On November 7, 2008, the Georgia Department of Audits and Accounts issued its Independent Audit Report on the Georgia Department of Transportation (GDOT) for the fiscal year ended June 30, 2008. The issuance of this report satisfied the April 2008 request for a special examination of GDOT finances by Governor Sonny Perdue and the Senate and House Appropriations Committees. The underlying causes for the preliminary deficit of $456,219,590.73 disclosed in the audit report and other anomalies noted, however, were not fully understood. Further investigation was needed to determine these causes.

Pursuant to O.C.G.A. 50-6-28, the State Government Division of the Georgia Department of Audits and Accounts initiated an investigation at the Georgia Department of Transportation. O.C.G.A. 50-6-28 requires the State Auditor to make an investigation when there are facts, records, circumstances, or information that indicates mismanagement or misconduct on the part of any official or any employee of any department. The Office of the Georgia Inspector General participated in this investigation.

Evidence found of possible financial statement fraud and a change in business processes that does not appear to be authorized by the Georgia Constitution

What we found
Our fiscal year (FY) 2008 financial audit report (statutory basis) of the Georgia Department of Transportation (GDOT), issued on November 7, 2008, disclosed that GDOT avoided a constitutional deficit of $456,219,590.73 at June 30, 2008 by utilizing FY 2009 State Motor Fuel funds to offset the over-obligation. During the course of the financial audit, we also determined that GDOT had a previously undisclosed constitutional deficit in the amount of $2.2 billion as of June 30, 2007. Our investigation was conducted to determine the causes of the deficit financial positions that have begun to plague GDOT in recent fiscal years. Our investigation found evidence to support the following:

✓ The former GDOT Treasurer, Mr. Earl Mahfuz, reportedly instructed certain members of his staff to stop recording FY 2008 executed contracts. Mr. Mahfuz denied giving such instructions. (Pages 15-17)

✓ GDOT management had a clear and accurate understanding regarding constitutional debt and its contractual obligation limitations, including the Advanced Construction Program. (Pages 18-22)

✓ It appears that Treasurer Mahfuz was responsible for the decision to implement business process changes at GDOT during FY 2006 and FY 2007 that he knew would violate the Georgia Constitution. (Pages 30-33)
It appears that GDOT implemented The North Highland Company’s recommendation to cash flow its ‘total construction program’ despite North Highland's warning that legal restrictions must be changed before implementation. (Pages 28-33)

GDOT’s cash balance dropped approximately $1 billion (FY 2006 through 2008) subsequent to North Highland's recommendation to cash flow its 'total program' to make more efficient use of its cash balances. (Pages 43-47)

On July 10, 2007, the former GDOT Deputy Commissioner, Mr. Buddy Gratton, presented materially inaccurate/misleading financial information regarding GDOT’s financial position as of May 31, 2007 to the Joint Study Committee on Transportation Funding. (Pages 37-39)

We estimate GDOT has lost in excess of $111 million in State Motor Fuel interest earnings since FY 2006 as a result of the aforementioned changes to its business processes. (Pages 48-49)

Two invalid budget amendments and over-stated Federal accounts receivables masked the GDOT statutory deficit of $2.2 billion as of June 30, 2007. (Pages 39-42)

Cash disbursements to construction companies nearly doubled from FY 2006 to FY 2008, with certain companies receiving significantly more than others. (Pages 50-51)

The operating environment, during the time period applicable to our investigation, was dysfunctional to the extent that GDOT was ripe for fraud, waste, abuse, and mismanagement. (Pages 10-11)

**Recommendations**

Due to the severity of the matters disclosed in this report, we recommend that, at a minimum, GDOT obtain specific legal advice from the Attorney General’s Office regarding the constitutional limitations on its contractual authority including, but not limited to, the application of 2001 Op. Att’y Gen. 01-10. We further recommend that GDOT undertake a comprehensive review and analysis of all business processes to ensure compliance with Georgia law.

GDOT should not have cash-flowed its total program in the absence of the adoption of an appropriate Constitutional amendment to allow multi-year financial obligations; however, if it wishes to cash flow its total program in the future, it should seek such appropriate constitutional and/or legislative changes to authorize this practice.

**Conclusion/Acknowledgements**

Conclusions reached in this report resulted from the review of thousands of email messages; inspection of numerous computer hard-drives/network files; and numerous interviews of GDOT employees (present and former), members of the Governor’s staff (present and former), and others.
The evidence/conclusions disclosed in this report may have been limited because certain evidence (email, computer files, etc.) may have no longer been available at the time of this investigation, or due to certain facts and circumstances not being divulged by those who were interviewed.

We would like to thank the Office of the Inspector General which also participated in this investigation.
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Background

The following areas are provided to aid in your understanding of the contents of this report:

1. The Georgia Constitution
2. 2001 Op. Att’y Gen. 01-10
3. Governor’s Transportation Choices Initiative
4. Fast Forward
5. The Advanced Construction Program
6. Duties of the GDOT Treasurer
7. Overview of GDOT Operating Environment

1. The Georgia Constitution

The Constitution of 1983 became effective on July 1, 1983 after it was overwhelmingly approved by the citizens of Georgia during the 1982 general election.

Conservative Fiscal Policies
As a fiscally conservative document, the Georgia Constitution establishes Georgia’s governance framework and fiscal policies. Consistent adherence to the provisions of the Georgia Constitution have been a cornerstone of Georgia’s continued financial health and is the primary reason Georgia has been able to receive and maintain the highest bond ratings awarded by the bond rating community. On January 29, 2009, Moody’s Investors Service provided the following commentary regarding Georgia’s 2009A and 2009B General Obligation Bonds:

“Georgia’s Aaa general obligation bond rating is based on conservative financial management enforced by statutory and constitutional provisions.”

