

**STATE OF NEW HAMPSHIRE
HIGHWAY FUND**

**MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2016**



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To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Highway Fund as of and for the fiscal year ended June 30, 2016 and have issued our report thereon dated January 27, 2017.

This management letter, a byproduct of the audit of the New Hampshire Highway Fund for the fiscal year ended June 30, 2016, contains our auditor's report on internal control over financial reporting and on compliance and other matters and related audit findings. The appendix, starting on page 13 of the management letter, provides a summary of the status of observations related to the Highway Fund presented in the fiscal year 2005 Department of Transportation Management Letter and the fiscal year 2009 audit of the Department of Safety, Road Toll Bureau.

The New Hampshire Highway Fund fiscal year 2016 audited financial statements can be accessed online at:

http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Highway%20Fund_Fund15_2016.pdf

A handwritten signature in cursive script that reads "Office of Legislative Budget Assistant".

Office Of Legislative Budget Assistant

January 27, 2017

STATE OF NEW HAMPSHIRE
HIGHWAY FUND
2016 MANAGEMENT LETTER

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* Audit comments suggest legislative action may be required.

This report, and all other LBA-issued financial audit reports, can be accessed on-line at:
<http://www.gencourt.state.nh.us/LBA/AuditReports/financialreports.aspx>



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Independent Auditor's Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

To The Fiscal Committee Of The General Court:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the New Hampshire Highway Fund (Fund) which comprise the Balance Sheet as of June 30, 2016, and the Statement of Revenues, Expenditures, and Changes in Fund Balance for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 27, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the internal control over financial reporting (internal control) of the Fund to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the following observations, we identified certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented,

or detected and corrected on a timely basis. We consider the deficiency described in Observation No. 1 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Observations No. 2 through No. 4 to be significant deficiencies.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, contracts, and grant agreements, 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in Observations No. 5 and No. 6.

Auditee Responses To Findings

The responses by the Fund's management to the findings identified in our audit are included with each reported finding. Management's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose Of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Highway Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Office Of Legislative Budget Assistant

January 27, 2017

Internal Control Comments
Material Weakness

Observation No. 1: Strengthen Financial Reporting Protocols

Observation:

The financial accounting and reporting processes and controls applied by the State in its preparation of the fiscal year 2016 Highway Fund financial statements did not prevent, or detect and correct on a timely basis, two material errors in the financial statements submitted for audit.

Insufficient processes and controls applied in the preparation of the financial statements resulted in auditors proposing and management making material correcting audit adjustments.

Auditors proposed and management made material adjustments to:

- Eliminate a \$29 million overstatement of revenues and expenditures in the Highway Fund necessitated by management's prior adjustments to accounts intended to correct for limitations in the State's accounting system in recording mixed funding sources.
- Reclassify \$22 million as cash that had been initially reported as an accounts receivable - due from other funds.

Recommendation:

Highway Fund financial management should strengthen financial reporting protocols for the Highway Fund, particularly in the area of recognizing, recording, and reporting adjustments necessary for the fair reporting of the fund.

Management should consider developing comprehensive tools that outline responsibilities and timing and that would support the preparation of timely, accurate, and informative financial statements. Such an effort could improve the coordination and communication among the responsible departments in the preparation of the Highway Fund financial statements going forward.

Department of Administrative Services (DAS) Response:

We concur, in part.

The State's financial system limits activities to be recorded in a single fund. This was the first year that mixed funding had a significant, but not material impact on the general fund and highway fund reporting. DAS established a manual process resulting in the adjustment of system-generated activity for financial reporting purposes, which led to the corrections identified by the auditors. DAS concurred with the corrections, however while significant, DAS does not concur that the observation rises to the level of a material weakness in financial accounting and reporting processes and controls. It is important to note that the

correcting entries were isolated to mixed funding and did not result in any change to the Highway Fund net position as of June 30, 2016. One correction resulted in offsetting adjustments to both revenues and expenditures, and the other resulted in offsetting adjustments within total assets. Therefore, DAS believes that the corrections would not have a material impact on the financial statements users' decision-making process.

As a result of the added complexity of mixed funding, management has begun to implement financial system changes to minimize the need for manual adjustments and mitigate the risk of financial misstatement.

LBA Rejoinder:

The concept of materiality in a financial audit is an auditor's device, based on professional judgment. In this instance, the errors identified were clearly of material amounts. The fact that there were other material, offsetting errors does not change the fact that the control structure of the Highway Fund's financial reporting process did not detect and correct these errors.

