November 12, 1998

The Honorable David M. Beasley, Governor
and
Members of the South Carolina Transportation Commission
South Carolina Department of Transportation
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Department of Transportation for the fiscal year ended June 30, 1998, was issued by Rogers & Laban, P.A., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/cwc
# SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

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INDEPENDENT AUDITORS' REPORT

Mr. Thomas L. Wagner, Jr., CPA,
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying financial statements of the South Carolina Department of Transportation (the Department) as of and for the year ended June 30, 1998 as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit. An audit similar in scope of the Department's financial statements was performed by us for the year ended June 30, 1997 and our report thereon was dated October 24, 1997 and expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements of the Department are intended to present the financial position and results of operations and cash flows of its proprietary fund type of only that portion of the funds and account groups of the State of South Carolina that is attributable to the transactions of the South Carolina Department of Transportation, an agency of the State.

The Department declined to present a statement of revenues, expenditures, and changes in fund balances - budget and actual, for the general fund and special revenue fund type for the year ended June 30, 1998. Presentation of such statements for those governmental funds for which budgets have been legally adopted is required by generally accepted accounting principles.

In our opinion, except that the omission of the statement of revenues, expenditures, and changes in fund balances - budget and actual results in an incomplete presentation as explained in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the South Carolina Department of Transportation as of June 30, 1998, and the results of its operations and its cash flows of its proprietary fund type for the year then ended in conformity with generally accepted accounting principles.

As described in Note 18 to the financial statements, the Department changed its method of accounting for cash and cash equivalents in the State's internal investment pool as required by the provisions of Governmental Accounting Standards Board (GASB) Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Also, as described in Note 18, an error in the application of accounting principles regarding the classification of the transfer to the Agency Fund (County Transportation Program) was discovered by management of the Department during the current year.
Our audit was performed for the purpose of forming an opinion on the financial statements of the Department taken as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Also, the accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued our report dated October 19, 1998, on our consideration of the Department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Columbia, South Carolina
October 19, 1998
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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Reporting Entity

The South Carolina Department of Transportation (the Department) was established pursuant to Section 57-1-20 of the Code of Laws of South Carolina as an administrative agency of State government, comprised of a Division of Mass Transit; a Division of Construction, Engineering and Planning; and a Division of Finance and Administration. The funds and account groups of the Department are included in the Comprehensive Annual Financial Report of the State of South Carolina.

The Department is governed by the South Carolina Transportation Commission, which is comprised of seven members, six of whom are elected by the Legislative Delegations of each of the State's Transportation Districts. These Transportation Districts coincide with the State's Congressional Districts. One at-large member is appointed by the Governor and, upon confirmation by the South Carolina Senate, serves as Chairman of the Commission. The Commission serves as a general policy-making body for the various functions and purposes of the Department as prescribed by law. The Commission defines policies that are to be administered by the Director.

The core of the financial reporting entity is the primary government, which has a separately elected governing body. As required by generally accepted accounting principles, the financial reporting entity includes both the primary government and all of its component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In turn, component units may have component units. The Department has determined it has no component units.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity. The Department reports as part of the State's primary government.

A primary government or entity is financially accountable if it appoints a voting majority of the organization's governing body, including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex officio capacity on the component unit's board are considered appointments by the primary entity) and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally dependent on the primary government that holds one or more of the following powers:

1. Determine its budget without another government having the authority to approve and modify that budget;
2. Levy taxes or set rates or charges without approval by another government; or,
3. Issue bonded debt without approval by another government.

The organization is fiscally independent if it holds all three of those powers. Based on these criteria, the Department has determined it is not a component of another entity and the Connector 2000 Association, Inc. is a component unit of the Department under Statement 14 of the Governmental Accounting Standards Board. This financial reporting entity includes only the Department (a primary entity) and its component unit.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

The Connector 2000 Association, Inc. (the Association) is a not-for-profit public benefit corporation that was organized in 1996. Its current purpose is to assist the Department in the financing, acquisition, construction and operation of turnpikes, highway projects and other transportation facilities pursuant to Section 57-3-200 of the Code of Laws of South Carolina. The Association is considered a component unit of the Department because the Department initially fixed the toll rates for the Southern Connector in Greenville County, South Carolina and, after consultation with the Association, has the right (but not the obligation) to revise the toll rates from time to time to rates which are not less than 90% and not more than 120% of the optimum toll rates as estimated by an independent traffic consultant retained by the Association. Rates set by the Department must satisfy the applicable revenue covenants contained in the Association's financing documents.

The Association utilizes a December year end for financial reporting purposes and no financial statements were issued on it for the year ended December 31, 1997 since it did not have any assets or revenues. Governmental accounting standards require that the reporting entity's financial statements include the year end statements of the component unit which falls within the reporting entity's fiscal year. Since there were no financial statements issued by the Association and the Association did not have any assets or revenues, no financial activity of the Association is included in these financial statements.

The Department's inclusion of the Association as a component unit is done for the purpose of communicating information about its component unit as required by generally accepted accounting principles, and the Association's relationship with the Department. It is not intended to create the perception that the Department and the Association are one legal entity. From a legal standpoint, the State of South Carolina and the Department have only a contractual relationship with the Association. This contractual relationship came about as a result of the Association's submittal of the successful proposal to construct and operate the Southern Connector. In addition, the Supreme Court of South Carolina has held that the State of South Carolina and the Department are not a joint owner in the Association, and, accordingly, have no legal or financial accountability for the Association.

The financial statements of a component unit is blended in with the Department if it has substantially the same board or provides services almost entirely to the Department. Since the Association does not meet these criteria, the Association's financial activity will be presented discretely in the Department's future financial statements.

The Department is granted an annual appropriation for operating purposes as authorized by the South Carolina General Assembly. The appropriation as enacted becomes the legal operating budget for the Department. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The laws of the State and the policies and procedures specified by the State for State agencies and institutions are applicable to the activities of the Department. Generally, all State departments, agencies, and colleges are included in the State's reporting entity, which is the primary government of the State of South Carolina. These entities are financially accountable to and fiscally dependent on the State. Although the Department operates somewhat autonomously, it lacks full corporate powers. In addition, the Governor and/or the General Assembly appoints most of its board members and budgets a significant portion of its funds.

The accompanying financial statements present the financial position and the results of operations and cash flows of only that portion of the funds of the State of South Carolina that is attributable to the transactions of the Department.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

Basis of Presentation and Description of Funds

The financial statements of the Department are presented in accordance with generally accepted accounting principles applicable to state and local governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The Department uses funds and account groups to report its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fund is a separate fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with related liabilities and residual equities or balances and changes therein. These accounts are segregated to carry on specific activities or attain certain objectives in accordance with applicable regulations, restrictions, or limitations. Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds that have similar characteristics have been combined into fund types. Accordingly, all financial transactions in the combined statements have been reported by fund type. An account group, on the other hand, is a financial reporting device designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net expendable available financial resources.

The Department's funds are classified as governmental, proprietary and fiduciary. Each category, in turn, is divided into separate “fund types”.

Governmental Fund Types

Governmental funds are those through which most governmental functions typically are financed and are used to account for all or most of a government's general activities, including the collection and disbursement of earmarked monies (special revenue funds). Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used; current liabilities are assigned to the fund from which they are to be paid; the difference between the assets and liabilities is fund balance.

General Fund - The general fund accounts for all activities except those required to be accounted for in another fund. For the Department, the general fund consists of funds appropriated from the State General Fund for public transportation.

Special Revenue Fund - The special revenue fund generally records the expenditure of revenues that are restricted to specific programs or projects. The special revenue fund accounts for Federal grant programs, taxes levied with statutorily defined distributions, and other resources restricted as to purpose. Also, the Department reports the acquisition, construction, maintenance of general fixed assets in its special revenue fund.

The State Highway Fund was established pursuant to Section 57-11-20 of the Code of Laws of South Carolina. This Fund accounts for, among others, the gasoline tax, except for the 2.66 cents per gallon that is allocated to the County Transportation Program Agency Fund, and other special imposts upon highway users for the construction and maintenance of highways and bridges and for other operations of the Department. This fund also accounts for revenue that is received from other entities which have entered into participation agreements with the Department to share costs of construction projects and from the County Transportation Program Agency Fund for projects that are administered for County Transportation committees. Revenues from the participation agreement type contracts are recognized as earned based on the percentage of completion method. The unearned portion is reflected as deferred revenue in the liability section of the balance sheet until earned.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

Proprietary Fund Types

Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Goods or services from such activities can be provided either to outside parties (enterprise funds) or to other departments or agencies primarily within the government (internal service funds).

Internal Service Fund - The Internal Service Fund accounts for the rental pool the Department operates for vehicles and other equipment that are utilized primarily for highway projects. The Fund is intended to recover variable costs and certain costs associated with the operation of the equipment, including depreciation.

Fiduciary Fund Types

Fiduciary funds are used to account for assets held by the Department in a trustee capacity or as an agent for individuals, private organizations, other governmental units and/or other funds. The Department uses the Agency Fund fund type of fiduciary funds. Agency funds are purely custodial (assets equal liabilities) and thus do not involve the measurement of the results of operations.

The Right-of-Way Fund is used to account for payments for the purchase of right-of-way property which has been contested by the property owner. An amount equal to the Department's offer remains in this Fund until such time as an agreement is reached and price established with the property owner. The property owner has the right to receive 75% of the offer, in which case 25% of the offer is held in the Right-of-Way Fund. Effective April 1, 1988, right-of-way deposits are held by the Clerk of Court in the appropriate county. Deposits held by the Department as of April 1, 1988 will remain in the Department's Right-of-Way Fund until such time as those respective cases are settled. Current year's activity represents receipt of funds from various clerks of court and disbursement to property owners upon settlement of contested cases.

The Special Deposits Fund is used to account for various funds that are collected from other governments or agencies and outside parties. These funds are held until resolution of various matters, such as anti-trust violations, oversize and overweight charges and other similar items that occur.

The County Transportation Program Fund was established pursuant to Section 12-27-400 of the South Carolina Code of Laws to provide for the receipts from distribution and use of the 2.66 cents per gallon gasoline tax collected by the Department of Revenue and remitted to the Department of Transportation. In addition to the gasoline tax, the Department is required to transfer $9,500,000 annually from the State Highway Fund to the Program. Effective April 1, 1988, right-of-way deposits are held by the Clerk of Court in the appropriate county. Deposits held by the Department as of April 1, 1988 will remain in the Department's Right-of-Way Fund until such time as those respective cases are settled. Current year's activity represents receipt of funds from various clerks of court and disbursement to property owners upon settlement of contested cases.