“The highest-quality rating reflects Georgia’s conservative fiscal management, moderate debt burden, well-funded pensions, and strong, albeit declining, reserves.”

Prohibition Against Deficit Fund Balances (Debt)

The Georgia Constitution does not permit debt based on the independent actions of a State agency. This prohibition regarding debt is established in Article VII, Section IV, Paragraph VIII of the Constitution (1983), which provides that “…the credit of the state shall not be pledged or loaned to any individual, company, corporation, or association…” In simple terms, debt to the State is created when an agency incurs an obligation without
current funds available.

The Georgia Attorney General, in 1974 Op. Att’y Gen. 74-115 (AG Opinion 74-115), offered the following commentary regarding contracts with State agencies and private parties:

“...No agency of the State may execute a contract with a private party for the purchase of goods or services which purports to obligate appropriations or state funds from any other source not on hand at the time of the contract or where the fiscal obligation of the state agency depends for its full performance upon such future appropriations or the continued existence of any other source of state funds.”

2. 2001 Op. Att’y Gen. 01-10

On December 14, 2001, the Georgia Attorney General (AG) issued 2001 Op. Att’y Gen. 01-10 (AG Opinion 2001-10) which states, in part, as follows:

“Therefore, it is my official opinion that the Department of Transportation may enter into transportation construction contracts with all or a portion of the financial backing for the contracts coming from a contractual promise from the State Road and Tollway Authority to borrow and provide money to DOT as when needed to expend on projects that are the subjects of construction contracts.”

As stated in the AG Opinion 2001-10, the basis for the Attorney General’s conclusion is found in the “Intergovernmental Contracts Clause” of the Georgia Constitution. The Official Opinion further states “an intergovernmental contract made pursuant to the Intergovernmental Contracts Clause is not subject to the debt limitation provisions of the constitution.”

AG Opinion 2001-10 was applied during the audit of the FY 2008 financial statements (statutory basis) when establishing appropriate accounts receivable balances from the State Road and Tollway Authority (SRTA) pursuant to an intergovernmental contract between GDOT and SRTA.

3. Governor’s Transportation Choices Initiative

On June 28, 2001, former Governor Roy Barnes announced a new transportation plan aimed at solving Atlanta’s traffic problems and alleviating traffic congestion statewide. The plan, the Governor’s Transportation Choices Initiative (GTCI), was a five-year, $8.3 billion plan which encompassed bus and rail programs, highway expansion and lane widening, additional high-occupancy vehicle (HOV) lanes, and the Northern Arc. The Governor's plan was to be financed with

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1 Kelly Simmons and Kathey Pruitt, “Georgia Governor’s $8.3 Billion Transit Plan is on Fast Track,” Atlanta-Journal Constitution 29 Jun 2002: D1.
Guaranteed Revenue Bonds, and Grant Anticipation Revenue Vehicle (GARVEE) Bonds issued through the SRTA.

The Governor’s Transportation Choices Initiative was predicted to spur economic growth in the State of Georgia. The Georgia Regional Transportation Authority (GRTA) conducted a study and concluded that the plan would create 23,000 new jobs and a net gain of $1.4 billion in total regional income.²

The November 2002 Georgia gubernatorial election brought about a change in administration, as Governor Sonny Perdue was elected the 81st Governor of Georgia, succeeding Governor Roy Barnes. With the change in administration, Governor Barnes’ GTCI program was effectively phased out. GTCI was later replaced by Governor Perdue’s Fast Forward plan.

4. Fast Forward

On April 14, 2004, Governor Sonny Perdue announced a new transportation initiative known as Fast Forward. Fast Forward’s primary objective was to relieve traffic congestion and expand economic development in urban and rural Georgia. Fast Forward was a six year plan, scheduled to begin in FY 2005 and to be completed in FY 2010. Original plans were for Fast Forward to be a $15.57 billion investment, comprised of a mixture of:

1. GARVEE Bonds
2. General Obligation/Guaranteed Revenue Bonds
3. GDOT Regular Program

5. The Advanced Construction Program

The Advanced Construction Program (AC) has been utilized by GDOT for many years. AC is the process by which GDOT finances Interstate or National Highway System Projects without the immediate aid of Federal funds. AC may be used for all phases of a project, including preliminary engineering, right of way, and construction.

Upon prior approval by the Federal Highway Administration (FHWA), an AC project is deemed to be a ‘Federally eligible project’ that may be converted to a Federal project in the future. FHWA’s

² Georgia Regional Transportation Authority Press Release, October 17, 2001.
approval of an AC project is not considered to be a promise to pay GDOT the Federal share of the cost of the project. To the contrary, Title 23 CFR § 630.705 expressly states that, “The FHWA authorization does not constitute any commitment of Federal funds on the project, and the FHWA shall not reimburse the State until the project is converted under § 630.709.”

Prior to FY 2007, GDOT had traditionally utilized AC conservatively. GDOT normally utilized AC during the first quarter of a State fiscal year (July 1 through September 30) until October 1 of each year, the beginning of the new Federal fiscal year.

AC is an excellent financial management tool at the disposal of the GDOT. It must, however, operate within the confines of the debt principle of the Georgia Constitution, as discussed on pages 6 and 7, meaning that each AC project must be backed by an available alternative source of funds until it is converted to a Federally funded project.

“Traditionally, GDOT utilized Advance Construction funds as a stop gap or last resort fund. Therefore, AC projects were typically executed the end of each fiscal year and funds were converted the beginning of each Federal fiscal year.”


