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**Alan G. Hevesi  
COMPTROLLER**



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**OFFICE OF THE  
NEW YORK STATE COMPTROLLER**

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**DIVISION OF STATE SERVICES**

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**DEPARTMENT OF  
TRANSPORTATION**

**WRITTEN SUPPORT OF  
INTERNAL CONTROLS  
OVER FINANCIAL  
REPORTING OF CAPITAL  
ASSETS**

**Report 2006-S-44**

## AUDIT OBJECTIVE

Our audit objective was to determine whether the Department of Transportation (Department) has written support for internal controls over its systems for reporting capital assets activity. These systems produce the financial information for reporting capital asset data to the Office of the State Comptroller (OSC) for use in the State's Comprehensive Annual Financial Report.

## AUDIT RESULTS - SUMMARY

We found that in most areas the Department has adequate written support over its internal controls for reporting capital assets. We believe these controls, as written, and if followed, should decrease the risk of significant misstatements in the financial information the Department reports to OSC for the State's Comprehensive Annual Financial Report. Documentation consisted of mission and ethics statements; policy and procedure manuals; the Department's IntraDOT internal web site; internal memoranda, and reports from external parties. Department officials provided ample current documentation to support four of the five components of internal control.

However, we found that documentation supporting risk assessment over financial reporting of capital assets was inadequate. Capital assets are an integral part of the State's financial reporting. Further, since 2003, the State's financial statement auditors have identified conditions (significant problems detailed later in this report) regarding capital asset reporting that could impact the accuracy of the State's Comprehensive Annual Financial Report. Because problems have persisted, Department management must ensure that appropriate priority (including sufficient staff time and resources) is placed on adequately

documenting the assessment of risk over the financial reporting of capital assets. It is also Department management's responsibility to eliminate future opportunities for the State's financial statement auditors to criticize the control systems in place over capital asset reporting.

The State's Comprehensive Annual Financial Report is designed for general purpose use. Financial service companies, for example, use it to help determine the commercial ratings of the State's outstanding financial obligations. Consequently, it is vital that information within the State's Comprehensive Annual Financial Report be complete and accurate. An effective system of internal control is necessary to ensure that financial data is complete and accurate.

This report, dated October 4, 2006, is available on our website at: <http://www.osc.state.ny.us>. Add or update your mailing list address by contacting us at: (518) 474-3271 or  
Office of the State Comptroller  
Division of State Services  
State Audit Bureau  
110 State Street, 11<sup>th</sup> Floor  
Albany, NY 12236

## BACKGROUND

Internal controls are a combination of attitudes, policies, and efforts of the people within an organization working together to achieve the organization's objectives and mission. A strong system of internal controls benefits all aspects of an organization's operations; it improves the reliability of organizational operations, provides confidence that an organization is using funds and resources efficiently and effectively, and provides comfort that assets and resources are well protected and managed. Written support of these controls is essential to an

organization because it provides its employees with guidance on proper behavior, job expectations, and how to attain organizational objectives and goals. In addition, written support provides the public with a level of assurance that the financial information reported by the organization is accurate and reliable. All State agencies are required by law to put into practice a system of internal controls over their operations. Agency management is responsible for making sure this system of internal controls has been developed, implemented, and communicated throughout the organization.

The Department directly maintains and improves more than 40,000 State highway lane miles and 7,500 bridges. Roads and bridges totaled about \$63 billion, or 89 percent of the Department's reported capital assets as of March 31, 2005. The primary systems that are used to classify and collect capital projects data are the Program Management System (PSS) and the Integrated Accounting System (IAS). Using the PSS system, staff separate projects that the Department works on during the year into capital projects and non-capital projects. Costs for completed capital projects are capitalized in the appropriate road or bridge category; costs for incomplete projects are capitalized and treated as construction in progress. Non-capital project costs are expensed as incurred. Staff uses IAS to collect the cost data. The resulting schedules are submitted to OSC and are used as the basis for reporting Department infrastructure activity in the State's Comprehensive Annual Financial Report. This audit focused on the Department's written support of internal controls for financial reporting of capital assets.