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Account Groups

General Fixed Assets Account Group - This group of accounts is established to account for all fixed assets of the Department with the exception of those accounted for in the Internal Service Fund and the Department's investment in infrastructure. Infrastructure includes roads, bridges, lighting systems, and the underlying and adjoining right-of-way land. Infrastructure is considered to be of value only to the government and the cumulative investment in such is not accounted for in the Department's financial statement.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

Donated fixed assets are recorded at estimated fair market value at the time of acquisition. Reporting infrastructure fixed assets is optional and the Department has chosen not to report these assets.

General Long-Term Debt Account Group - This account group is used to account for the outstanding balance of any unmatured general long-term liabilities that are expected to be financed from governmental funds. These liabilities include compensated absences and the principal portion owed on bonds payable and the contribution payable to the South Carolina Transportation Infrastructure Bank, an agency of the State of South Carolina.

Significant Accounting Policies

Basis of Accounting

All governmental funds are accounted for using a current financial resources measurement focus whereby only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases and decreases in net current assets.

The modified accrual basis of accounting is utilized for governmental fund types and the Agency Funds. Under this method, revenue, including taxes, is recognized when it becomes measurable and available to finance expenditures of the current fiscal year. Federal grants for the Department are recorded as revenue when the related expenditures are incurred. Federal grant monies that are allocated to subrecipients are recognized as an expenditure when the subrecipient requests reimbursement for incurred costs. Expenditures are recognized when the related fund liability is incurred except for unmatured interest on general long-term debt, which is recognized when due. Payments for insurance and similar services benefiting more than one period are recognized as an expenditure in the year of payment.

The proprietary fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of this fund are included on the balance sheet. Fund equity (i.e., total net assets) is segregated into contributed capital and retained earnings components. Proprietary fund-type operating statements present increases and decreases in total net assets.

Proprietary fund revenue and expenses are recognized on the accrual basis of accounting. Revenue is recognized in the accounting period in which it is earned and becomes measurable; expenses are recognized in the period incurred, if measurable.

The Department implemented Governmental Accounting Standards Board Statement No. 20 Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting in a prior fiscal year. The Department has elected to apply only those standards issued by the Financial Accounting Standards Board on or before November 30, 1989.

Operating transfers in and out are recognized in the accounting period in which the interfund payable and receivable arise. Operating transfers do not represent loans, reimbursements or quasi-external transactions.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

Budget Policy

The Department is granted an annual appropriation for public transportation by the General Assembly. The appropriation as enacted becomes the legal operating budget for the Department. The Appropriation Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The Total Funds column in the Appropriation Act for each individual budgetary unit authorizes expenditures from all budgeted resources. A revenue budget is not adopted for individual budgetary units. The General Assembly enacts the budget through passage of line-item appropriations by program within budgetary unit within budgetary fund category, State General Fund or other budgeted funds. Budgetary control is maintained at the line-item level of the budgetary entity. Agencies may process disbursement vouchers in the State's budgetary accounting system only if enough cash and appropriation authorization exist.

Transfers of funds may be approved by the State Budget and Control Board under its authority or by the agency as set forth in Appropriation Act Proviso 72.9 as follows: Agencies shall be authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and the State Comptroller General. No such transfer may exceed twenty percent of the program budget. Transfers from personal services accounts or from other operating accounts may be restricted to any level set by the Board.

During the fiscal year-end closeout period in July, agencies may continue to charge vendor, interagency, and interfund payments for the fiscal year to that fiscal year's appropriations. Any unexpended State General Fund monies as of June 30 automatically lapse to the General Fund of the State on July 31 unless authorization is received from the General Assembly to carry over the funds to the ensuing fiscal year. State law does not require the use of encumbrance accounting.

State law does not precisely define the budgetary basis of accounting. The current Appropriation Act states that the General Assembly intends to appropriate all State funds and to authorize and/or appropriate the use of all other monies to operate State government for the current fiscal year. The State's annual budget is prepared primarily on the modified accrual basis of accounting with several exceptions, principally the cash disbursements basis for payroll expenditures.

The level of legal control for each agency is reported in a publication of the State Comptroller General's Office titled "A Detailed Report of Appropriations and Expenditures" for each fiscal year. The Department has not presented a statement of revenues, expenditures and changes in fund balances - budget and actual for the governmental fund types as required by generally accepted accounting principles since the Department's records are not maintained in a manner which allows the accumulation of the required information.

Cash and Cash Equivalents

The amounts shown in the financial statements as "cash and cash equivalents" represent petty cash, cash on hand with the State Treasurer, and cash invested in various instruments by the State Treasurer as part of the State's internal cash management pool.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

Most State agencies, including the Department, participate in the State's internal cash management pool. Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United States and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. For credit risk information pertaining to the cash management pool, see the deposits disclosure in Note 2.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Investments in the pool are recorded at fair value. Interest earned by the Department's special deposit accounts is posted to the Department's account at the end of each month and is retained by the Department. Interest/investment earnings are allocated based on the percentage of the Department's accumulated daily interest receivable to the income receivable of the pool.

Some State Treasurer accounts are not included in the State's internal cash management pool because of restrictions on the use of the funds. For those accounts, cash equivalents include investments in short-term highly liquid securities having an initial maturity of three months or less.

Effective July 1, 1995, Section 12-28-2740 of the South Carolina Code of Laws, 1976 was amended to provide for interest earned on the State Highway Fund and the County Transportation Fund to be deposited in the Department's State Highway Fund. Effective July 1, 1997, Section 12-28-2740 was further amended to provide that earnings on the County Transportation Fund administered by the Department be credited to the counties in the proportion the county's distribution of "C" funds is of the total of such distributions statewide and to provide that these distributions shall not include those counties that administer their own "C" funds.

Inventories

The Department maintains inventories of supplies for its use and merchandise for resale to other state agencies and local governments. All inventories are valued at cost using the weighted average method. Expenditures for inventory are accounted for using the purchases method of accounting, in which inventory purchases are recorded as expenditures when purchased. Inventories on hand at year end are reflected in the balance sheet with an equal amount of the fund balance reserved specifically for inventories.

Interfund Receivables/Payables

Long-term interfund loans are classified as "advance to" or "advance from" particular funds. Short-term amounts are classified as "due to" or "due from" the particular funds. No interest is charged on the advances to or due from amounts. Short-term amounts are generally repaid within 60 days. There were no long-term advances outstanding as of June 30, 1998.
NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

Fixed Assets

General fixed assets acquired or constructed are recorded as expenditures from the applicable governmental fund and are capitalized at cost in the general fixed asset account group. Major capital additions which are being constructed over several years are recorded as expenditures in the applicable governmental fund and simultaneously capitalized as construction-in-progress in the general fixed assets account group. When construction projects are completed, they are reclassified from construction-in-progress to buildings and improvements. Donated assets are valued at their fair market value when received. Fixed assets are not depreciated in accordance with generally accepted accounting principles for governmental entities. Equipment costing more than $500 and having a useful life of more than one year is capitalized. Fixed assets transferred between the General Fixed Asset Account Group and the Internal Service Fund are recorded at the historical cost of the originating fund. When an internal service fund is the receiving fund, cost is less accumulated depreciation or accumulated depreciation which would have been recorded had the fixed asset always been an asset of proprietary funds. A net value is recorded as contributed capital by the receiving internal service fund.

Depreciation of vehicles and equipment in the proprietary fund is computed using the straight-line method over the estimated useful life of the asset (passenger vehicles - 5 years; trucks - 7 years; and equipment - 5-15 years) after allowing for salvage value.

No interest expense has been capitalized for any fixed assets, since the only debt incurred by the Department has been for the construction of infrastructure.

Fund Equity

In accordance with governmental accounting standards, the portions of fund balances that are not available for appropriation and expenditure and/or are legally segregated for a specific use are presented as reserved at year end. Designated unreserved fund balances represent tentative plans for future use of financial resources. The reserves for inventory and long-term advances receivable represent financial resources not available for current expenditures.

Contributed capital is recorded in the proprietary fund, consisting of capital contributions in the form of vehicles and equipment transferred from the General Fixed Assets Account Group. Depreciation expense on these assets is recorded as a reduction in contributed capital.

Interfund Transactions

Quasi-external transactions are accounted for as revenues, expenditures, or expenses. Quasi-external transactions are those that would be treated as revenues, expenditures or expenses if they involved organizations external to the government unit. Transactions that constitute reimbursements to a fund for expenditures/expenses initially made from it that are properly applicable to another fund, are recorded as expenditures/expenses in the reimbursing fund and as reductions of expenditures/expenses in the fund that is reimbursed.

All other interfund transactions, except quasi-external transactions and reimbursements, are reported as transfers. Nonrecurring or nonroutine permanent transfers of equity are recorded as residual equity transfers. All other interfund transfers are reported as operating transfers. There have been no eliminations of interfund transfers in the financial statements.
NOTE 1.  SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)

Compensated Absences

Generally all permanent full-time State employees and certain part-time employees scheduled to work at least one-half of the agency's work week are entitled to accrue and carry forward at calendar year-end maximums of 180 days sick leave and of 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum, but are not entitled to any payment for unused sick leave. The compensated absences liability includes accrued annual leave earned for which the employees are entitled to paid time off or payment at termination. The leave liability also includes an estimate for accrued sick leave and leave from the agency's leave transfer pool for employees who have been approved as leave recipients under personal emergency circumstances which commenced on or before June 30, 1998. The Department calculates the gross compensated absences liability based on recorded balances of unused leave. The entire unpaid liability for which the employer expects to compensate employees through paid time off or cash payments, inventoried at fiscal year-end current salary costs and the cost of the salary-related benefit payments, is recorded in the general long-term debt group of accounts.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts of assets, liabilities, revenues and expenditures and affect disclosure of contingent assets and liabilities at the balance sheet date of the financial statements. Accordingly, actual results could differ from those estimates.

Memorandum Only Columns – Totals and Comparative Amounts

Amounts in the "Totals (Memorandum Only) columns included in the combined balance sheet and statement of revenues, expenditures and changes in fund balances present an aggregation of the financial statement line-items as previously reported to facilitate financial analysis. Such amounts are not comparable to a consolidation and do not present information in conformity with generally accepted accounting principles. Interfund eliminations have not been made in the aggregation of this data.