6. Duties of the GDOT Treasurer

In O.C.G.A. § 32-2-2l, the State Transportation Board is charged with the responsibility of confirming or rejecting recommendations for the appointment of the following Department Officers:

- Deputy Commissioner
- Chief Engineer
- Treasurer
- Assistant Treasurer

Because this investigation involved matters related to recent GDOT deficits and other financial anomalies, we felt it necessary to obtain a deeper understanding of the duties and responsibilities of the GDOT Treasurer.

O.C.G.A. § 32-2-42(c) states in part that:

“...The duties of the treasurer shall be to receive all funds from all sources to which the department is entitled, to account for all funds received by the department, and to perform such other duties as may be required of him by the commissioner...”

During the time period of this investigation, the Treasurer, Mr. Earl Mahfuz, had the following departmental offices under his control and supervision:

- Division of Administration
  - Office of Budget Services
  - Office of General Accounting
  - Office of Financial Management
- Office of Audits
- Office of General Support
- Office of Air Transportation
- Office of Strategic Development

A copy of the GDOT organizational chart during the period of this investigation can be found in the Appendix on page 52 of this report. Mr. Mahfuz served as the GDOT Treasurer from April 11, 2002 until July 26, 2008, at which time he became the Assistant Treasurer.

7. Overview of GDOT Operating Environment

This investigation focused primarily on activities occurring during FY 2006 and FY 2007, and, to some extent, surrounding years as became necessary. During the course of this investigation, we obtained and reviewed thousands of email messages; inspected numerous computer hard drives/network files; and conducted a substantial number of interviews of GDOT employees (present and former), members of the Governor's staff (present and former), and others.

From this investigation we were made aware of strained relationships between GDOT's board and GDOT's upper management, great discord within GDOT's upper management, and a heightened level of mistrust expressed between the Governor's Office and certain members of GDOT's board/management.

During the period of our investigation, we learned that GDOT's board had become more active in the day-to-day operations of the Department. Previously, GDOT's board had functioned more closely in the role of a traditional governing board by directing departmental policy and general oversight. GDOT's board, however, reportedly became more active in the day-to-day operations of the department when David Doss was board chairman (July 1, 2004 to June 30, 2006). We received information that Chairman Doss did not work well with (then) Commissioner Harold Linnenkohl and that Chairman Doss would frequently bypass Commissioner Linnenkohl by taking important departmental issues directly to (then) Treasurer Earl Mahfuz.

From interviews conducted, we also became aware that a strained working relationship existed between Commissioner Linnenkohl and Treasurer Earl Mahfuz. On two occasions, Commissioner Linnenkohl did not allow Mr. Mahfuz to hire someone for the “Director of Administration" position, which was a direct-report to the Treasurer. Rather, Commissioner Linnenkohl twice selected the candidates of his choice for this vital position that managed the offices of accounting, budget, and financial management. On both occasions, Commissioner Linnenkohl selected engineers for these positions. Both individuals who served in the ‘Director of Administration’ position under the Treasurer were reportedly well-respected
engineers, but in our estimation did not possess the financial background and skills to properly oversee these important offices. According to Commissioner Linnenkohl, the two individuals were selected to serve in the ‘Director of Administration’ position for the purpose of cross-training management.

We found information indicating that Commissioner Linnenkohl did not seem very knowledgeable of GDOT’s financial operations, but seemed more interested in the engineering aspects of the Department. In fact, Commissioner Linnenkohl delegated his contract signing responsibilities to (then) Deputy Commissioner Buddy Gratton.

We also obtained information indicating that the Governor’s Office had developed a great mistrust for GDOT upper management, particularly with Treasurer Mahfuz and Chairman Doss. The Governor’s Office expressed great frustration over inconsistent financial information reported by GDOT and its perceived unwillingness to provide complete and accurate financial information. This uncertainty led the Office of the Governor to request that GDOT hire an outside consultant to document GDOT’s business processes during FY 2006. The North Highland Company conducted the study and issued a report, titled 2005 Funding Process Master Document, which became an important part of this investigation.

Mr. Mahfuz and Mr. Doss both expressed to us that the Governor's Office had exerted excessive pressure on GDOT to successfully implement Fast Forward. However, former Commissioner Harold Linnenkohl told us that the Governor’s Office never instructed GDOT to violate the Georgia Constitution. On the other hand, former GDOT board Chairman Mike Evans told us that the pressure to deliver construction projects did not come primarily from the Governor’s Office, rather it came from within the GDOT Board as a result of the Board’s more active role in day-to-day operations.

Collectively, we conclude that a dysfunctional operating environment existed during the time period covered by of our investigation such that GDOT was susceptible to fraud, waste, abuse, and mismanagement.
About the Investigation

In April 2008, the Governor, the House Appropriations Committee, and the Senate Appropriations Committee each requested that the State Auditor conduct a special examination of the Georgia Department of Transportation. This examination was requested pursuant to O.C.G.A. § 50-6-4 amid concerns of a financial shortfall at GDOT.

Pursuant to the requests, on November 7, 2008, the Georgia Department of Audits and Accounts issued its opinion on GDOT’s FY 2008 financial statements (statutory basis). After significant post-closing and audit adjustments, a qualified opinion was rendered. We determined that the financial statements (statutory basis) were fairly presented, except for the effects of the uncapped fuel price adjustment index, which is contained in many of GDOT’s construction contracts.

