintenance and janitorial service for all 41 interstate rest areas to a private vendor by 1997. Starting in 1994, the Department phased in the privatization by region. During these three years, management reassigned 40 employees to other maintenance activities. The Department evaluates the vendor's performance on an annual basis.
- The Department conducted a three-year pilot program in 1995 that contracted bridge safety inspections. As a result of the contract, 18 full-time positions were lost. The employees that had filled these positions either retired or took jobs with the company the Department contracted with to conduct the bridge safety inspections. The Department renewed the contract for another three years during 1998.
- The Location and Design Division continues its efforts to contract engineering services to supplement Department staff. As a result of the new competency based payroll program, which we discuss later in this report, the Division expects to reduce the number of engineering service contracts over the next several years as it hires and trains new employees.

- Fleet Management Division continues their pilot program with a vendor to provide small sedans on an as-needed basis. The Department evaluated this two-year pilot at the end of fiscal year 1998 and extended it for one year.
- The Management Services Division expanded the pilot contract with NAPA for warehouse services and equipment repair parts to include the Fredericksburg and Bristol Districts with a two and a half year extension to March 31, 2000. This pilot resulted in temporary re-assignment of eight employees to other activities during the initial implementation of the pilot program and will result in an additional reassignment of employees during 1999 due to the expansion of the pilot program.
- The Department is conducting a one-year pilot program that contracts tire management services for the Fredericksburg District. The Department finished compiling data in November 1998. Once the Department analyzes the data, it will decide whether to continue the pilot program.
- The Department privatized the installation, maintenance, and administration of its highway logo program in 1995 with a five-year contract. This resulted in the reassignment of three full-time employees.
- The Human Resources Division continues its efforts to contract customer service training programs.

It is the Commissioner's policy that Department employees will not lose their jobs to outside contractors. In the instances above, managers reassigned displaced employees to other areas within the Department.

The Department's corrective action for the prior year findings related to contract management entitled "Assign Responsibility for Contracts" and "Develop Automated Procedures to Monitor Contract Costs" was the implementation of their new accounting system (FMS II) in September 1998. The Department expects FMSII to enhance contract tracking and monitoring. Due to the recent implementation of the system, we could not determine the adequacy of management's ability to monitor and measure services provided by private companies, but we will review the system and its controls during the fiscal year 1999 audit. However, during our audit work on the statewide SMART TAG system, we found an instance of non-compliance with contract procurement.

Properly Procure Consulting Contracts

The Department improperly increased the scope and cost of a 1987 contract with Castle Rock Consultants for consulting services for the Hirst-Brault Expressway's SMART TAG system to include consulting services for the Powhite Parkway Extension's implementation of the same system by over \$1 million. The scope of the original contract was to provide consulting services for the development of the SMART TAG system at the Hirst-Brault Expressway only. In 1996, rather than issuing a new Request for Proposal, the Department added several supplements to the Hirst-Brault Expressway agreement to provide consulting services to implement the SMART TAG system on the Powhite Extension.

The Department should not have included the consulting services for the Powhite Extension with the original Hirst-Brault contract. The Department should have procured the services for the Powhite Extension through a separate Request for Proposal. Supplementing agreements to include work or projects not in the original scope limits competition and violates the Procurement Act.

The Department should ensure that they procure distinct and separate projects in compliance with the Virginia Public Procurement Act, not through supplements or modifications to existing contracts. Management should ensure that they do not add any services relating to the SMART TAG implementation on future projects to the original Hirst-Brault Expressway agreement but procure them separately.