The comparative amounts column for the prior year is included in the statements of revenues, expenses and changes in retained earnings and cash flows as previously reported is included to provide a summarized comparison with the current year amounts. The prior year figures and totals are not intended to present all of the information necessary for a fair presentation of results of operations and cash flows in accordance with generally accepted accounting principles.

NOTE 2.  DEPOSITS:

All deposits of the Department are under the control of the State Treasurer who, by law, has sole authority for investing State funds.

The following schedule reconciles deposits within the footnotes to the balance sheet amounts:

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Footnotes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Cash Equivalents</td>
<td>$317,385,129</td>
</tr>
<tr>
<td>Cash on Hand</td>
<td>$</td>
</tr>
<tr>
<td>Deposits Held by</td>
<td></td>
</tr>
<tr>
<td>State Treasurer</td>
<td>$317,384,879</td>
</tr>
</tbody>
</table>
$317,385,129  $317,385,129
NOTE 2.  DEPOSITS: (CONTINUED)

Deposits Held by State Treasurer

State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days.

Information pertaining to carrying amounts, fair value, and credit risk of the State Treasurer's investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina. Cash and cash equivalents reported on the balance sheet include $9,629,839 in unrealized gains at June 30, 1998, of which $4,054,125 is attributable to the Agency Fund.

Deposits at June 30, 1998 held by the State Treasurer include $46,604,465 of unexpended funds related to the recent bond issues (including $1,520,069 of unrealized gains).

NOTE 3.  STATE APPROPRIATIONS:

The 1997-98 original appropriation is the Department's base budget amount presented in the General Funds column of Section 69, Part I A of the 1997-98 Appropriation Act.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original appropriation</td>
<td>$585,976</td>
</tr>
<tr>
<td>Transfer to South Carolina Department of Corrections for Prison Industries – Printing Division</td>
<td>(7,000)</td>
</tr>
<tr>
<td>Revised appropriation received in fiscal year 1998</td>
<td>$578,976</td>
</tr>
</tbody>
</table>

The Department brought forward $4,341 of appropriations from the year ended June 30, 1997 pursuant to Proviso 72.44 of the 1997-98 Appropriations Act.

NOTE 4.  RECEIVABLES:

Federal Government - The $37,173,530 receivable amount represents reimbursements due the Department under various Federal grant programs in which the Department participates. Revenues and related receivables are recognized at the time expenditures are incurred under such programs.

State Government - The receivable amount of $43,258,226 is comprised of $33,512,751 for gasoline taxes and other fees collected by the South Carolina Department of Revenue but not remitted to the Department by June 30, 1998 and $9,745,475 for sales of supplies and services and reimbursement of expenditures which is due from various State agencies.

The $9,745,475 includes an unpaid balance of $6,225,659 due under two repayment agreements with the South Carolina Department of Public Safety (SCDPS). The reimbursement is primarily for data processing, motor vehicle repairs and operating expenses in fiscal years 1994 and 1995. The two agencies entered into one repayment agreement on August 25, 1995 covering an unpaid balance of $8,839,817. That agreement provides for SCDPS to pay $100,000 per month beginning on January 1, 1996 and each month thereafter with the final payment due April 1, 2003. $1,300,000 was paid during the fiscal year ended June 30, 1998, leaving a balance due on this obligation of $5,565,463 as of year end. The repayment terms do not provide for interest. The Department entered into a second repayment agreement on July 18, 1996 for an unpaid balance of $897,867. This agreement provides for the SCDPS to pay $13,204 per month beginning in January, 1997 for 68 months. $171,651 was paid during the fiscal year ended June 30, 1998, leaving a balance due on this obligation of $660,196 as of year end. Due to the long-term nature of the two receivables, the $6,225,659 balance has been equally offset as a reservation of fund balance to reflect that this portion is not currently available.
NOTE 4. RECEIVABLES: (CONTINUED)

The $4,994,428 receivable amount in the Agency Fund is comprised of gasoline tax collected by the South Carolina Department of Revenue for the County Transportation Program Fund and not remitted to the Department by June 30, 1998.

County and Municipal Governments - The $2,918,489 receivable balance represents amounts due from various county and municipal governments as described below.

During the years 1968 through 1972, the County and the Department entered into a series of contracts for the implementation of the Columbia Area Thoroughfare Plan and the construction of certain capital improvements. These contracts provided for Richland County to reimburse the Department 25% of the right-of-way costs of certain highway improvements. The County's resultant share of costs totaled $1,697,810 which are being paid to the Department under a settlement agreement dated December 13, 1978. The terms of repayment provide for an annual payment of $50,000. The agreement provides that no interest or charges of any nature whatsoever shall accrue and that all payments made will be a reduction of the principal balance due. To date, $960,000 has been paid, leaving a balance due at June 30, 1998 of $737,810. Due to the long-term nature of this advance, it has been equally offset as a reservation of fund balance to reflect that this portion is not currently available.

The Department and the Town of St. Stephens entered into a participation agreement on December 16, 1994 for a construction project. The Town's share of the cost was $250,000 and is to be paid in annual installments of $20,833 each for twelve years following completion of the project without interest. The first installment was due March 10, 1997 with annual installments due each year thereafter. In fiscal year 1998, the Department received the first annual installment in September 1997 in addition to the regularly scheduled March, 1998 payment. Due to the long-term nature of the $208,333 receivable at June 30, 1998, it has been equally offset as a reservation of fund balance to reflect that this portion is not currently available.

The remaining amount of $1,972,346 is comprised of $1,883,595 from various county and municipal governments pursuant to participation agreements under which such governments participate in the cost of certain highway construction projects and $88,751 due from various county and municipal governments for sales of various supply items.

Accounts Receivable - The account receivable balance of $635,061 at June 30, 1998 represents amounts due from other entities including $196,250 due from Woodruff-Roebuck Water District (the District) as described below.

The Department advanced $785,000 in 1992 to the District for certain construction costs which are being reimbursed to the Department. The District is repaying $98,125 annually with no interest under an agreement dated May 26, 1992. Due to the long-term nature of the $196,250 receivable at June 30, 1998, it has been equally offset as a reservation of fund balance to reflect that this portion is not currently available.

NOTE 5. INVENTORIES:

Inventories as of June 30, 1998 consist of the following:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sign Shops</td>
<td>$5,839,346</td>
</tr>
<tr>
<td>Repair Shops</td>
<td>2,925,465</td>
</tr>
<tr>
<td>Supply Depot</td>
<td>1,629,778</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>241,328</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$10,635,917</strong></td>
</tr>
</tbody>
</table>
NOTE 6. **FIXED ASSETS:**

The following is a summary of changes in the General Fixed Assets Account Group during the fiscal year:

<table>
<thead>
<tr>
<th></th>
<th>Land and Improvements</th>
<th>Buildings and Improvements</th>
<th>Furniture, Vehicles and Equipment</th>
<th>Construction in Progress</th>
<th>Total General Fixed Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance, June 30, 1997</strong></td>
<td>$3,335,774</td>
<td>$61,850,514</td>
<td>$203,264,327</td>
<td>$8,187,706</td>
<td>$276,638,321</td>
</tr>
<tr>
<td><strong>Additions purchased</strong></td>
<td>521,664</td>
<td>13,607,548</td>
<td>2,251,237</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Donated assets</strong></td>
<td>2,958,515</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Transfers from Internal Service Fund</strong></td>
<td>2,297,910</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Retirements/disposals</strong></td>
<td>(24,103)</td>
<td>(12,222,879)</td>
<td>(12,246,982)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Transfers to Internal Service Fund</strong></td>
<td>(2,687,744)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Construction completed</strong></td>
<td>663,660</td>
<td></td>
<td>(663,660)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Balance, June 30, 1998</strong></td>
<td>$3,335,774</td>
<td>$63,011,735</td>
<td>$207,217,677</td>
<td>$9,775,283</td>
<td>$283,340,469</td>
</tr>
</tbody>
</table>

The following is a summary of proprietary fund-type fixed assets included in the Internal Service Fund at June 30, 1998:

- Vehicles and equipment $10,041,445
- Less: accumulated depreciation (5,833,338)
- Net fixed assets $4,208,107

NOTE 7. **GENERAL LONG-TERM DEBT:**

A summary of changes in general long-term debt for the year ended June 30, 1998 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Bonds Payable</th>
<th>Liability for Compensated Absences</th>
<th>Contribution Payable - State Agency</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balances, beginning of year</td>
<td>$92,770,000</td>
<td>$14,561,761</td>
<td>$</td>
<td>$107,331,761</td>
</tr>
<tr>
<td>Increases</td>
<td>47,500,000</td>
<td>1,043,748*</td>
<td>114,000,000</td>
<td>162,543,748</td>
</tr>
<tr>
<td>Decreases</td>
<td>(2,405,000)</td>
<td>(10,000,000)</td>
<td>(12,405,000)</td>
<td></td>
</tr>
<tr>
<td>Balances, end of year</td>
<td>$137,865,000</td>
<td>$15,605,609</td>
<td>$104,000,000</td>
<td>$257,470,609</td>
</tr>
</tbody>
</table>

* Change is shown at net since details to support the gross increases and decreases are not available.

**Bonds Payable**

Sections 57-11-210, *et seq.*, of the South Carolina Code (the "State Highway Bond Act"), as continued and amended by Section 11-27-30 thereof, authorized the issuance of general obligation State Highway Bonds for highway construction and related purposes backed by the full faith, credit, and taxing power of the State. State Highway Bonds are additionally secured by a pledge of so much of the revenues as may be made applicable by the General Assembly for highway purposes from any and all taxes or licenses imposed upon individuals or vehicles for the privilege of using the public highways of the State. Such taxes include the gasoline tax, the fuel oil tax, the road tax and the motor vehicle license tax described herein. So long as any State Highway Bonds are outstanding the amount of revenues made applicable thereto by the General Assembly may not be less than the amounts needed to fund the general operations budget of the Department and meet debt service requirements for annual principal and interest payments on such bonds. Section 57-11-240 provides that the debt limit for State Highway Bonds is the maximum annual debt service limitation which results from the application of the constitutional limitation imposed by said Paragraph 6(a) of Section 13 of the Article X of the South Carolina Constitution. From time to time, the State Budget and Control Board may authorize the issuance of various amounts of State Highway Bonds for specific types of projects or individual projects and may authorize the total to be issued in one or more series depending on the projections of the timing of project expenditures to be funded from the
proceeds.
NOTE 7.  GENERAL LONG-TERM DEBT: (CONTINUED)

On October 1, 1997, the Department issued $30,000,000 in bonds (Series 1997A). The net bond proceeds realized was $30,159,155 including an original issue premium of $159,155. This issue, along with the previous issues of $20,000,000 (Series 1995) and $30,000,000 (Series 1996A) make up the $80,000,000 of general obligation State Highway Bonds that were authorized to provide funds to pay the costs of replacing approximately 182 structurally deficient bridges in the State of South Carolina.