The report also included 10 significant audit findings and is summarized as follows:

- Finding 1 – Preliminary deficit of $456,219,590.73 avoided by the recognition of FY 2009 State Motor Fuel Funds
- Finding 2 – Improper Revenue Recognition
- Finding 3 – General Ledger not suitable for day-to-day operations
- Finding 4 – Sub-ledger deficiencies
- Finding 5 – Contingency Reserve Account
- Finding 6 – Contract monitoring deficiencies
- Finding 7 – Liabilities for Asphalt and Fuel Indices not properly recorded
- Finding 8 – Improper Budget Amendment
- Finding 9 – Weaknesses in GDOT’s ability to record process and report contractual Obligations
- Finding 10 - Inadequate accounting records at the legal level of budgetary control

Our financial statement audit focused on correcting GDOT’s FY 2008 financial statements. The underlying causes for the preliminary deficit of $456,219,590.73 and other anomalies noted were not fully developed or understood, which warranted further investigation.

Statutory Authority to Investigate
O.C.G.A. § 50-6-28 requires the State Auditor to make an investigation when there are facts, records, circumstances, or information that indicates mismanagement or misconduct on the part of any official or any employee of any department.

This investigation initially focused on three primary areas:

1. The causes of the spike in expenditures during FY 2007 that led to GDOT’s deficit.
2. Improper budget amendments reported in finding No. 8 of the financial audit.
3. Unrecorded contracts and supplemental agreements reported in Finding No. 9 of the financial audit.

During the course of this investigation, additional questions were raised. A summary of the questions we sought to answer are shown in the “Objectives of Investigation” section below. Other financial management concerns at GDOT will be the subject of future audits.

Objectives of Investigation

Questions raised before and during this investigation were as follows:

1. Were the unrecorded contracts identified in the FY 2008 financial statement audit ‘intentionally’ not recorded in order to mask the GDOT deficit?

2. Did the GDOT/Treasurer understand its Constitutional limitations (Debt) and the Advanced Construction Program?

3. What caused the spike in the GDOT’s annual expenditures during FY 2007?

4. Is ‘Cash Flow Forecasting’ permitted under the Georgia Constitution?

5. Were there other attempts to mislead the public about the GDOT’s financial position at June 30, 2007 or 2008?

6. What were the consequences of the unauthorized change in business process to ‘Cash Flow Forecasting’ during FY2006/2007?

7. Where did the cash go?

The Georgia Inspector General

The Office of Inspector General for the State of Georgia routinely reviews audit reports issued by the Georgia Department of Audits and Accounts. Upon issuance of the FY 2008 financial audit report (statutory basis), the Office of Inspector General began initial follow-up to certain findings contained in the audit report. As indicated above, the Georgia Department of Audits and Accounts was also preparing to investigate the underlying causes of the preliminary deficit and other anomalies. To avoid a duplication of effort, the Department of Audits and Accounts and the Office of Inspector General chose to conduct a joint investigation.

The results of this report are based on the collaborative efforts of the two offices; however, the two offices have chosen to issue separate reports.
Results of Investigation

Question 1

Were the unrecorded contracts identified in the FY 2008 financial statement audit ‘intentionally’ not recorded in order to mask the GDOT deficit?

Background
In an effort to determine GDOT’s true financial position as part of our FY 2008 financial statement audit (statutory basis), we tested GDOT’s year-end close-out process as of March 31, 2008. Consequently, the simulated closing of the GDOT’s accounting process revealed a negative State Motor Fuel fund balance of ($839,218,772) as of March 31, 2008.

In an effort to end FY 2008 (June 30, 2008) with a positive State Motor Fuel fund balance, GDOT adjusted stale purchase orders, converted AC projects to federal-aid projects, and corrected significant data entry errors. The efforts eventually resulted in a June 30, 2008 negative State Motor Fuel fund balance of ($456,219,590.73), which was subsequently eliminated by using 54% of GDOT’s $840,809,092 FY 2009 amended appropriated State Motor Fuel Funds.

Unrecorded Contracts Discovered
On August 27, 2008, prior to confirming the State Motor Fuel fund balance for the end of FY 2008, we were notified that GDOT staff had discovered a significant number of executed contracts and supplemental agreements which had never been recorded into the PeopleSoft accounting system. The unrecorded contracts and supplemental agreements consisted of both FY 2008 and FY 2009 transactions. Of the total unrecorded contracts and supplemental agreements in the amount of $321,910,316.01, $153,402,135.80 applied to FY 2008. A summary of the unrecorded contracts and supplemental agreements is set forth below:

<table>
<thead>
<tr>
<th>Unrecorded Contracts and Supplemental Agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2008</td>
</tr>
<tr>
<td>---------</td>
</tr>
<tr>
<td>341 Unrecorded Contracts</td>
</tr>
<tr>
<td>1041 Unrecorded Supp. Agreements</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Investigation Results
Upon notification of the existence of unrecorded contracts, we initiated an investigation. We obtained information indicating that the (then) GDOT Treasurer, Mr. Earl Mahfuz, instructed certain members of his staff to cease recording FY 2008 executed contracts. According to multiple members of the Treasurer’s staff, Mr. Mahfuz directed them to stop entering the fully executed contracts into the PeopleSoft accounting system in the late May/early June, 2008 time period due to the GDOT’s financial deficit situation. Additionally, it was reported to us that Mr. Mahfuz stated that the staff could resume recording contracts on July 1, 2008, which was the beginning of FY 2009. When questioned about his alleged directives to stop recording executed contracts, Mr. Mahfuz emphatically denied ever issuing such directives.
During the months of May through August 2008, GDOT upper management and accounting staff worked feverishly to find ways to legitimately free-up State Motor Fuel funds and avoid a year-end deficit. On numerous occasions, (then) Commissioner Gena Abraham (Evans) asked GDOT staff if they were aware of any remaining adjustments that could impact the FY 2008 State Motor Fuel fund balance. As the audit fieldwork was nearing completion, on August 8, 2008, approximately three weeks prior to the discovery of the unrecorded contracts, those at GDOT charged with tracking the deficit signed a document signifying they did not know of any other matters which could impact the ending State Motor Fuel fund balance. Based on the results of our investigation, we have reason to believe Mr. Mahfuz was fully aware and possessed the financial background to understand the implications of the unrecorded contracts when he signed the statement on August 8, 2008 (See Exhibit 1 on page 17). We also believe the other GDOT employees signing the document were either unaware of the unrecorded contracts or did not possess a sufficient financial background to understand the implications on GDOT’s financial position by not recording the executed contracts.