Significant Deficiencies

Observation No. 2: Fully Document The Implementation Of GASB Statement No. 54

Observation:

The Highway Fund's financial reporting management did not fully document its implementation of the Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting And Governmental Fund Type Definitions* (the Statement) in its preparation of the fiscal year 2016 financial statements. An objective of the Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications.

According to the Statement, the *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by "constitution, external resource providers, or through enabling legislation." In the case of the Highway Fund, restrictions are placed on use of the funds primarily by Part II, Article 6-a of the New Hampshire State Constitution, for certain motor vehicle related tolls and fees, and by external resource providers, primarily for revenues from federal grants and related contracts. The Highway Fund financial reporting entity includes other revenues, such as motor vehicle title fees and motor vehicle fines, that do not meet the Statement's criteria for reporting in a restricted fund balance. In order to properly report restrictions on the Highway Fund balance, all revenues in the Fund need to be properly classified as restricted, committed, and assigned, and the funded expenditures need to be reviewed in similar categories to determine the mix of those funds remaining unspent in the June 30 Fund balance. The Highway Fund's financial reporting management did not make available for audit the documentation to support its reporting of the entire June 30, 2016 spendable Highway Fund balance (balance remaining after consideration of the nonspendable inventory balance) as restricted.

In addition, the Highway Fund financial statements did not disclose accounting policies that determine whether restricted, committed, or assigned amounts are considered to have been spent in the funding of an expenditure. The Statement requires disclosure of those policies in the notes to the financial statements.

Recommendation:

The Highway Fund's financial reporting management should fully document its implementation of GASB Statement No. 54. A review of the classifications of all Highway Fund revenues and expenditures should be undertaken to allow for the accurate classification of revenues and funded expenditures and to determine, document, and report the appropriate classification of balances in the fund.

The financial reporting of the Highway Fund should include all appropriate disclosures.

Department of Administrative Services (DAS) Response:

We concur, in part.

While the GASB 54 classification analysis was not documented in a formalized manner, DAS does not believe that improved documentation and disclosure would have resulted in a significant change to the amounts or classifications reported in the Highway Fund financial statements, and therefore, does not concur that there is a significant deficiency in the reporting of fund balance.

A portion of the revenues reported in the Highway Fund does not meet the criteria to be reported as restricted fund balance. Management assessed the impact of these revenues as a percentage of the entire amount of revenue reported in the Highway Fund, and concluded that any amounts not meeting the classification of restricted fund balance, would be immaterial. This is based on an analysis in which management identified approximately \$13 million of revenues within total revenues of \$484 million, that would not be restricted under Part II, Article 6-a of the New Hampshire State Constitution. Management will continue to perform this analysis and formally document and disclose its methodology.

LBA Rejoinder:

Auditors inquired about the implementation of GASB 54 early in the audit, but were provided no evidence of the implementation of the standard for fiscal year 2016. That the financial reporting management had not formally performed and documented its implementation of GASB 54 for the Highway Fund is, in the auditor's view, a significant deficiency in internal control over financial reporting.

Auditors brought the \$13 million of motor vehicle title fees and motor vehicle fines revenues to the attention of the Highway Fund financial reporting management as an example of the significance of the revenues that need to be considered in the implementation of GASB 54. A full analysis and accurate classification of all Highway Fund revenues, as well as a full consideration of the State's spending protocol (restricted balances are expended prior to expending balances that are not restricted) is required to determine the accurate reporting of fund balance at fiscal yearend.

Observation No. 3: Establish Formal Risk Assessment Processes

Observation:

Two departments with significant financial activity reported in the State Highway Fund did not have formal risk assessment processes in place during fiscal year 2016.

Management's assessment of and response to risks facing the entity is an integral component of internal control. The purpose of an entity's risk assessment efforts is to identify, analyze, and, where appropriate, respond to risks and thereby manage risks that could affect the entity's ability

to reach its objectives. Effective risk assessment practices should be a core element of management's planning activities and should be an ongoing activity.

The Department of Transportation (DOT) reported that it had a draft of a risk assessment process covering transportation asset management during fiscal year 2016. According to the DOT, that risk assessment document is required by the Federal Highway Administration (FHWA) and will move out of draft when related federal guidelines are finalized. The Department reported other risk assessment activities occur informally.