On April 1, 1998, the Department issued $17,500,000 in bonds (Series 1998A). The net proceeds realized was $17,412,500 after deducting a $87,500 original issue discount. The proceeds from these bonds will be used by the Department for the Greenville Southern Connector Project.

On July 1, 1996, $45,000,000 of Series B State Highway Bonds were issued at par. The proceeds from these bonds were used to pay a portion of the cost of the Hilton Head Island Cross-Island Parkway. The Department currently intends to impose tolls on the Parkway, to the extent permitted by law from time to time, in order to reimburse the State Highway Fund for the cost of debt service on the bonds.

A summary of the bonds payable as of June 30, 1998 is as follows:

<table>
<thead>
<tr>
<th>Original Issue Date</th>
<th>Series</th>
<th>Face Amount</th>
<th>Maturity Date</th>
<th>Interest Rate</th>
<th>Unpaid Principal Balance June 30, 1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>08/01/95 1995</td>
<td>$20,000,000</td>
<td>08/01/10</td>
<td>5.400%</td>
<td>$18,200,000</td>
<td></td>
</tr>
<tr>
<td>01/01/96 1996A</td>
<td>$30,000,000</td>
<td>02/01/11</td>
<td>6.100%</td>
<td>27,165,000</td>
<td></td>
</tr>
<tr>
<td>07/01/96 1996B</td>
<td>$45,000,000</td>
<td>07/01/21</td>
<td>5.025-5.650%</td>
<td>45,000,000</td>
<td></td>
</tr>
<tr>
<td>10/01/97 1997A</td>
<td>$30,000,000</td>
<td>10/01/11</td>
<td>4.500-5.000%</td>
<td>30,000,000</td>
<td></td>
</tr>
<tr>
<td>04/01/98 1998A</td>
<td>$17,500,000</td>
<td>04/01/23</td>
<td>4.500-6.500%</td>
<td>17,500,000</td>
<td></td>
</tr>
<tr>
<td>Total bonds payable</td>
<td></td>
<td></td>
<td></td>
<td>$137,865,000</td>
<td></td>
</tr>
</tbody>
</table>

Annual payments of principal and interest are due on the bonds and are being paid semiannually.

Details of annual debt service, including interest, for each year are as follows:

<table>
<thead>
<tr>
<th>Year Ending June 30,</th>
<th>Principal</th>
<th>Interest</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$4,320,000</td>
<td>$7,014,620</td>
<td>$11,334,620</td>
</tr>
<tr>
<td>2000</td>
<td>4,605,000</td>
<td>6,773,379</td>
<td>11,378,379</td>
</tr>
<tr>
<td>2001</td>
<td>4,805,000</td>
<td>6,529,008</td>
<td>11,334,008</td>
</tr>
<tr>
<td>2002</td>
<td>5,235,000</td>
<td>6,291,476</td>
<td>11,526,476</td>
</tr>
<tr>
<td>2003</td>
<td>5,765,000</td>
<td>6,029,637</td>
<td>11,794,637</td>
</tr>
<tr>
<td>Thereafter</td>
<td>113,135,000</td>
<td>49,937,787</td>
<td>163,072,787</td>
</tr>
<tr>
<td>Total debt service</td>
<td>$137,865,000</td>
<td>$82,575,907</td>
<td>$220,440,907</td>
</tr>
</tbody>
</table>

Interest expenditures for the fiscal year ended June 30, 1997 were $5,451,120. $35,327 of accrued interest received at the time of sale of the 1998A bonds was deducted from the interest payments made during the fiscal year ended June 30, 1998.

The Series 1995 State Highway Bonds maturing on or after August 1, 2006, are subject to redemption, at the option of the State, in whole or in part at any time in any order of maturity to be determined by the State, on and after August 1, 2005, at the Redemption Prices expressed as a percentage of the principal amount of each Series 1995 State Highway Bond, or portion thereof, to be redeemed, as set forth below, plus accrued interest to the date for redemption:

<table>
<thead>
<tr>
<th>Redemption Dates</th>
<th>Redemption Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 1, 2005 through July 31, 2005</td>
<td>102%</td>
</tr>
<tr>
<td>August 1, 2006 through July 31, 2006</td>
<td>101%</td>
</tr>
<tr>
<td>August 1, 2007 and thereafter</td>
<td>100%</td>
</tr>
</tbody>
</table>
NOTE 7. GENERAL LONG-TERM DEBT: (CONTINUED)

The Series 1996A General Obligation State Highway Bonds maturing on and after February 1, 2007, shall be subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on and after February 1, 2006, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed as set forth below, plus accrued interest to the date fixed for redemption:

<table>
<thead>
<tr>
<th>Redemption Dates</th>
<th>Redemption Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 1, 2006 through January 31, 2007</td>
<td>102%</td>
</tr>
<tr>
<td>February 1, 2007 through January 31, 2008</td>
<td>101%</td>
</tr>
<tr>
<td>February 1, 2008 and thereafter</td>
<td>100%</td>
</tr>
</tbody>
</table>

The Series 1996B State Highway Bonds maturing on and after July 1, 2007, shall be subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on or after July 2006, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

<table>
<thead>
<tr>
<th>Redemption Dates</th>
<th>Redemption Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1, 2006 through June 30, 2007</td>
<td>102%</td>
</tr>
<tr>
<td>July 1, 2007 through June 30, 2008</td>
<td>101%</td>
</tr>
<tr>
<td>July 1, 2008 and thereafter</td>
<td>100%</td>
</tr>
</tbody>
</table>

The Series 1997A State Highway Bonds maturing on and after October 1, 2008, shall be subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on or after October 1, 2007, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

<table>
<thead>
<tr>
<th>Redemption Dates</th>
<th>Redemption Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>October 1, 2007 through September 30, 2008</td>
<td>102%</td>
</tr>
<tr>
<td>October 1, 2008 through September 30, 2009</td>
<td>101%</td>
</tr>
<tr>
<td>October 1, 2009 and thereafter</td>
<td>100%</td>
</tr>
</tbody>
</table>

The Series 1998A State Highway Bonds maturing on and after April 1, 2009, shall be subject to redemption, in whole or in part, at any time in any order of maturity to be determined by the State, on or after April 1, 2008, at the Redemption Prices expressed as a percentage of the principal amount to be redeemed set forth below, plus accrued interest to the date fixed for redemption:

<table>
<thead>
<tr>
<th>Redemption Dates</th>
<th>Redemption Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1, 2008 through March 31, 2009</td>
<td>102%</td>
</tr>
<tr>
<td>April 1, 2009 through March 31, 2010</td>
<td>101%</td>
</tr>
<tr>
<td>April 1, 2010 and thereafter</td>
<td>100%</td>
</tr>
</tbody>
</table>
NOTE 7. GENERAL LONG-TERM DEBT: (CONTINUED)

Contribution Payable – State Agency

The Department entered into an intergovernmental agreement on March 10, 1998 with Horry County and the South Carolina Transportation Infrastructure Bank (the Bank) to fund $545,000,000 in project costs for certain highway and road permanent improvement needs of Horry County.

The agreement provides that the Department will fund $114,000,000 of the project costs. The Department's commitment includes contributing to the Bank $10,000,000 a year for eleven years and $4,000,000 in the twelfth year. $10,000,000 was paid by the Department in the year ended June 30, 1998.

The remaining balance of $104,000,000 is included in the Department's combined balance sheet in the general long-term debt group account as a contribution payable – State agency and the $10,000,000 expenditure made during the current fiscal year is included in the statement of revenues, expenditures and changes in fund balances as allocations to other entity – State agency.

NOTE 8. INTERFUND RECEIVABLES/PAYABLES:

The $9,277,207 due to the Special Revenue Fund from the Agency Fund represents June, 1998 billings for work performed for the County Transportation Program. The $67,156 due to the Agency Fund from the Special Revenue Fund represents an excess billing by the Special Revenue Fund at June 30, 1998.

NOTE 9. RETIREMENT PLANS:

The majority of employees of the Department are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally all State employees are required to participate in and contribute to the SCRS as a condition of employment unless exempted by law as provided in section 9-1-480 of the South Carolina Code of Laws. This plan provides retirement annuity benefits as well as disability, cost of living adjustment, death, and group-life insurance benefits to eligible employees and retirees.

The Retirement Division maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (CAFR) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the Retirement Division, 202 Arbor Lake Drive, Columbia, South Carolina 29223. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

Under the SCRS, employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 30 years credited service regardless of age. The benefit formula for full benefits effective since July 1, 1989, for the SCRS is 1.82 percent of an employee’s average final compensation multiplied by the number of years of credited service. Early retirement options with reduced benefits are available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon completion of 15 years credited service. Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of five years credited service. A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.
NOTE 9.  RETIREMENT PLANS: (CONTINUED)

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. Effective July 1, 1997, the employer contribution rate became 9.466 percent which included a 1.916 percent surcharge to fund retiree health and dental insurance coverage. The Department's actual contributions to the SCRS for the years ended June 30, 1998, 1997 and 1996 were approximately $8,809,000, $8,691,000 and $8,547,000, respectively, and equaled the required contributions of 7.55 percent (excluding the surcharge) for each year. Also, the Department paid employer group-life insurance contributions of approximately $175,000 in the current fiscal year at the rate of .15 percent of compensation.

The South Carolina Police Officers Retirement System (PORS) is a cost-sharing multiple employer defined benefit public employee retirement system. Generally, all full-time employees whose principal duties are the preservation of public order or the protection or prevention and control of property destruction by fire are required to participate in and contribute to the System as a condition of employment. This plan provides annuity benefits as well as disability and group-life insurance benefits to eligible employees and retirees. In addition, participating employers in the PORS contribute to the accidental death fund which provides annuity benefits to beneficiaries of police officers and firemen killed in the actual performance of their duties. These benefits are independent of any other retirement benefits available to the beneficiary.