Public Private Transportation Act

The Public Private Transportation Act (PPTA) 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. The following is the status of the Department's efforts under the Act:

- The Department executed a comprehensive agreement in December 1996 with Virginia Maintenance Services (VMS). This contract is a five and a half-year pilot to provide for maintenance of designated sections of the interstate highway system. VMS will maintain 104 miles of interstate 95 from the North Carolina border to Hanover County. Management anticipates that this program will save \$22 million over the pilot period. Management moved 74 employees displaced by this contract from interstate maintenance to other maintenance operations services.
- The Department entered into a comprehensive agreement in June 1998 for the private development of the Route 895 connector with FD/MK Limited Liability Company. The Route 895 connector will be a nine mile, four lane limited access toll road. The Department expects construction to begin during fiscal year 1999. Various agreement provisions outline the Department's responsibilities such as the approval of project budgets, toll rates, and debt issuance. The \$354 million in bond issuances to finance the project issued in July 1998 are tax-exempt and are not a debt of the Commonwealth, the Department, or any other agency.

New Federal Transportation Legislation – TEA-21

The President signed TEA-21, or the Transportation Equity Act for the 21st Century, into law on June 9, 1998. Overall, the funding level in the legislation provides for an annual highway program increase of 44 percent nationally. Summary information indicates Virginia will receive an annual average of \$664 million in formula apportionments and demonstration project funding over the life of the bill (1998-2003). In contrast, Virginia received an average of \$415 million annually over the life of the old legislation (1992-1997). This 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.

The Department identified several special funding provisions under TEA-21 that will significantly impact the Commonwealth:

- \$900 million for the replacement of the federally-owned Woodrow Wilson Bridge
- \$86 million in transit funding for the Washington-Dulles Corridor transit project
- \$13 million for traffic calming measures in Loudoun and Fauquier Counties

Highway Construction

With over \$1.2 billion spent on highway construction projects during FY 1998, building a road is a time consuming process that includes years of research, planning, design, engineering, and budgeting. Project monies come from projected federal funds and anticipated state revenues. The Department maintains approximately 55,600 miles of highway, primary, and secondary roads and assists localities with about 9,900 miles of urban streets.

Construction projects go through four major phases (initiation, pre-construction, construction, and maintenance.)

- **INITIATION PHASE:** Each of the nine districts holds pre-allocation hearings to receive input about prioritizing needed road construction. Once the Department identifies a project as a priority and the Commonwealth Transportation Board approves it; the project becomes part of the Six-Year Improvement Plan (updated annually).
- **PRE-CONSTRUCTION PHASE:** Various divisions work together during this phase of the process to get the project ready for the construction phase. Depending on the needs of the project the following activities take place during the pre-construction phase: planning, design, assessment of environmental impacts, purchase of materials, purchase of property, traffic engineering, evaluation of structures and bridges, coordination of utilities, and coordination with the construction and maintenance teams.

The Department contracts out larger project studies to consultants. The Department uses the professional services of consultant engineers in virtually every phase of the pre-construction activities.

With the approval of the pre-construction plans, the Construction Division receives the plans for the preparation of contract documents and advertisement.

- **CONSTRUCTION PHASE:** The construction phase officially begins upon contract execution. Each project has an assigned District Administrator, Resident Engineer, Project Engineer or Project Manager, and an Inspector. The Construction Division plans and executes the procurement and administration of construction and maintenance.
- **MAINTENANCE PHASE:** Upon completion of construction, the maintenance of the highway becomes the responsibility of the residency maintenance forces at the district level.

I-95/I-395/I-495 Springfield Interchange Improvement

The Department 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, the Department 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 from through traffic, making it easier for commuters to get to work and travelers to pass through the area.

The project will cost about \$350 million and could last up to eight years, affecting thousands of commuters. It is the highest dollar non-bridge or tunnel project the Department has ever undertaken. Because of the project's magnitude and cost, as well as the need to keep existing roadways open during construction, the Department is making the improvements in stages. Each stage, costing approximately \$80-\$110 million, will have a separate contract. The Department completed portions of the first two phases during 1996, and is expecting to begin the next two phases in January 1999, which will focus on the reconstruction of the Route 644 interchange. Later phases of the project will improve I-95, the Beltway interchange, portions of the Beltway, and the HOV lanes.