## AUDIT FINDINGS AND RECOMMENDATIONS

### *Control Environment*

Control environment is the attitude toward, and awareness of, internal control by management and employees of an organization. It is the product of management's philosophy, style and supportive attitude, as well as the competence, ethical values, integrity, and morale of the organization's people. Organization structure and accountability relationships are key factors in the control environment.

Department management provided us with adequate written support for the overall control environment. The mission statement, together with the Five Priority Results (department goals), Guiding Principles, Values, and Responsibilities and Functions provide staff with a sense of the Department's purpose and objectives. The organization charts provide staff with high-level policy and organizational structure. The Fraud and Investigations Reporting Hotline (F.A.I.R.), an in-house hotline that the Department implemented in 2005, is a confidential way for employees to report fraud, policy violations, and other workplace issues that involve ethics. Department employees have access to an internal controls awareness course via the IntraDOT.

We met with the Department's Internal Control Officer, who also serves as the Chief Administrative Officer. We found that she was conscious of internal controls and their importance to the organization. Her role is largely one of overseeing internal control and

compliance activities; thus she relies on the Audit and Risk Management Services group to perform the day-to-day activities that support her in her role as Internal Control Officer.

(In responding to our draft audit report, the Department disputed our conclusion that the Department had not completed a risk assessment related to the financial reporting of capital assets. However, Department officials could not provide written support of a risk assessment. Moreover, Department staff acknowledged that the documentation of risk assessment of capital asset reporting was limited because the function was not critical to Department operations. This limited view has serious implications to the State's financial position. More than \$2 billion in adjustments were made by the State's financial statement auditors to capital assets to properly reflect actual capital assets. Consequently, if Department management continues to allocate relatively little staff time and resources to assessing the risks associated with capital asset reporting, the State remains at risk of producing incorrect financial statements).

(Given the magnitude (\$63 billion in total capital assets at the Department) of this matter, senior Department officials must give greater priority to it, including the allocation of sufficient staff time and resources. It is also Department management's responsibility to eliminate future opportunities for the State's financial statement auditors to criticize the control systems in place over capital asset reporting.)

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#### *Information and Communication*

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Communication is the exchange of useful information between and among people, inside and outside the organization, to support decisions and coordinate activities. Within an

organization, important information should be clearly communicated in a timely manner to management and employees who need it to help them carry out their every day jobs.

Department management provided us with adequate written support for information and communication as it relates to financial reporting of capital assets. The Department publicizes its mission statement, guiding principles, and similar statements on its website, as well as its 2005-2010 Capital Program, Master Plan for 2030, and numerous publications related to bridge and road inspection and maintenance. Additionally, Department employees use the IntraDOT to learn about training opportunities and job-specific topics. We reviewed internal email correspondence which demonstrated that Department staff communicated with each other about requirements for complying with GASB 34, as well as correspondence with the Federal Highway Administration (FHWA) concerning changes in contract rates and bids.

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#### *Risk Assessment*

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Risks that potentially threaten the success of an organization's mission and objectives should be identified and managed; they can be both internal (e.g., human error, fraud, or system breakdowns) and external (e.g., changes in legislation or natural disasters). An organization's management should seek to prevent risks from occurring. For each risk that is identified, management should evaluate the likelihood of occurrence and magnitude, and decide whether to accept the risk, reduce the risk to an acceptable level, or avoid the risk.

We assess documentation of the Department's risk assessment process pertaining to financial reporting for capital assets as inadequate. Although the Department engages in risk assessment efforts, it does not maintain

adequate written support for these efforts. It has not completed a risk assessment related to financial reporting of capital assets. Department management cited staff shortages as a contributing factor for the lack of written support. Department officials also stated that they do not consider financial reporting of capital assets to be a high-risk area; however, they did not provide a written rationale for this determination. Documenting the decision-making process, even for low-risk areas, is necessary to support historical decisions, make future plans, and provide an audit trail.