Employees covered under PORS are eligible for a monthly pension payable at age 55 with a minimum of five years service or 25 years credited service regardless of age. In addition, employees who have five years of credited service prior to age 55, can retire yet defer receipt of benefits until they reach age 55. A member is vested for a deferred annuity with five years service. The benefit formula for full benefits effective since July 1, 1989, for the PORS is 2.14 percent of the employee's average final salary multiplied by the number of years of credited service. Disability annuity benefits and the group-life insurance benefits for PORS members are similar to those for SCRS participants. Accidental death benefits provide a monthly pension of 50 percent of the member's budgeted compensation at the time of death.

Since July 1, 1988, employees participating in the PORS have been required to contribute 6.5 percent of all compensation. Effective July 1, 1997, the employer contribution rate became 12.216 percent which, as for the SCRS, included the 1.916 percent surcharge. The Department's actual contributions to the PORS for the years ended June 30, 1998, 1997, and 1996 were approximately $4,700, $4,600 and $4,800, respectively, and equaled the required contributions of 10.3 percent (excluding the surcharge) for each year. Also, the Department paid employer group-life insurance contributions of approximately $100 and accidental death insurance contributions of approximately $100 in the current fiscal year for PORS participants. The rate for each of these insurance benefits is .20% of compensation.

The amounts paid by the Department for pension, group-life benefits and accidental death benefits are reported as employer contribution expenditures within the applicable functional expenditure categories to which the related salaries are charged.

Article X, Section 16 of the South Carolina Constitution requires that all State-operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS (and PORS) are actuarially determined. The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest 12 consecutive quarters of
compensation).
NOTE 9. RETIREMENT PLANS: (CONTINUED)

The Systems do not make separate measurements of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Department's liability under the plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Department's liability under the pension plans is limited to the amounts appropriated therefor in the South Carolina Appropriation Act and amounts from other applicable revenue sources. Accordingly, the Department recognizes no contingent liability for unfunded costs associated with participation in the plans.

At retirement, employees participating in the SCRS or PORS may receive additional service credit for up to 90 days for accumulated unused sick leave.

NOTE 10. POSTEMPLOYMENT AND OTHER EMPLOYEE BENEFITS:

In accordance with the South Carolina Code of Laws and the annual Appropriation Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time and certain permanent part-time employees of the Department are eligible to receive these benefits. The State provides postemployment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirements, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State-funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits.

These benefits are provided through annual appropriations by the General Assembly to the Department for its active employees and to the State Budget and Control Board for all participating State retirees except the portion funded through the pension surcharge and provided from other applicable sources of the Department for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. The number of State retirees that meet these eligibility requirements is not available.

The Department recorded employer contributions expenditures within the applicable functional expenditure categories for these insurance benefits for active employees of approximately $11,721,000 for the year ended June 30, 1998. As discussed in Note 9, the Department paid approximately $2,235,000 applicable to the 1.916% surcharge included with the employer contributions for retirement benefits. These amounts were remitted to the South Carolina Retirement Systems for distribution to the Office of Insurance Services for retiree health and dental insurance benefits.

Information regarding the cost of insurance benefits applicable to Department retirees is not available. By State law, the Department has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements.

In addition, the State General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from Systems’ earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS and PORS benefits.
NOTE 11. DEFERRED COMPENSATION PLANS:

Several optional deferred compensation plans are available to State employees and employers of its political subdivisions. Certain employees of the Department have elected to participate. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401(k) and 403(b), are accounted for as agency funds of the State and included in the Comprehensive Annual Financial Report of the State of South Carolina. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

Compensation deferred under the Section 401(k) and 403(b) plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Under the Section 457 plan, all deferred compensation plan amounts and earnings remain assets of the employer (the State) subject to the claims of the employer's general creditors, one of whom is the employee participant. It is unlikely, however, that the State would ever use plan assets to satisfy claims of the State's general creditors. The portion of assets of the Section 457 plan to which the State has access is disclosed in its annual financial report.

On August 20, 1996, the provisions of Internal Revenue Code Section 457 were amended by adding subsection (g). That subsection provides that new plans will not be considered eligible plans unless all assets and income of the plans are held in trust for the exclusive benefit of the participants and their beneficiaries. Existing plans also must comply with this requirement by January 1, 1999. South Carolina's plan adopted this change effective July 24, 1998.

NOTE 12. RELATED PARTY TRANSACTIONS:

The Department has significant transactions with the State of South Carolina and various State agencies.

The Department sells supply items, gasoline and oil to and makes vehicle and equipment repairs for various State agencies. Total sales to state agencies were approximately $4,567,000 for the year ended June 30, 1998.

The gasoline tax is collected by the South Carolina Department of Revenue (DOR) and remitted to the Department on a monthly basis. Taxes collected by DOR and remitted to the special revenue fund amounted to approximately $339,000,000 for the year ended June 30, 1998. Gasoline tax revenues amounted to approximately $56,600,000 for the County Transportation Program Agency Fund for the year ended June 30, 1998.

The Special Revenue Fund infrastructure expenditures and revenues include approximately $45,000,000 for County Transportation Program projects administered by the Department.

Services received at no cost from State agencies include legal services from the Attorney General, grants services from the Governor's Office and bond trustee services from the State Treasurer's Office.

Services received at no cost from the various divisions of the State Budget and Control Board include insurance plan administration, procurement services, retirement plan administration, audit services, personnel management, assistance in the preparation of the State Budget, review and approval of certain budget amendments and other centralized functions.

The Department had financial transactions with various State agencies during the fiscal year. Significant payments were made to divisions of the State Budget and Control Board for retirement plan contributions and health insurance premiums, insurance coverage, office supplies, printing, telephone, and interagency mail. Payments were also made to other agencies for unemployment insurance and workers' compensation coverage. The amounts of expenditures applicable to related party transactions are not readily available.
NOTE 12. RELATED PARTY TRANSACTIONS: (CONTINUED)

In addition, the Department transferred the following amounts to the General Fund of the State of South Carolina for its proportionate share of the cost of administration of central state services and other specified support pursuant to Provisos 69.4 and 69.11 of the 1997-98 Appropriations Act:

<table>
<thead>
<tr>
<th>Statewide Cost Allocation Plan:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Collection of highway revenues</td>
<td>$3,069,811</td>
</tr>
<tr>
<td>Central Service Agency recoveries</td>
<td>1,103,894</td>
</tr>
<tr>
<td>Other indirect cost recoveries</td>
<td>705,518</td>
</tr>
<tr>
<td>Payments for Servicing Functions:</td>
<td></td>
</tr>
<tr>
<td>Comptroller General's Office</td>
<td>471,500</td>
</tr>
<tr>
<td>State Treasurer's Office</td>
<td>123,546</td>
</tr>
<tr>
<td>Total</td>
<td>$5,474,269</td>
</tr>
</tbody>
</table>

The $5,474,269 was paid to the State during the year and there was no related payable at year-end.

The Department provided no material services free of charge to other State agencies during the fiscal year. The Department participates in the statewide dual employment program.

The Department was obligated to the State Accident Fund for $1,092,278 which includes $334,365 for unpaid accident claims at June 30, 1998 (also see Note 16) and $757,913 for fiscal year 1998 workers' compensation insurance premiums. This amount is included in intergovernmental payables on the balance sheet of the Special Revenue Fund. Expenditures for fiscal year 1998 of $2,396,801 are included in the general expenditure category of the Special Revenue Fund.

The Department had transactions with the South Carolina Transportation Infrastructure Bank ("the Bank") which was created June 26, 1997 by Act Number A-418 of the Code of Laws of South Carolina. The Bank's purpose is to assist governmental units and private entities in constructing and improving highway and transportation facilities by providing loans and other financial assistance. The Chairman of the Department's Commission is an ex-officio member of the Bank's governing Board of Directors. The Department entered into an intergovernmental agreement with the Bank and Horry County to provide funds and services in connection with the construction of the Conway By-pass. In addition to the $10,000,000 payment to the Bank referred to in Note 7, the Department paid the Bank $15,750,000 during fiscal year 1998 which represented the three percent of funds appropriated under Section 11-43-160 of the Code of Laws of South Carolina to the Department from State highway taxes and fees for the construction and maintenance of highways from State highway taxes and fees. The $25,750,000 is included in the statement of revenues, expenditures and change in fund balance as allocations to other entity – State agency. The intergovernmental agreement also provides that the Department shall be paid a fee of $3,000,000 for construction management services. The fee is payable in thirty-six (36) equal monthly installments commencing with the execution of the loan agreement with Horry County and the Bank. At June 30, 1998, the Department recorded a receivable from the Bank for $250,000. The $250,000 is included in intergovernmental receivables from State agencies at June 30, 1998 and other revenues for the year ended June 30, 1998.

During the fiscal year ended June 30, 1998, the Department purchased from and sold to the following state agencies certain right-of-way lands:

- South Carolina Office of Adjutant General – Received consideration of $5,400
- South Carolina Employment Security Commission – Paid consideration of $240,000
- South Carolina Department of Mental Health – Paid consideration of $1,600
NOTE 13. MAJOR CONTRACTUAL OBLIGATIONS:

The estimated costs of projects in progress to construct, acquire and maintain various capital facilities and infrastructure at June 30, 1998 amounted to approximately $3,714,000,000; the estimated costs to complete these projects amounted to approximately $706,000,000; and, the outstanding contractual obligations attributable to these projects amounted to approximately $277,000,000. The estimated time frame for completion of these projects is several years.

The costs of projects in progress and future projects will be funded from state taxes and fees, federal grants, County Transportation Fund reimbursements and bond proceeds.

NOTE 14. CONTRIBUTED CAPITAL:

The following is a summary of the changes in contributed capital in the Internal Service Fund during the fiscal year:

- Contributed capital, beginning of year $3,888,589
- Vehicles and equipment transferred from the General Fixed Assets Account Group ($2,687,744 net of prior accumulated depreciation of $477,965) 2,209,779
- Vehicles and equipment transferred to the General Fixed Assets Account Group ($2,297,910 net of accumulated depreciation of $1,697,571) (600,339)
- Current fiscal year reduction for depreciation on contributed assets (1,289,922)
- Contributed capital, end of year $4,208,107

NOTE 15. FEDERAL GRANTS AND REIMBURSABLE CONTRACTS:

The Department has grants and reimbursable contracts with the Federal government for the funding of specific costs related to the various programs described in each grant or contract. These funds are subject to audit and/or adjustment by the various funding sources.