Intentional misrepresentation of an organization’s financial statements may constitute financial statement fraud, as defined by the Association of Certified Fraud Examiners. Mr. Mahfuz’ reported directives given to certain accounting staff to cease recording contracts executed during FY 2008 was a departure from normal GDOT practices and generally accepted accounting principles.
EXHIBIT 1

To the best of our knowledge, as of 8-3-08, the GDOT 6-30-08 fund balance is approximately ($284,754,246.28). A meeting to be held on 8-11-08 with State Auditor may reduce this shortfall by another $15 million if we get approval to re-categorize fund source categories in FMIS, which will allow additional conversions. We also believe we have approximately $100,000,000 remaining in FMIS authority to which we may be able to convert more GARVEE projects, thereby further reducing this shortfall.

Therefore, to the best of our knowledge, the best case scenario will appear to be:

($284,754,246.28)

$15,000,000

$100,000,000

($169,754,246.28) = minimum to be funded from FY09

SIGNED in HARMONY:

[Signatures]

[Signatures]
Question 2

Did the GDOT/Treasurer understand its Constitutional (debt) limitations and the Advanced Construction Program (AC)?

The Georgia Constitution and various State/Federal laws and regulations largely dictate the financial operations of GDOT. Through FY 2006, GDOT had little difficulty in complying with the array of financial regulations and constraints under which it operates. Due to the recent deficits and other deficiencies reported at GDOT, many have questioned whether GDOT clearly understood the legal constraints on its financial operations.

Based on evidence we obtained during the course of this investigation, we believe that upper management of GDOT, including Treasurer Mahfuz, clearly understood the debt principles (see pages 6 and 7) of the Georgia Constitution and the complexities of the Federal Highway Construction grant program, including the AC Program (see pages 8 and 9). We obtained several internal documents that clearly demonstrate GDOT’s expertise and knowledge of these two critical areas prior to the FY 2007 deficit (debt).

Constitutional (Debt) Limitations

The recent deficit fund balances occurred when GDOT entered into contractual arrangements without sufficient funds on hand at the time the contracts were executed. Evidence we were able to obtain indicated that prior to FY 2006, GDOT did not have formal documentation of its financial operations and frequently did not satisfactorily answer and/or explain the complexities of its operations to the Governor’s Office. The resulting document, dated November 2005, known as the Funding Process Master Document, was prepared by North Highland based on information gathered by GDOT employees, including GDOT Treasurer, Earl Mahfuz.

Based on our inspection, we believe this GDOT document correctly indicates that GDOT, like all other State Agencies, is prohibited from entering into any contract with a private party for which it does not have sufficient funds available. See Exhibit 2 on page 19, an excerpt from this document.
EXHIBIT 2

Synopsis of Laws and Impact to GDOT

Use of Funds and Restrictions on Use of Funds

Sufficient Funds – Like all other State of Georgia agencies, GDOT is expressly prohibited from making or contracting any debts or entering into any contract for which it does not have sufficient funds appropriated at the time of making said debt or entering into said contract to enable it to meet such debt or such contract obligation. ¹⁰ Simply stated, this means that GDOT must have money in the bank to cover the full amount of a particular contract.

¹⁰ 32-2-61(a)

Source: GDOT Funding Process Master Document – November 2005

To further support our belief that GDOT’s upper management understood its constitutional limitations, we discovered a presentation given to the Joint Study Committee on Transportation Funding by (then) Deputy Commissioner Buddy Gratton on July 10, 2007. See Exhibit 3 for a list of Committee members and GDOT staff and board members present at the July 10 meeting.

EXHIBIT 3

When interviewed during this investigation, Mr. Gratton indicated that the PowerPoint slides used in his presentation were prepared by financial staff under the supervision of (then) GDOT Treasurer Earl Mahfuz. The ‘notes’ to the PowerPoint slides, however, were prepared by Mr. Gratton. In the notes to the first slide, Mr. Gratton recognized Mr. Mahfuz’s financial
expertise and indicated that Mr. Mahfuz would be available to answer any questions he could not answer.

In his presentation, Mr. Gratton clearly explained that “one of the challenges that faces GDOT is the fact that we can not enter into a contract without having the funds on hand at the time of the contract.” See Exhibit 4 for a copy of Mr. Gratton's PowerPoint slide in which he appropriately references Article VII, Section IV, Paragraph VIII of the Georgia Constitution, and Attorney General Opinion No. 74-115.

EXHIBIT 4

State Funds

- Per the Georgia Constitution (Article VII, Section IV, Paragraph VIII):
  - State agencies are prohibited from entering into any contract for which it does not have sufficient funds appropriated at the time of entering into the contract.

- Per 1974 Attorney General Opinion No. 74-115
  - “AGENCY NOT AUTHORIZED TO PLEDGE CREDIT OF STATE. --No agency may execute a contract with a private party for the purchase of goods or services which purports to obligate appropriations or state funds from any other source not on hand at the time of the contract or where the fiscal obligation of the agency depends for its full performance upon such future appropriations or the continued existence of any other source of state funds.”