(As noted previously, in their response to our draft report, officials disputed our conclusion that the Department had not completed a risk assessment related to the financial reporting of capital assets. However, as our report details, the Department did not have written support to indicate that a risk assessment over the financial reporting of capital assets had, in fact, been performed. Moreover, Department officials acknowledged that there was room for improvement in documenting their risk assessment efforts. Consequently, officials plan to improve the documentation of risk assessments of the internal controls over the financial reporting of capital assets in the future.)

(Department officials also stated that mitigating control activities reduced the residual risk in this area to an acceptable level. However, this conclusion is incorrect. In fact, the independent CPA firm's annual audits of the State's comprehensive financial reports has produced several reportable conditions in recent years that were critical of the internal controls intended to ensure the complete and accurate reporting of capital assets. For example, for the fiscal year ended

March 31, 2004, the CPA firm noted that specific policies and procedures and related system modifications were not established and complete for Department construction in progress, completed projects, and deletions of related roads and bridges. As a result, off-system calculations (adjustments) were needed to identify and record \$2.2 billion in construction in progress, \$430 million in additions, and \$246 million in deletions for financial reporting purposes.)

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### *Control Activities*

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Control activities are policies, procedures and other safeguards an organization puts in place to help prevent or reduce risks that threaten the success of its objectives and mission. Management should establish control activities to aid in the efficient and effective success of the organization's objectives and mission.

Department management provided us with adequate written support for control activities over financial reporting of capital assets. We reviewed a written procedure that details the steps involved in accounting for and reporting road and bridge infrastructure activity, as well as a list of project work types and subtypes (e.g. rehabilitation-bridge deck replacement) that describes projects that should be capitalized. Additionally, Department staff provided us with spreadsheets showing detailed support for bridge additions and deletions for the year ended March 31, 2005, and these amounts agreed with the schedule provided to OSC for financial reporting purposes. The Department also provided examples of current system manuals and various reports that can be produced by both PSS and IAS to determine amounts for financial reporting.

## *Monitoring*

Monitoring is the review of an organization's activities and/or transactions to assess its performance over time and to determine whether controls are effective. This is accomplished by putting procedures in place to monitor internal controls and the success of organizational objectives.

We assess the Department's documentation of its monitoring of financial reporting of capital assets as adequate. There is a Program and Project Management Information System (PPMIS) Steering Committee that reviews, evaluates, and recommends modifications to PPMIS. The PPMIS encompasses several systems including the PSS, which is one of two main systems that contain information used in capital asset reporting. We also reviewed correspondence from the FHWA (that illustrates its role as an external monitor) regarding appropriate support for payments and compliance with Federal requirements. Additionally, FHWA conducted a procedural review of the Department's processing of federally-funded construction contractor payments during fiscal year 2005. Finally, we reviewed internal documents that demonstrate that the Department verifies the work descriptions (types) that are key determinants of whether or not a project is capitalized in the financial records.

## **Recommendations**

1. Periodically perform and maintain written support of a risk assessment of the internal controls over the financial reporting of capital assets.
2. Ensure that sufficient priority (including the allocation of staff and resources) is placed on the formal assessment of risk over the financial reporting of capital assets.

3. Eliminate future opportunities for the State's financial statement auditors to criticize the control systems in place over capital asset reporting.

## **AUDIT SCOPE AND METHODOLOGY**

We did our audit according to generally accepted government auditing standards. We audited the Department's written support for internal controls over its financial reporting of capital assets for the period April 1, 2005 through July 18, 2006. Internal controls are defined as the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance the organization will achieve its objectives and mission. To do our objective, we interviewed Department officials and reviewed documentation provided by Department personnel that supports their system of internal controls over the financial reporting of capital assets.

In addition to being the State Auditor, the Comptroller of New York State performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

## **AUTHORITY**

The audit was performed according to the State Comptroller's authority under Article V, Section 1, of the State Constitution; and Article II, Section 8, of the State Finance Law.