Management feels that adjustments, if any, will not have a material adverse effect on the financial position of the Department. Furthermore, there is no evidence to indicate that a liability should be recorded at June 30, 1998.
NOTE 16. RISK MANAGEMENT:

The Department is exposed to various risks of loss and maintains State or commercial insurance coverage for each of those risks. Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks except for a provision for $950,000 for possible claims that may be payable by the Department on two tort cases in excess of insurance coverage. There were no significant reductions in insurance coverage in the prior year. Settled claims have not exceeded this coverage in the prior two years. The liability for $950,000 is included in other liabilities and the expenditure is included in the general expenditure category in the Special Revenue Fund. The Department pays insurance premiums to certain other State agencies and commercial insurers to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits except for deductibles.

Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of State employees for unemployment compensation benefits (Employment Security Commission);
2. Claims of covered employees for workers’ compensation benefits for job-related illnesses or injuries (State Accident Fund);
3. Claims of covered public employees for health and dental insurance benefits (Office of Insurance Services); and

Employees elect health coverage through either a health maintenance organization or through the State's self-insured plan. All of the other coverages listed above are through the applicable State self-insured plan except dependent and optional life premiums are remitted to commercial carriers.

The Department and other entities pay premiums to the State's Insurance Reserve Fund (IRF) which issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to the following assets, activities, and/or events:

1. Theft of, damage to, or destruction of assets;
2. Real property and contents;
3. Motor vehicles;
4. Data processing equipment;
5. Business interruptions;
6. Torts; and,
7. Medical malpractice claims against covered employees.

The IRF is a self-insurer and purchases reinsurance to obtain certain services and specialized coverage and to limit losses in the areas of certain property and equipment and auto liability. Reinsurance permits partial recovery of losses from reinsurers, but the IRF remains primarily liable. The ISF’s rates are determined actuarially.

State agencies and other entities are the primary participants in the State's Health and Disability Insurance Fund and ISF.

The Department obtains coverage up to $50,000 through a commercial insurer for employee fidelity bond insurance for its Director for losses arising from theft or misappropriation. Employee fidelity bond coverage is not maintained on the Department's other employees. The Department self-insures itself for any losses because it feels the likelihood of losses are remote.
NOTE 16. RISK MANAGEMENT: (CONTINUED)

The Department has not transferred the portion of the risk of loss related to insurance policy deductibles and limits for capital assets and fidelity coverages to a State or commercial insurer. The Department has not reported an estimated claims loss expenditure, and the related liability at June 30, 1998, based on the requirements of GASB Statement No. 10 and No. 30 which state that a liability for claims must be reported only if information prior to issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred on or before June 30, 1998 and the amount of the loss is reasonably estimable. Liabilities include an amount for incurred but not reported (IBNR) losses when it is probable a claim will be asserted. Claims liabilities when recorded are based on estimates of the ultimate cost of settling known but not paid claims and IBNR claims at June 30 using past experience adjusted for factors that would modify past experience.

In management's opinion, claims losses in excess of insurance coverage, except as mentioned above for certain tort claims, are unlikely and, if incurred, would be insignificant to the Department's financial position. Furthermore, there is no evidence of asset impairment or other information to indicate that a loss expenditure and liability should be recorded; and, therefore, no loss accrual has been recorded.

The Department has recorded insurance premium expenditures in the current expenditures and capital outlay expenditure categories.

Prior to January 1, 1994, the Department was self-insured for its workers compensation insurance. The Department reimburses the State Accident Fund for claims paid which were incurred prior to January 1, 1994. The Fund acts as a claims servicer for those claims. All risks of loss are retained by the Department which reimburses the Fund for the full amounts of claims paid plus an amount for administrative costs. These reimbursements include claims for employees that were transferred to other State agencies from the Department of Highways and Public Transportation pursuant to reorganization as of July 1, 1993.

A summary of changes in the self-insured workers compensation claims for the past three years is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Beginning Liability</th>
<th>Changes in Estimates</th>
<th>Claims Payments</th>
<th>Ending Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>$1,463,550</td>
<td>$ (353,635)</td>
<td>$ 775,550</td>
<td>$ 334,365</td>
</tr>
<tr>
<td>1997</td>
<td>$ 0</td>
<td>$1,464,512</td>
<td>$ 962</td>
<td>$1,463,550</td>
</tr>
<tr>
<td>1996</td>
<td>$2,711,620</td>
<td>$ 768,740</td>
<td>$3,480,360</td>
<td>$ 0</td>
</tr>
</tbody>
</table>

At June 30, 1997, the Department recorded an estimated claims liability of $688,000 for the expected remaining old claims outstanding. That estimate was provided by the State Accident Fund. An estimate of the old claims was not available prior to that time. The actual amount due on reported claims at June 30, 1998 is $334,365 resulting in a claims expenditure adjustment decrease of $353,635 during the current year. The State Accident Fund has accepted the liability for any additional claims allowed after June 30, 1998.
NOTE 17. CONTINGENCIES AND SUBSEQUENT EVENTS:

The Department is a defendant in various lawsuits arising from the conduct of its normal business. Although any litigation has an element of uncertainty, it is management’s and legal counsel’s opinions that the outcome of any litigation pending or threatened, or the combination thereof, will not have a materially adverse effect on the financial position of the Department. The risk of material loss in excess of insurance coverage is unlikely except for $950,000 discussed in Note 16.

On July 1, 1998, the Department’s Commission approved a resolution to request the State Budget and Control Board to authorize the issuance of the following State Highway Bonds:

- Up to $130,000,000 to fund the Interstate Upgrade Acceleration Program
- Up to $295,000,000 to fund the Metropolitan Planning Organization Project Acceleration Program; and,
- Up to $226,000,000 to fund the Council of Governments (COG) Project Acceleration Program

The Commission authorized the timing and amounts of the various bond issues to be determined by the Department's staff.

In May, 1997, the State Budget and Control Board authorized the Department to transfer an island consisting of approximately 8,000 acres to the South Carolina Department of Natural Resources (DNR), another State agency. This land was acquired as part of infrastructure costs which are not capitalized. The acreage is being banked to provide an offset for environmentally sensitive lands that will be required for future highway projects. As of June 30, 1998, an agreement to transfer the land to DNR had not been executed.

The Connection 2000 Association, Inc. (the Association) issued bonds totaling $200,177,680 on February 1, 1998 to be used for the construction of the Southern Connector in Greenville County, South Carolina. The bonds consist of $21,400,000 in current interest bonds with a final maturity of January 1, 2023 with an average yield of 5.57%; $44,800,000 in current interest bonds with a final maturity of January 1, 2038 with an average yield of 5.625%; $87,385,622 in senior capital appreciation bonds with interest rates of 5.3% to 5.85% maturing January 1, 2008 – January 1, 2038; and, $46,592,058 in subordinate capital appreciation bonds with interest rates of 6.15% to 6.30% maturing January 1, 2008 – January 1, 2038. According to the official offering statement, these bonds are special, limited obligations of the Association, payable solely from the tolls to be paid by the users of the Southern Connector remaining after the payment of operating expenses. The bonds do not constitute an indebtedness of the State of South Carolina or the Department according to an affirmative ruling by the South Carolina Supreme Court.

NOTE 18. ACCOUNTING CHANGES:

Effective July 1, 1997, the Department adopted Governmental Accounting Standards Board (GASB) Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. This Statement requires that most investments of governmental entities be stated at fair value rather than at cost. For internal investment pools, this Statement requires that the equity position of each fund that sponsors the pool to be reported as assets in those funds. The Department has restated its beginning fund balances as of July 1, 1997 for changes resulting from adoption of Statement No. 31, which are disclosed in the following schedule:

<table>
<thead>
<tr>
<th>Fund Balances – June 30, 1997</th>
<th>As Previously Reported</th>
<th>Restatement Adjustment</th>
<th>As Restated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special Revenue Fund</td>
<td>$136,842,672</td>
<td>$ 568,327</td>
<td>$137,410,999</td>
</tr>
</tbody>
</table>
NOTE 18.  ACCOUNTING CHANGES: (CONTINUED)

As a result of this accounting change, interest/investment income reported includes interest, realized gains (losses) and unrealized gains (losses). If the adoption of Statement 31 were retroactive to June 30, 1996, the interest/investment income for the Special Revenue Fund would have increased $1,777,683 for the year ended June 30, 1997.

For the County Transportation Program Fund, which is a part of the Agency Funds, the cash and cash equivalents balance and the related liability for funds held for counties balance were each increased $570,507 as of June 30, 1997 to reflect the change resulting from the adoption of Statement No. 31.

In prior years, the Department reported the $9,500,000 transfer to the County Transportation Program fund which is a part of the Agency Fund as an operating transfer instead of an expenditure. The $9,500,000 should have been reported as an expenditure to be in accordance with generally accepted accounting principles.
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SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 1998

<table>
<thead>
<tr>
<th>Federal Grantor/Program Title</th>
<th>Federal CFDA Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>U.S. Department of Transportation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Programs:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Highway Planning and Construction (Federal-Aid Highway Program)</td>
<td>20.205</td>
<td>$238,840,683</td>
</tr>
<tr>
<td>Federal Transit Technical Studies Grant (Metropolitan Planning, Section 8)</td>
<td>20.505</td>
<td>269,113</td>
</tr>
<tr>
<td>Public Transportation for Non-Urbanized Areas (Non-Urbanized Formula Grants, Section 18)</td>
<td>20.509</td>
<td>3,376,729</td>
</tr>
<tr>
<td>Capital Assistance Program for Elderly Persons and Persons with Disabilities (Elderly and Disabled, Section 16)</td>
<td>20.513</td>
<td>1,252,442</td>
</tr>
<tr>
<td><strong>TOTAL U.S. DEPARTMENT OF TRANSPORTATION</strong></td>
<td></td>
<td>243,738,981</td>
</tr>
<tr>
<td><strong>Appalachian Regional Commission</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Programs:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appalachian Development Highway System (Appalachian Corridors)</td>
<td>23.003</td>
<td>18,014</td>
</tr>
<tr>
<td><strong>TOTAL APPALACHIAN REGIONAL COMMISSION</strong></td>
<td></td>
<td>18,014</td>
</tr>
<tr>
<td><strong>TOTAL FEDERAL ASSISTANCE</strong></td>
<td></td>
<td>$243,756,981</td>
</tr>
</tbody>
</table>

**NOTE:** The Department used the accrual basis method of accounting in preparing the above Schedule. This is the same basis of accounting used by the Department in the preparation of its annual financial statements which are audited.
REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

Mr. Thomas L. Wagner, Jr., CPA,
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the financial statements of the South Carolina Department of Transportation (the Department) as of and for the year ended June 30, 1998, and have issued our report thereon dated October 19, 1998. We conducted our audit 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.