The Department of Safety (DOS) reported that it had no written risk assessment process during fiscal year 2016 and that risk identification occurs informally during biweekly meetings with DOS Division of Administration unit heads and is considered normal course of business with risks identified via review of processes and related controls. DOS further reported that when there are changes to a process, the respective process is revisited from a risk perspective.

While both departments reported they had components of fraud risk management programs, neither department reported having formal fraud risk management programs covering all their significant financial activities reported in the Highway Fund.

Recommendation:

The DOT and the DOS should establish formal risk assessment processes, supported by written policies and procedures, for recognizing and responding to relevant risks, including, but not limited to, risks associated with operational, compliance, and financial reporting objectives.

The DOT and the DOS should establish formal fraud risk management programs to support effective management of fraud risks.

Department of Transportation Response:

We concur, in part.

The Department completed in draft form, a formal risk assessment process as part of the Transportation Asset Management Plan in January of 2016. The draft document identifies risks significant to the Department's Operations, prioritizes the risks, and identifies strategies to enhance the effectiveness of the Department's planning and resource allocation and control processes. It is anticipated that this component of a formal risk assessment will be completed by June 2017.

The Department has also completed a formal Continuity of Operations Plan (COOP) in June 2013. This plan formally addresses the risks associated with the DOT's ability to continue operations in the event of all types of emergencies. Additionally, a Federal Emergency Management Plan and various other processes to assess and mitigate risk have also been prepared.

The Department will continue to assess these and other programs and will formally document.

Department of Safety Response:

We concur, in part.

The Department of Safety (DOS) recognizes that risk assessment is an ongoing process that must consider new and emerging situations to be effective. Risk assessment activities and consideration, including fraud risk, occur on an ongoing basis during management team meetings to ensure an effective response to developing situations that impact operations, compliance, and financial reporting. Additional risk assessments occur during review and development of processes and procedures at all levels of the Department.

DOS has completed a formal Continuity of Operations Plan (COOP) which formally addresses the risks associated with the Department's ability to continue operations in the event of all types of emergencies. The COOP was last updated in June 2016.

We concur that our ongoing process of risk assessment should be documented in a formal procedure. DOS will review current risk assessment processes and identify areas to appropriately document existing risk assessment activities while ensuring that risk assessments continue to occur on an ongoing basis.

Observation No. 4: Establish Strong Password Protocols On All Information Systems

Observation:

The Department of Transportation (DOT) does not require employees to use secure password practices for passwords used to access employee accounts on the Department's payroll system (MATS).

Employees are given a standard format password made up of common characters and the employees' initials when initially granted access to MATS. There is no requirement for employees to subsequently change the initially-assigned password to a personal, private password and there is no periodic requirement for employees to change their password. Allowing users to continue to use standard-format passwords enables any individual knowledgeable of the DOT's practices to know the password of an employee who had not reset their initially-assigned MATS password.

Operating an information system with weak password protocols, such as not preventing employees from continuing to use default passwords, is contrary to essentially all information technology control guidance. Systems with weak password controls are at greater risk of abuse. Inconsistent application and reinforcement of key control concepts, such as the necessity for effective access controls, can undermine employee understanding and appreciation of the need for control compliance.

Recommendation:

The DOT should establish strong password protocols on all information systems requiring password controls. Password protocols should direct employees to utilize complex passwords and require employees to regularly change those passwords.

Department of Transportation Response:

We concur.

The Department currently has secure password practices and protocols to control initial user log-on access to all DOT systems. The finding is that once access to the DOT system is achieved, access to software applications on the system could be better controlled. Numerous information technology software applications are maintained by the Department and the effort to identify, perform cost benefit analysis, and prioritize security needs will be initiated to ultimately determine the software applications that require implementation of this recommended improvement.

State Compliance Comments

Observation No. 5: Comply With The Betterment Fund Allocation Provisions Of RSA 235:23-a

Observation:

The Department of Transportation (DOT) did not spend betterment funds in strict compliance with the allocation formula specified in RSA 235:23-a. While the DOT used the statutory formula to calculate each of the six highway district's allocation of the \$21.2 million of fiscal year 2016 betterment fund appropriations, the actual expenditures of betterment funds on behalf of each district did not correspond to their calculated allocation. The DOT reported the differences between the calculated allocations and the actual expenditures were primarily due to the DOT expending some betterment funds on "Statewide" projects, as well as unforeseen projects and emergencies that arise over the course of the year.