## **REPORTING REQUIREMENTS**

Draft copies of this report were provided to Department officials for their review and comment. Their comments were considered in preparing this report and are included as Appendix A. Our rejoinders to the Department's response are presented in Appendix B, State Comptroller's Comments. Also, in light of the Department's response to the draft audit report, we added recommendations 2 and 3 to this final report.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner for the Department of Transportation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising of the steps that were taken to implement the recommendations it contained, and/or the reason the recommendations were not implemented.

## **CONTRIBUTORS TO THE REPORT**

Major contributors to this report include David R. Hancox, Brian Mason, Melissa Little, Andrew Fischler, Heather Pratt, Theresa Lawrence, Sharon Salembier, and Scott Heid.

## APPENDIX A - AUDITEE RESPONSE



State of New York  
Department of Transportation  
Albany, N.Y. 12232  
<http://www.dot.state.ny.us>

Thomas J. Madison, Jr.  
Commissioner

George E. Pataki  
Governor

August 30, 2006

Mr. David Hancox, Audit Director  
Office of the State Comptroller  
State Audit Bureau  
110 State Street, 11th Floor  
Albany, New York 12236

Subject: Draft Report 2006-S-44

Dear Mr. Hancox:

In response to your draft report concerning the Department of Transportation's (Department) written support of internal controls over financial reporting of capital assets, we are providing the following comments.

**Report Reference:** Page 4, Risk Assessment. (*The Department*) has not completed a risk assessment related to financial reporting of capital assets.

**DOT Comment:** We do not agree with this audit observation. The Department's Enterprise Risk Management group assesses risks and controls associated with the financial reporting of capital assets as part of its annual risk assessment process. This process includes the following activities:

- ♦ discussion with relevant program managers regarding risks and related controls;
- ♦ analysis of prior audits which reviewed the Department's capital asset reporting controls; and
- ♦ consideration of financial reporting improvements implemented in accordance with prior audit recommendations.

\*  
Comment 1

Consistent with the general conclusions in your audit report, the Department's risk assessment efforts also concluded that the mitigating control activities in place had reduced the residual risk in this area to an acceptable level. Although the Department has assessed risk related to the financial reporting of capital assets, we acknowledge that there is room for improvement in documenting these efforts.

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Comment 2

\* See State Comptroller's Comments, page 10

Mr. David Hancox  
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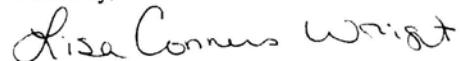
**Response to Recommendations**

**Recommendation 1:** *Periodically perform and maintain written support of a risk assessment of the internal controls over the financial reporting of capital assets.*

**DOT Response:** We agree that the Department should periodically perform a risk assessment of the internal controls over financial reporting; and as noted above, the Department has annually assessed this risk over the last several years and will continue to do so. Nonetheless, we do plan to make improvements in the documentation of our risk assessment of the internal controls over the financial reporting of capital assets.

\*  
Comments  
1 and 3

Sincerely,



Lisa C. Wright  
Chief Administrative Officer

cc: Lisa Ng, Division of the Budget

\* See State Comptroller's Comments, page 10

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## **APPENDIX B - STATE COMPTROLLER'S COMMENTS**

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1. Although Department officials informed us these activities took place, the Department did not have written support to indicate that a risk assessment of the internal controls over the financial reporting of capital assets had been performed. Consequently, we maintain that our conclusion that the Department had not completed a risk assessment related to financial reporting is correct.
2. Department management is not correct that mitigating control activities reduced the residual risk to an acceptable level. As noted in our report, audits of the State's comprehensive financial reports have produced reportable conditions in recent years that were critical of the internal controls to ensure the complete and accurate reporting of capital assets.

Moreover, as a result of system control weaknesses, adjustments were needed for the fiscal year ended March 31, 2004, to identify and record \$2.2 billion in construction in progress, \$430 million in additions, and \$246 million in deletions for financial reporting purposes. It is imperative Department management begin to appropriately assess, properly allocate resources and eliminate the need for future audit adjustments by the State's financial statement auditors.

3. We commend Department officials for planning to improve the documentation of their risk assessment of the internal controls over the financial reporting of capital assets, and we urge officials to take substantive actions related to this matter promptly.