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 instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department'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 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 the Department's ability to record, process, summarize and report financial data consistent with the assertion of management in the financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs.

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 the reportable conditions described on the accompanying schedule of findings and questioned costs are material weaknesses. We also noted other matters involving the internal control over financial reporting which we have reported to management of the Department in a separate letter dated October 19, 1998.
This report is intended for the information of the Board of Commissioners, management and federal awarding agencies. This restriction is not intended to limit the distribution of this report which, upon acceptance by the State Auditor's Office, is a matter of public record.

Columbia, South Carolina
October 19, 1998
Mr. Thomas L. Wagner, Jr., CPA,
State Auditor
State of South Carolina
Columbia, South Carolina

Compliance

We have audited the compliance of the South Carolina Department of Transportation (the Department) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 1998. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 1998.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be 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 noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.
This report is intended for the information of the Board of Commissioners, management and federal awarding agencies. This restriction is not intended to limit the distribution of this report which, upon acceptance by the State Auditor's Office, is a matter of public record.

Columbia, South Carolina
October 19, 1998
SUMMARY OF AUDITOR'S RESULTS

1. An unqualified opinion dated October 19, 1998 on the financial statements of the Department for the year ended June 30, 1998 was issued.

2. Reportable conditions that were determined to be material weaknesses were noted as described below.

3. No instances of noncompliance that were material to the financial statements were noted.

4. An unqualified opinion on compliance for major programs dated October 19, 1998 was issued.

5. There are no findings required to be reported under Section .510(a) of OMB Circular A-133.

6. The major programs of the Department are Highway Planning and Construction (CFDA #20.205) and Public Transportation for Non-Urbanized Areas (CFDA #20.509).

7. The dollar threshold used to distinguish between Type A and Type B programs was $3,000,000.

8. The Department was not determined to be a low-risk auditee.

FINDINGS RELATED TO THE FINANCIAL STATEMENTS

The following reportable conditions are material weaknesses, are related to the Department's financial statements and are required to be reported in accordance with generally accepted government auditing standards.

BOOKS OF ACCOUNT NOT MAINTAINED IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR GOVERNMENTAL ENTITIES

As noted in prior management letters issued to the Department and its predecessor, the Department does not maintain its books of account in accordance with generally accepted accounting principles (GAAP) for governmental entities. Several practices as noted below require a substantial amount of additional work and procedures to be performed at year end to ensure that the financial statements are in accordance with GAAP.

- The Department's financial statements consist of two governmental funds, a proprietary fund, fiduciary funds, and two account groups. In addition, one of the governmental funds (the special revenue fund) and the agency fund consist of a number of individual funds. The Department's general ledger is not set up to adequately account for the Department's activity in each correct fund.

- The Department's general ledger contains accounts for recording estimated revenues and expenditures known as budgetary accounts. These accounts should be self-balancing; however, the entries to these accounts resulted in these budgetary accounts being out of balance. The Department made numerous entries directly to its fund balance account during the year. Generally, no entries should be made to fund balance during the year.

- The Department's general ledger is not maintained by type of expenditure to allow the accumulation of information necessary to present a budget versus actual statement. Expenditures in the general ledger are recorded by function instead of personnel costs, employer contributions, supplies, etc.

A similar finding was included in the prior management letters.
BOOKS OF ACCOUNT NOT MAINTAINED IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR GOVERNMENTAL ENTITIES (CONTINUED)

We recommend that the Department consider the following:

- Set up the necessary funds within its general ledger to properly account for its activity in accordance with GAAP.
- Each fund should be self-balancing.
- Adopt a policy to properly classify expenditures as highway maintenance or construction.
- Review the manner in which all transactions are posted to its general ledger to ensure that all transactions are properly posted in accordance with GAAP.
- Post expenditures in a manner which would allow the preparation of a budget versus actual statement.

ACCOUNTS RECEIVABLE NOT RECORDED ON MODIFIED ACCRUAL BASIS

The Department's accounts receivable include balances from numerous sources, including other state agencies. The Department records revenues relating to these receivables on the accrual basis of accounting instead of the modified accrual basis of accounting required by GAAP for governmental funds. Revenues and the related receivables should only be recorded if they are collected soon enough after each year end to finance current expenditures.

This finding was included in the prior management letters.

We recommend that all accounts receivable be recorded on the modified accrual basis as required for governmental funds.

YEAR END JOURNAL ENTRIES NOT POSTED BY DEPARTMENT

Some of the adjusting journal entries prepared by the audit firm as of the prior year end were not posted by the Department. This causes the beginning fund balances per the Department's general ledger accounts not to agree with the Department's audited financial statements. Additional time is required to adjust the beginning fund balances to agree to the prior year's audited financial statements.

This finding was included in the prior management letters.

We recommend that the Department review, and upon approval, post all auditor prepared adjusting journal entries.

IMPROVEMENT NEEDED OVER ACCOUNTING FOR PARTICIPATION AGREEMENTS

Improvements are needed in the accounting for participation agreements. A review of Report #CA-213, "Status of Outstanding Participation Agreements", and the related client prepared schedule disclosed the following deficiencies:

1. The prepared schedule included some incorrect amounts.
2. Our testing of the various contracts disclosed they were not being handled on a consistent basis and one file was not located.
3. The schedule did not reflect those contracts closed out during the fiscal year. Our review of the contract files reflected several agreements that had been completed and should have been closed out.
4. The prepared schedule did not include the gross allotment (budget) amount which was necessary to determine the participating entity's share of the project; and, it did not include total project expenditures to date. This resulted in extra work being required to obtain those amounts so the accounts receivable amount and deferred revenue amount could be computed as of year end.
5. We noted several contracts for which expenditures were made and recorded prior to the budget amounts being entered into the project records. Also, we noted an instance for which budget amounts were incorrectly entered in the project records.
IMPROVEMENT NEEDED OVER ACCOUNTING FOR PARTICIPATION AGREEMENTS (CONTINUED)

6. The Department’s accounting staff does not maintain any type subsidiary records for amounts due from the various participating entities.
7. The Department’s general ledger and subsidiary ledgers do not include amounts due on long-term accounts receivable from two participating entities.
8. Two participation agreements that appeared on the report did not reflect payments received.

Weaknesses similar to findings 1 through 7 were included in the prior year’s management letter.

We recommend that the Department accounting staff set up detail and control records so that an accurate accounting can be made of participating contracts. A schedule should be prepared as of each month end that is mathematically correct; properly reflects all contract data; excludes all completed and closed contracts; properly reflects all amounts due and/or deferred; and agrees with the related general ledger accounts.

PROPRIETARY FUND FIXED ASSETS ACQUISITIONS AND DISPOSALS NOT RECORDED CORRECTLY

The Department recorded all fixed assets acquisitions and disposals for proprietary fund (internal service fund) assets in the general fixed asset account group. All acquisitions are purchased utilizing special revenue funds and then recorded as a transfer from the general fixed asset account group to the internal service fund. All disposals are recorded as fixed assets transferred from the internal service fund to the general fixed asset account group and then recorded as a retirement or disposal. Because of this method of handling fixed asset transactions, the internal service fund rates do not reflect full costs for fixed assets, such as gains and losses on disposals and, therefore, the reported results of Internal Service Fund operations are misstated. Furthermore, the Special Revenue Fund bears the additional costs of losses on disposals for Internal Service Fund assets. The result is costs are not properly allocated to the benefiting fund. The Department has apparently been handling these transactions in this manner because of limitations in its general ledger system.

This finding was included in the prior management letters.

We recommend that any acquisitions that are to be initially utilized by the internal service fund be recorded as a purchase by that fund. All disposals should be recorded in the internal service fund and not transferred to the general fixed asset account group unless the asset will continue to be utilized by the Department.

STATUS OF ALLOTMENT REPORTS INACCURATE

Our review of the status of allotment reports disclosed that the reports were not accurate. This report was used to determine the outstanding commitments and estimated costs to complete various projects. We noted several instances of the expenditures being greater than the allotment for various areas. This continues to occur because the budgets (allotments) do not include purchase order obligations from the prior year and the allotments are therefore understated.

This finding was also included in the prior management letters.

We recommend that the allotments include all expected expenditures in each fiscal year.
OVER-ALLOCATION OF FRINGE BENEFITS

The Department over-allocated fringe benefits related to payroll to the various functional expenditure accounts by approximately $5,700,000 during the current fiscal year. An adjusting entry was made to credit the over-allocation to the functional expenditure accounts. The over-allocation was caused by incorrect projection of the costs for the year.

We recommend that the Department review its projected costs more carefully in determining the allocation ratios for each fiscal year.

FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS

There were no findings and questioned costs for federal awards that are required to be reported under Section .510(a) of OMB Circular A-133.
INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL

Mr. Thomas L. Wagner, Jr., CPA,
State Auditor
State of South Carolina
Columbia, South Carolina

In planning and performing our audit of the financial statements of the South Carolina Department of Transportation (the Department) for the year ended June 30, 1998, we considered its internal control 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. However, we noted a matter as detailed on the following page involving the internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable 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 errors or irregularities in amounts that would be material 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 internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. We believe the condition noted is a material weakness.

We also noted one other matter involving internal control and its operation as detailed on the following page.

This report is intended for the information of the Board of Commissioners and management. This restriction is not intended to limit the distribution of this report which, upon acceptance by the State Auditor's Office, is a matter of public record.

Columbia, South Carolina
October 19, 1998
MANAGEMENT LETTER COMMENTS

MATERIAL REPORTABLE WEAKNESS

FAILURE TO TIMELY PAY INVOICES

Our tests of expenditures disclosed that four out of 25 invoices tested were not paid within 30 working days as required by State law.

We recommend that invoices be timely approved for payment and payment processed within the time parameters established by State law.

OTHER WEAKNESS

FAILURE TO BILL FOR FEDERAL SHARE OF PROJECT COSTS

During our tests of Federal projects, we noted one project that was closed out before an invoice for $553,146 was received from a vendor. Since the project was closed, the 75% Federal portion of the project costs which amounted to $414,859 was not billed.

The Department expects to bill the grantor agency for the federal share during the next fiscal year.