The DOT describes Statewide projects as betterment projects spanning two or more highway districts. The DOT reports that because it has not established a practical way to allocate the Statewide project expenditure of betterment funds to the individual districts, it is difficult to demonstrate that betterment funds are expended in compliance with the RSA 235:23-a allocation.

Betterment Funds - Allocated And Expended
Fiscal Year 2016
(in millions)

District	Allocated		Expended	
	Dollars	Percent	Dollars	Percent
District 1	\$ 3.92	18.5%	\$ 6.15	23.9%
District 2	3.80	17.9%	3.94	15.3%
District 3	3.87	18.3%	5.76	22.4%
District 4	2.94	13.9%	2.91	11.3%
District 5	4.10	19.3%	2.96	11.5%
District 6	<u>2.56</u>	<u>12.1%</u>	<u>2.34</u>	9.1%
	\$ 21.19	100.0%	24.06	
Statewide			<u>1.69</u>	<u>6.5%</u>
			\$ 25.75	100.0%

Betterment funds are nonlapsing. The amount expended during fiscal year 2016 exceeded the funds allocated for the same period, as the fiscal year 2016 expenditures included amounts available from the prior fiscal year.

Based on a three year average of the betterment project expenditures in the six highway districts, excluding the betterment funds spent in the Statewide category, Districts 1, 2, 4, and 6 received

more betterment fund expenditures, and Districts 3 and 5 received less betterment fund expenditures than they would have received based on the allocation in RSA 235:23-a.

Recommendation:

The DOT should expend betterment funds in accordance with the allocation formula in RSA 235:23-a.

If the DOT determines that compliance with the statute is not in the best interest of the DOT and State, the DOT should pursue an appropriate amendment to RSA 235:23-a.

Department of Transportation Response:

We concur.

As recommended, the Department of Transportation has introduced legislation to amend RSA 235:23-a to better address the allocation formula.

Dependent upon legislative approval or the Department fully incorporates current law to its allocation methodologies, the Department considers this finding will be fully resolved by July 1, 2017.

Observation No. 6: Adopt Required Administrative Rules

Observation:

The Department of Safety (DOS) has not adopted certain administrative rules required by statute affecting its operation in the Highway Fund.

RSA 21-P:14, III states in part, "The commissioner of safety shall adopt rules, under RSA 541-A and RSA 260:5, relative to motor vehicle registration as follows:

- (c) Maintaining records of motor vehicle certificates of title, as authorized by RSA 261:7.
- (q) Extension of registration expiration, as authorized by RSA 261:63.
- (r) Exemption from the registration requirement for certain construction equipment, as authorized by RSA 261:64.
- (s) Issuing certificates of registration for vehicles owned by diplomats and certain other officials, as authorized by RSA 261:65." [RSA 21-P:14, III (s) was repealed, effective July 26, 2016.]

At June 30, 2016, the DOS had not adopted the above-mentioned rules.

Recommendation:

The DOS should adopt statutorily-required administrative rules.

If the DOS determines that adopting the rules is not in the interest of the DOS or State, the DOS should request that the statutes be appropriately amended.

Department of Safety Response:

We concur.

Administrative rulemaking is a highly detailed and time consuming process crucial to the administration of programs and services. DOS has struggled to remain current on all administrative rules due to a lack of available personnel resources.

As part of ongoing risk assessment activities during fiscal year 2016, DOS identified a lack of personnel resources to address expiring administrative rules as a risk. In response to this assessment, DOS established and hired a new part-time Rules Coordinator in July 2016 to identify, coordinate, and develop timely administrative rules.

APPENDIX A

Current Status Of Prior Audit Findings

The following is the Department of Transportation management's summary of the fiscal year 2016 status of the observations related to the Highway Fund contained in the Department Of Transportation Management Letter for the fiscal year ended June 30, 2005. That report can be accessed at, and printed from, the Office of Legislative Budget Assistant website:
http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/DOT_ML_2005_full.pdf