One of the challenges that faces GDOT is the fact that we can not enter into a contract without having the funds on hand at the time of a contract. As shown are the Georgia Constitution section and an Attorney General's opinion on this issue. From this challenge or issue always leads to the perception that GDOT has money on hand that we are not spending. We do have money on hand in our state GDOT accounts. That funding is there to cover contract obligations of the Department and the State. If GDOT has signed a state contract for specific services for a total amount of $1 million and we only receive expenses for $200,000 then GDOT has the remaining $800,000 in the bank accruing interest. This is true with Federal projects as well when the state is obligated for the typical 20% match on the Federal Funds.

Source: Mr. Buddy Gratton’s PowerPoint Presentation July, 10, 2007 – Slide No. 18
The Advanced Construction Program (AC)

As previously indicated, contractual arrangements entered into by GDOT without funds on hand at the time of the contract during FY 2007 propelled GDOT into a deficit fund balance position (statutory basis). As further discussed in Question 3, an acceleration of AC seems to be the major cause of the deficit.

Based on information gathered in this investigation, we believe that prior to FY 2007 GDOT had utilized AC conservatively (generally from $400 million to $1.2 billion) because it apparently understood that AC should only be used to start ‘Federally eligible projects’ (may be converted to Federal projects in the future as Federal funding becomes available) only to the extent that unobligated State Motor Fuel Funds or other non-Federal funds were available.

As of June 30, 2007, GDOT’s AC balance had grown to $3.973 billion, with it peaking at $4.048 billion as of August 2007. When asked, ‘why did GDOT depart from its normal AC ceiling of $1.2 billion’, most responded with disbelief regarding the elevated AC balance. In spite of the responses we received, we believe sufficient evidence exists to conclude that GDOT management, including the Treasurer fully understood AC and its financial limits which are based on the debt principles of the Georgia Constitution.

The November 2005 North Highland document referred to earlier, known as the Funding Process Master Document, includes a section on Advanced Construction. Our inspection of this document found that it correctly indicates that AC contracts must initially be funded through other available means such as State Motor Fuel funds, in order to comply with the Georgia Constitution. See Exhibit 5, an excerpt from this document.

EXHIBIT 5

Flow of Funds

Advanced Construction

Advanced Construction (AC) is a provision of FHWA that enables a State DOT to “borrow” against future federal obligation authority in order to achieve needed transportation improvements in the present time. Projects are funded currently through other means such as motor fuel funds, bond proceeds, etc., and when the projects are converted at some point in the future, FHWA reimburses GDOT from the obligation authority for that year.

This provision enables GDOT flexibility to advance the purchase of ROW, leverage available motor fuel funds, and bond proceeds to gain transportation improvements sooner, and still qualify for federal reimbursement on those projects in future years.

EXHIBIT 5

Source: GDOT Funding Process Master Document – November 2005
ROW - ‘Right of Way’
Further supporting our contention that GDOT management fully understood AC, the presentation given to the Joint Study Committee on Transportation Funding by Deputy Commissioner Buddy Gratton on July 10, 2007 clearly (and correctly) explains that AC contracts must utilize “state or other non-Federal funding to advance construction”. Further, Mr. Gratton explained to the Study Committee that GDOT’s AC balances range from $400 million to $1.2 billion. (See Exhibit 6)

### EXHIBIT 6

**Federal Aid Funds**

**General Facts & Definitions**

- **Apportionment** – Upper limit of Federal Aid Funding approved in the Multiyear Surface Transportation Bill
- **Obligation Authority** – Maximum amount of Federal Aid Funding available to be obligated in a specific federal fiscal year through annual appropriations bill
- **Advance Construction Authority**
  - Methodology to use state or other non-Federal funding to advance the construction, including PE and ROW, of a Federal Aid eligible project before actual Federal funding is obligated on the project
  - Project is authorized as AC in the Federal system and represents a promise to pay by the appropriate Federal agency if future Federal funds are applied to the project

Going over some facts and definitions. I just discussed in principle the apportionment amount set up in each multi year transportation bill and that each year a maximum amount is authorized for obligation on an annual basis that will be guaranteed by the Highway Trust Fund. For FY 07 the obligation authority amount to Georgia was $1.1 billion and this is the maximum amount that is guaranteed by the Trust Fund for this year.

Each state has the opportunity go over the Obligation Authority by utilizing what is called Advance Construction authority. This Methodology utilizes state or other non-Federal funding to advance the construction, including PE and ROW, of a Federal Aid eligible project before actual Federal funding is obligated on the project. All the FHWA requirements are still required to be met. The Department utilizes this opportunity and thru money management the AC for the Department runs from $400 million to $1.2 billion.

Source: Mr. Buddy Gratton’s PowerPoint Presentation July, 10, 2007 – Slide No. 7

PE = ‘Preliminary Engineering’
ROW = ‘Right of Way’
Question 3

What caused the spike in GDOT’s annual expenditures during FY 2007?

Fast Forward was a $15.57 billion initiative that began in FY 2005. Because Fast Forward planned to do in six years what would normally take 18 years to complete, it was expected that expenditures in FY 2005 through FY 2010 would be substantially higher than previous years. As shown in Exhibit 7, GDOT’s total expenditure levels for FY 2005 and FY 2006 increased over the FY 2004 (the last pre-Fast Forward year) amount, but were actually under the amounts originally planned for Fast Forward. In FY 2007, however, GDOT’s expenditures dramatically increased with reported expenditures exceeding $5.1 billion.