We recommend that budgets and outstanding obligations be reviewed for each project prior to the closing of the project.
During our current audit, we reviewed the status of corrective action taken on the findings reported in the prior auditor's report on the financial statements of the Department dated October 24, 1997, resulting from the audit of the financial statements for the year ended June 30, 1997. We found that adequate corrective action has been taken on the finding entitled "Cash accounts not timely reconciled to Comptroller General's records" and the other findings are included in the current year's schedule of findings and questioned costs.
MATERIAL REPORTABLE CONDITIONS:

BOOKS OF ACCOUNT NOT MAINTAINED IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR GOVERNMENTAL ENTITIES.

The Department’s financial statements consist of two governmental funds, a proprietary fund, fiduciary funds, and two account groups. In addition, one of the governmental funds (the special revenue fund) and the agency fund consists of a number of individual funds. The Department’s general ledger is not set up to adequately account for the Department’s activity in each correct fund.

We recommend that the department consider the following:

- Set up the necessary funds to properly account for its activity in accordance with GAAP.
- Each fund should be self-balancing

RESPONSE:
The Department concurs that it does not have the necessary funds to properly account for its activity in accordance with GAAP and that each fund should be self-balancing. The general ledger design has been completed and the financial system is in the testing phase. Implementation will occur in March of 1999, and will address this issue.

The Department’s policy for classification of highway expenditures as maintenance or capital outlay is based on the source of funding and not the actual nature of the expenditure.

- Adopt a policy to properly classify expenditures as highway maintenance or construction.

RESPONSE:
There has been no definition of construction and maintenance activities adopted by the Department. Traditionally expenditure classification has followed the AASHTO guidelines. The development of a policy will involve the formulation of a definition agreed upon by the engineering sector.

The Department’s general ledger contains accounts for recording estimated revenues and expenditures known as budgetary accounts. These accounts should be self-balancing; however, the entries to these accounts resulted in these budgetary account being out of balance. The Department made numerous entries directly to its fund balance account during the year. Generally, no entries should be made to fund balance during the year.

- Review the manner in which all transactions are posted to its general ledger to ensure that all transactions are properly posted in accordance with GAAP.

RESPONSE:
The Department will review the posting to the general ledger to ensure they are correct and in accordance with GAAP. The Department will also review entries made to fund balance account to ensure they are appropriately recorded.

The Department’s general ledger is not maintained by type of expenditure to allow the accumulation of information necessary to present a budget versus actual statement. Expenditures in the general ledger are recorded by function instead of personnel cost, employer contributions, supplies etc.
• Post expenditures in a manner which would allow the preparation of a budget vs. actual statement.
RESPONSE:
The general ledger portrays a summary of account activity on a monthly basis by function. The department produces a budget worksheet which compares budget to actual for each functional area by line item category. This gives the user information by category of personal services, employer contributions, supplies, and contractual services for individual allotments within a functional area.

ACCOUNTS RECEIVABLE NOT RECORDED ON MODIFIED ACCRUAL BASIS

The Department’s accounts receivable include balances from numerous sources, including other state agencies. The Department records revenues relating to these receivables on the accrual basis of accounting instead of the modified accrual basis of accounting required by GAAP for governmental funds. Revenues and the related receivables should only be recorded if they are collected soon enough after each year-end to finance current expenditures.

- We recommend that all accounts receivable be recorded on the modified accrual basis as required for governmental funds.

RESPONSE:
The Department will continue to utilize working paper adjustments to annually portray accounts receivable on a modified accrual basis, however the Department will continue to record actual receivables and revenues on an accrual basis to provide a true picture of revenues and amounts due from outside entities.

YEAR END JOURNAL ENTRIES NOT POSTED BY DEPARTMENT

Some of the adjusting journal entries prepared by the audit firm as of the prior year-end were not posted by the Department. This causes the beginning fund balances per the Department's general ledger accounts not to agree with the Department's audited financial statements. Additional time is required to adjust the beginning fund balances to agree to the prior year's audited financial statements.

- We recommend that the Department review, and upon approval, post all auditor prepared adjusting journal entries.

RESPONSE:
The year-end adjusting entries are reviewed and recorded to the extent possible. The Department recognizes that those not posted will require adjustment at the beginning of the subsequent audit and will advise the auditors of those not posted.

IMPROVEMENT NEEDED OVER ACCOUNTING FOR PARTICIPATION AGREEMENTS

Improvements are needed in the accounting for participation agreements. A review of Report CA-213, "Status of Outstanding Participation Agreements", and the related client prepared schedule disclose the following deficiencies: incorrect amounts, handled in an inconsistent manner, closed contracts carried on the statement, omission of budgetary amount, no subsidiary ledger, exclusion of long term accounts receivable, omission of payments received on two agreements.

- We recommend that the Department accounting staff set up detail and control records so that an accurate accounting can be made of participating contracts. A schedule should be prepared as of each month end that is mathematically correct; properly reflects all contract data; excludes all completed and closed contracts; properly reflects all amounts due and/or deferred; and agrees with the related general ledger accounts.
RESPONSE:
A monthly statement is prepared and is mathematically correct. There were also numerous contracts closed out during the fiscal year and properly removed from the schedule. Participation agreements are negotiated based upon the outside entities' willingness to provide funding for the various stages of construction and are handled by the Contracts Grants Coordinator. The accounting staff is coordinating efforts to ensure the participation agreements are allotted and recorded on the statement. The financial system will meet the expanded reporting requirements recommended.

PROPRIETARY FUND FIXED ASSETS ACQUISITIONS AND DISPOSALS NOT RECORDED CORRECTLY

The Department recorded all fixed assets acquisitions and disposals for proprietary fund (internal service fund) assets in the general fixed asset account group. All acquisitions are purchased utilizing special revenue funds and then recorded as a transfer from the general fixed asset account group to the internal service fund. All disposals are recorded as fixed assets transferred from the internal service fund to the general fixed asset account group and then recorded as a retirement or disposal. Because of this method of handling fixed asset transactions, the internal service fund rates do not reflect full cost for fixed assets, such as gains or losses on disposals and, therefore, the reported results of internal service fund operations are misstated. Furthermore, the special revenue fund bears the additional costs of losses on disposals for internal service fund assets. The result is costs are not properly allocated to the benefiting fund. The Department has apparently been handling these transactions in this manner because of the limitations in its general ledger system.

- We recommend any acquisitions that are to be initially utilized by the internal service fund be recorded as a purchase by that fund. All disposals should be recorded in the internal service fund and not transferred to the general fixed asset account group unless the asset will continue to be utilized by the Department.

RESPONSE:
At the time of acquisition, the Department has not determined which items will be utilized by the internal service fund. During preparation for issue, items are issued to custodians in the internal service fund. Transfer of acquisition and preparation cost are accomplished at this time, therefore the proper fund incurs the cost. When items are no longer utilized by the internal service fund, they are transferred to the Equipment Depot for reassignment or disposal. The Department will continue to follow this procedure so that only active equipment is included in the internal service fund for depreciation calculation. The implementation of the new accounting system will account for all equipment in an internal service fund and will address this reportable condition.

STATUS OF ALLOTMENT REPORTS INACCURATE

Our review of the status of allotment reports disclosed that the reports were not accurate. This report was used to determine the outstanding commitments and estimated costs to complete various projects. We noted several instances of the expenditures being greater than the allotment for various areas. This continues to occur because the budgets (allotments) do not include purchase order obligations from the prior year and the allotments are therefore understated.

- We recommend that the allotments include all expected expenditures in each fiscal year.

RESPONSE:
The Status of Allotment Reports presents net expenditures and not cash expenditures. There are controls in place within the budget system to prevent the over expenditure of cash against allotted budgets. Our current budgetary system does not however account for the encumbrance of future obligations. The new
budget design will account for the outstanding purchase orders at the time of their creation in the automated system as well as outstanding contract information for encumbrance against established budgets.

FAILURE TO BILL FOR FEDERAL SHARE OF PROJECT COSTS

During our tests of Federal projects, we noted one project that was closed out before an invoice for $553,146 was received from a vendor. Since the project was closed, the 75% Federal portion of the project costs or $414,859 was not billed.

- We recommend that budgets and outstanding obligations be reviewed for each project prior to the closing of the project.

RESPONSE:

We agree with the recommendation. The Department realized the need to more accurately and timely monitor and close all projects. One year ago the department expanded the duties of the Federal Aid office to include a closing coordinator to ensure that all projects are closed in an appropriate time frame and that all expenditures are included. The situation indicated above was due to a Utility Agreement being charged to the wrong project when paid. This caused an error to be disclosed on the Federal Aid billing and would have been investigated by the office and a correction made. The charges have been corrected and moved to the appropriate project, a modified agreement submitted to the Federal Highway Administration, and reimbursement claimed. Because of the creation of the closing coordinator, the Department has made considerable improvements in monitoring projects and closing them in a timely manner; however, there will be errors made from time to time such as charging a payment item to the wrong project. The financial system will address this problem and will not allow an expenditure or exceed either allotment or federal authorization. Until the implementation of the system, we will continue to monitor the code overruns on the federal aid billing and make corrections as necessary.

OVER-ALLOCATION OF FRINGE BENEFITS

The Department over-allocated fringe benefits related to payroll to the various functional expenditure accounts by approximately $5,700,000 during the current year. An adjusting entry was made to credit the over-allocation to the functional expenditure accounts. The over-allocation was caused by incorrect projection of the costs for the year.

- We recommend that the Department review its projected costs more carefully in determining the allocation ratios for each fiscal year.

RESPONSE:

We agree with the recommendation. There was major variances in the cost of the Worker’s Compensation premium between two fiscal years due to credits being given by the State Accident Fund for past over payments. This resulted in the over-allocation. The expenditures for the additives and variance have been examined and current rates have been adjusted and corrections made to more accurately compute the fringe benefit rates for the current fiscal year.

MATERIAL REPORTABLE WEAKNESS

FAILURE TO TIMELY PAY INVOICES

Our test of expenditures disclosed that four out of 25 invoices tested were not paid within 30 working days as required by law.
• We recommend that invoices be timely approved for payment and payment processed within the time parameters established by State law.

RESPONSE:
We agree with the recommendation. The accounting area hired temporary employees during the first part of the calendar year and hired six summer temporaries to alleviate the backlog of unpaid agency obligations caused by a change in the agency’s procurement system in 1997. We have maintained two of those employees to assist in the payment process. We were also able to pull assistance from the key-entry area of Information Technology Services to enter payment information into the accounting system to produce vouchers. A tremendous effort was made and accounting process improved to expedite payment. We are now to the point with the retention of the two temporary employees to pay within the 30 days required by law.