	<u>Status</u>
<i>Internal Control Comments</i>	
<i>Material Weaknesses</i>	
1. Internal Controls Must Be Improved (<i>See Current Observation No. 3</i>)	● ● ●
2. Core Financial Accounting And Reporting Personnel Resources Must Be Strengthened	● ● ●
3. Regular Analysis Of Highway Fund Balances Must Be Performed (<i>See Current Observation No. 2</i>)	● ● ●
4. Controls Over Classification Of Participating Costs Should Be Improved	● ● ●
<i>Comment No. 5 Related To Turnpikes, Not Part Of The Scope Of This Audit.</i>	
<i>Significant Deficiencies</i>	
<u>Project Accounting</u>	
6. Monitoring Controls Need To Be Strengthened	● ● ●
7. Current Bill Limitations Related To Changes In Federal Participation Rates Should Be Reviewed	● ● ●
8. Controls Must Be Established For Summary Level Transfer Adjustments	● ● ●
9. Error Reports Must Be Reviewed And Acted Upon	● ● ●
10. Procedures To Ensure Complete Reporting Of Capital Assets Need To Be Improved	● ● ●
11. Encumbrance Controls Should Be Used For All Project Expenditures	● ● ●
12. Program Policies And Procedures Should Incorporate Financial Requirements	● ● ●
<i>Comments No. 13 through No. 17 Related To Turnpikes, Not Part Of The Scope Of This Audit.</i>	
<u>Other Administration</u>	
18. Controls Over Verifying Time Worked Should Be Clarified	● ● ●
19. Computer Access Controls Should Be Reviewed (<i>See Current Observation No. 4</i>)	● ○ ○
20. Payments For ROW Activities Should Be Drawn As Needed And Not Drawn Prior To Planned Disbursement	● ● ●
21. Procedures for Processing Employee Terminations Should Be Properly Segregated	● ● ●
22. Controls Should Be Established Over Road Toll Revenues Posted To The Department's Accounting Records By The Department of Safety	● ● ●

- 23. Comprehensive Policies And Procedures Manual Should Be Established For ROW Bureau ● ○ ○
- 24. Formal Fraud Prevention, Deterrence, And Detection Program Should Be Established (See Current Observation No. 3) ● ○ ○
- 25. Formal Risk Assessment Policies And Procedures Should Be Established (See Current Observation No. 3) ● ● ●
- 26. Fees Should Be Based In Statute Or Rule ● ● ○

State Compliance Comments

- 27. Compliance With State And Department Meal Reimbursement Policies Should Be Improved ● ● ●
- 28. Compliance With Administrative Rules Requirements Should Be Improved ● ● ●

Federal Compliance Comments

- 29. ROW Payments Should Be Based On Actual Costs And Not Estimates ■ ■ ■
- 30. ROW Payments Should Be Based On Actual Allowed Costs ■ ■ ■

Status Key

Count

Fully Resolved	●	●	●	18
Substantially Resolved	●	●	○	1
Partially Resolved	●	○	○	3
Unresolved	○	○	○	0
Did Not Concur With Recommendation	■	■	■	2

APPENDIX B

Current Status Of Prior Audit Findings

The following is the Road Toll Bureau management's summary of the fiscal year 2016 status of the observations related to the Highway Fund contained in the fiscal year 2009 audit of the Road Toll Bureau. That report can be accessed at, and printed from, the Office of Legislative Budget Assistant website:

http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/road_toll_2009_full.pdf

<i>Internal Control Comments</i>	<u>Status</u>		
<i>Significant Deficiencies</i>			
2. Revenue Responsibilities Should Be Segregated	●	●	●
3. Results Of Desk Audits Should Be Monitored And Acted Upon	●	●	○
4. Effective Controls Over Refunds Of Road Tolls Should Be Reestablished	●	●	●
5. Utilization Of Available Information Technology Controls Should Be Improved	●	●	○
6. Transactions Posted In Error Should Be Corrected	●	●	●
8. Adequacy Of Licensee Bonds Should Be Monitored	●	●	●
9. Policies and Procedures For Managing Accounts Receivable Should Be Formalized	●	●	○
10. Expenditures Should Be Charged To The Proper Account	●	●	●
<i>Comments No. 1 And No. 7 Related To The General Fund, Not Part Of The Scope Of This Audit.</i>			

<i>Compliance Comments</i>			
11. Administrative Rules Should Be Consistently Applied	●	●	●
12. Compliance With The Department's Interstate Agreements Should Be Improved	●	●	●
<i>Comments No. 13 And No. 14 Related To The General Fund Or Other Non-Highway Fund Activity, Not Part Of The Scope Of This Audit.</i>			

<u>Status Key</u>				<u>Count</u>
Fully Resolved	●	●	●	7
Substantially Resolved	●	●	○	3
Partially Resolved	●	○	○	0
Unresolved	○	○	○	0

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