EXHIBIT 7

![GDOT Yearly Expenditures Chart]


Since it is our belief that GDOT understood its constitutional constraints (See Question 2 beginning on page 18), our investigation took an in-depth look at what caused the FY 2007 expenditures to be so excessive.

Apparent Cause of the Spike

Some have expressed that the stresses of implementing Fast Forward caused the spike in expenditures reported in FY 2007 ($5.1 billion), and the resulting over-obligation of GDOT funds (deficit). Based on our investigation, however, we recovered evidence that GDOT was pursuing changes in its business processes prior to FY 2005 that appear to be the cause for the eventual spike in expenditures in FY 2007. Exhibit 8 on page 24 is a copy of a document we found on Larry Landrum’s (Cash Flow Manager) GDOT computer, dated March 21, 2003, and
indicates that GDOT was seeking to implement a new business process, **Cash Flow Forecasting**, through the expanded use of its Advanced Construction Program.

‘Cash Flow Forecasting’ is a process by which GDOT maximizes its capacity to enter into contracts while ensuring that it has sufficient cash on hand to pay invoices received from construction contractors and consultants.

**EXHIBIT 8**

<table>
<thead>
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<tr>
<td>Conceptual Model Design</td>
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</table>

**Conceptual Model**

1. **Introduction**

The process of analyzing the funding decisions for the GDOT projects has changed fundamentally. In the past, projects were funded via legislative allotments, state fuel taxes, federal reimbursements and several other funding sources. Recently, Georgia has joined a growing number of states that issue transportation bonds to fund the growing transportation needs. This shift from traditional funding sources to market driven funding requires that GDOT accurately estimate and monitor project costs as well as forecast disbursements and inflows. In addition, GDOT is planning to leverage cash forecasts in an effort to shift its Advanced Construction program approach. Traditionally, GDOT utilized Advance Construction funds as a stop gap or last resort fund. Therefore, AC projects were typically executed the end of each fiscal year and funds were converted the beginning of each Federal fiscal year. In the future, the cash forecasts will allow the Office of Financial management to place strategically placed projects in the Federal AC programs while managing the cash requirements and the conversion of the reimbursements as pipeline AC projects are billed and complete. This new information will help GDOT maximize the use of Contract Authority and maintain a steady stream of reimbursements to be used to fund new and existing projects.

*Source: North Highland's Conceptual Model Design v5.1 Document found on Larry Landrum’s GDOT computer*

This ‘Conceptual Model Design’ document, dated March 21, 2003, indicated that GDOT was preparing to cash flow projects prior to Fast Forward, which wasn't initiated until over a year later on July 1, 2004.

Based on the evidence gathered in this investigation, we believe that the implementation of ‘Cash Flow Forecasting’, utilizing its Advanced Construction Program, caused the spike in FY 2007 expenditures, not Fast Forward.

**Business Process changes initiated during GTCI**

The *Governor's Transportation Choices Initiative* (GTCI) preceded Fast Forward as the State of Georgia's accelerated transportation initiative. GTCI was a five-year plan that was designed to run from FY 2002 through FY 2006. During GTCI’s brief existence, however, several
significant events occurred that laid the foundation for ‘Cash Flow Forecasting’ as it would be implemented during FY 2006 and FY 2007.

- **Attorney General Opinion 2001-10**
  GTCI introduced Guaranteed Revenue Bonds (GRB) and GARVEE Bonds as financing vehicles to accelerate GDOT road projects. Opinion 2001-10 established the basis upon which GDOT could initiate designated SRTA-financed bond projects (execute contracts) based on SRTA’s ‘promise to pay’ in an intergovernmental agreement between GDOT and SRTA. According to this opinion, SRTA’s ‘promise to pay’ (or IOU) satisfied the Constitutional requirement that an agency must have “funds on hand” before entering into a contract. From an accounting perspective, GDOT could record an accounts receivable from SRTA in an amount equal to the incurred obligations, not to exceed the total amount promised by SRTA, in order to keep its books in balance.

  During this investigation, we learned that GDOT envisioned entering into a monetarily uncapped agreement with SRTA that would provide needed funding in the event that GDOT became over-obligated while cash flowing construction projects. GDOT believed that an uncapped agreement for SRTA to provide funding when needed would remedy any constitutional debt concerns.

- **Origin of Cash Flow Forecasting**
  Attorney General Opinion 2001-10 was issued on December 14, 2001. Approximately four months later, on April 11, 2002, Mr. Earl Mahfuz was promoted to the position of Treasurer by GDOT’s board. GDOT management, including Treasurer Mahfuz, apparently made liberal interpretations of AG Opinion 2001-10 and implemented a new way of doing business at GDOT known as ‘Cash Flow Forecasting’. Pursuant to this change in business process, on May 13, 2002, Treasurer Mahfuz promoted Mr. Larry Landrum to ‘Cash Flow Manager’, a new position at GDOT. The hiring of a cash flow manager highlights GDOT’s efforts to implement cash flow forecasting for qualifying SRTA bond-funded projects.

  Later in FY 2002, GDOT apparently began cash flowing SRTA bond projects based on its understanding of the Opinion. Approximately one year after GDOT implemented AG Opinion 2001-10, in a letter written to Governor Sonny Perdue dated May 12, 2003, (then) GDOT Commissioner Tom Coleman, Jr. disclosed this business process change. **Exhibit 9 on page 26** provides an excerpt of the letter.
This new initiative presented certain new legal and financial challenges under State law and since this was a departure from the Department’s standard business practices, the Department requested an Official Opinion of the Attorney General’s office which was rendered on December 14, 2001. In the attached Opinion the Attorney General stated that the GDOT could enter into transportation contracts with “all or a portion of the financial backing for the contracts coming from a contractual promise from SRTA to borrow and provide money to GDOT as and when needed to reimburse the GDOT for expenditures on projects that are the subject of construction contracts” (Attachment 3). In other words, the Department would not set aside the entire amount of a contract when executed as it had in the past but would pay on a cash flow basis as invoices came in from contractors and consultants for the qualifying bond projects. The Department would subsequently bill SRTA based on its promise to reimbursement the GDOT for these expenditures with GDOT money.