The Department is offering a \$10 million bonus to the contractor for the reconstruction of the Route 644 interchange if the contractor completes the work nine months before the deadline of June 1, 2002. The bonus is the largest in Virginia history. The bonus allows for recovery of overtime and other costs the contractor incurs plus approximately a ten percent profit incentive. In contrast, the incentive program also provides a \$30,000 per day penalty for each delayed workday past the June 1, 2002 deadline. The Department will assess other penalties, such as lane closures during peak hours, on a day-by-day basis. The Department anticipates offering similar incentive programs for each of the remaining contracts.

Dulles-Greenway Toll Road

The Department funded \$3.6 million of the startup construction planning and engineering costs for the privately financed Dulles-Greenway toll road, which the private investor agreed to repay. After a year of non-payment, the Department submitted their claim to the State Corporation Commission for their action. The private investors made a \$1 million payment and signed a contract modification extending repayment during 1997. On January 16, 1998, the investors paid \$500,000 and signed an agreement requiring them to pay the balance no later than July 31, 1998. On July 31, 1998, the investors signed an agreement extension requiring them to pay \$500,000 by August 14, 1998 (which was paid on time) and pay the remaining balance of \$1,642,239 plus accrued interest at 8 percent on the earlier of a refinancing of all of the investors' outstanding debt or February 15, 1999.

New Compensation Plans

The Department implemented two new pilots for alternative employee compensation programs. Approved by the Department of Personnel and Training (DPT) in July 1998, the FMS II Competency Initiative provides for additional compensation to key employees involved in the implementation and training programs for the Department's new financial system. This program involves about 300 employees.

The Competency-Based System (CBS), approved by DPT in October 1998, is a human resources management system intended to pay employees for results as well as for technical and behavioral skills. It will incorporate market-driven pay scales. CBS will allow the Department to compete in the tight marketplace for new engineers while increasing compensation for existing engineers who produce results and acquire new skills. The natural growth in state transportation revenue and the additional federal funding from the new national transportation law requires the Department to retain its qualified transportation engineers while recruiting additional engineers. Among other things, CBS provides a way for employees to have a greater role in their career development.

The initial phase of CBS involves 650 engineering employees. After completion of an evaluation of the effectiveness of the first phase around June 1999, additional employees will be included in three phases. The Department will eliminate the FMS II initiative around July 1999, converting these employees to the CBS. The Department will phase all employees into the CBS by July 2000.

December 18, 1998

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

The Honorable Richard J. Holland
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL
CONTROLS 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, 1998, issued our report dated December 18, 1998, and included it in the Financial Report issued by the Department of Transportation. We conducted our audit in accordance with generally accepted government auditing standards.

Management's Responsibility

The Department's management is responsible for establishing and maintaining an internal control structure and complying with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in accordance with generally accepted accounting principles; and the Department has complied with applicable laws and regulations.

Compliance

As part of obtaining reasonable assurance about whether the Department's financial 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 no material instances of noncompliance that are required to be reported under Government Auditing Standards. However, we noted an immaterial instance of noncompliance that is described in the section entitled, "Other Department Issues and Information."

Internal Controls Over Financial Reporting

In planning and performing our audit, we considered the Department's internal controls 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 controls over financial reporting. However, we noted certain matters involving the internal controls 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 controls over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the section entitled "Internal Control Background, Findings, and Recommendations."

We believe none of the reportable conditions described above are material weaknesses. 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 controls over financial reporting would not necessarily disclose all matters in the internal controls that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

Status of Prior Findings

The Department has taken adequate corrective action with respect to all audit findings reported in the prior year. The Department's corrective action for the prior year findings entitled "Assign Responsibility for Contracts" and "Develop Automated Procedures to Monitor Contract Costs" was the implementation of their new accounting system (FMS II) in September 1998. The Department expects FMS II to enhance contract tracking and monitoring. Due to the recent implementation of the system, we could not determine the adequacy of management's ability to monitor and measure services provided by private companies, but we will review the system and its controls during the fiscal year 1999 audit.

EXIT CONFERENCES

We discussed this report with management at an exit conference held on January 28, 1999.

AUDITOR OF PUBLIC ACCOUNTS

DBC:aom
aom:80