Source: Page 2, letter dated May 12, 2003 from Commissioner Coleman to Gov. Perdue

- **North Highland was hired to improve GDOT Cash Flow Process**
  
  On September 19, 2002, GDOT hired North Highland to “assist the Cash Forecasting unit in improving its Cash Flow process, identify improvements that will increase the accuracy and timeliness of Cash Flow forecasts, and implement the identified improvements”⁴.

  In a subsequent engagement, GDOT hired North Highland on December 13, 2002 to “define the requirements and implement the first phase of the Cash Forecasting Vision for the Department of Transportation (GDOT)”⁵. **Exhibit 10** lists the objectives of the implementation project per North Highland’s engagement letter.

**EXHIBIT 10**

Scope

The objectives of this project include:

- Definition of requirements for future cash forecasting functionality.
- Analysis and selection of technology tools that can provide this functionality, and
- Implementation of the first phase of the new application that will at least provide the capabilities to model:
  - Construction Phase Projects,
  - Right of Way Phase Projects,
  - Preliminary Engineering for consultant costs and in-house costs, and
  - Inflows from Advanced Construction and Motor Fuel Tax.

Source: North Highland’s “Cash Forecast Definition & Implementation Study” engagement letter dated December 13, 2002

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⁵ “Cash Forecast Definition & Implementation Study” engagement letter dated December 13, 2002.
As indicated above, it appears that upper management’s vision at GDOT included cash flow forecasting its ‘total program’ in addition to SRTA-financed programs.

**Fast Forward replaces GTCl as the State’s transportation initiative**

GTCl was never completed due to the gubernatorial change in January 2003. On July 1, 2004, approximately 18 months after GTCl ended, Fast Forward began. Similar to GTCl, Fast Forward sought to advance the construction of transportation projects through the use of SRTA as a financing vehicle for GDOT.

We found evidence that at the inception of Fast Forward, a balanced funding plan was in place. While Fast Forward was designed to substantially advance the construction of capital outlay projects, we did not find any evidence it was designed to operate outside the boundaries of the Georgia Constitution. To the contrary, as indicated on the year-by-year funding analysis in Exhibit II, Fast Forward was designed to operate within a balanced budget as required by the Georgia Constitution.

**EXHIBIT II**

<table>
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<th>PROGRAM</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tr>
<td>GDOT REGULAR CONSTRUCTION WORK PROGRAM</td>
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</table>

**TOTAL PROPOSED PROGRAM 2005-2010**

$15.57 Billion

GARVEE PROGRAM

GO/GRB PROGRAM

GDOT REGULAR PROGRAM

Costs shown in millions

Source: Governor Sonny Perdue’s April 14, 2004 Press Release
On May 16, 2005, GDOT procured a contract for consulting services for a “Project Funding Review”, which was awarded again to North Highland. This review was requested by the Governor's Office with the intent of documenting GDOT's complicated business processes. The Governor's Office reportedly had expressed great frustration over inconsistent financial information reported by GDOT management/board and their perceived unwillingness to provide complete and accurate financial information. Other objectives of the review included making recommendations for improvement in GDOT's business processes.

In November 2005, a final draft of North Highland's report, titled *GDOT Funding Process Master Document*, was completed. On page 78 of its report, North Highland recommended that GDOT “move further into the development of cash flow forecasting...” North Highland recommends that GDOT expand cash flow forecasting from its SRTA bond program to its ‘total program’. (Exhibit 12 on page 29)

**North Highland warns GDOT of legal restrictions**

As indicated in the last paragraph in Exhibit 12 on page 29, North Highland clearly discloses to GDOT that if it chooses to implement its recommendation of cash flow forecasting its ‘total program’, “legal restrictions on GDOT requiring the availability of the total contract amount at the time of contract award should be changed.”

Based on our investigation, we did not find any evidence that GDOT sought any constitutional or legislative changes prior to implementing this recommendation.
Findings and Recommendations

Cash Management

Similar to other states, such as Florida and Virginia, GDOT should move further in the development of a core business practice of cash flow forecasting and the management of funds based on these forecasts and actual tracking. While GDOT has done a good job in developing this business practice and associated systems support over the past few years, it has been primarily in support of the bond programs and associated projects. This does not include its total program, and few internal GDOT resources are knowledgeable and dedicated to this process. Full development of this practice as a core business function of the Department should result in even greater effectiveness in the use of available funds by focusing Department Management on a greater degree of “real-time” tracking and management of funds and project delivery.

Some of the critical success factors of this change include:

- Rigorous program and project management practices to ensure accurate estimation of dates and dollars for projects, and the on-time and on-budget delivery of projects,
- Systems integration and analysis/reporting capabilities to enable the comprehensive view of current status, account balances and projected funding needs at any given point, and
- Adequate staffing within the Department to manage this process.

Analysis, including the development of a business case, should be undertaken on this recommendation. The business case should determine the one-time and ongoing costs of this change compared to the expected savings and/or increased level of project delivery that can be expected as a result of this business process change.

This would be a fundamental change to core business processes within the Department. It is recommended that some form of parallel effort and phased implementation be conducted between the current cash management process and this new process.

Contract Legislation

Based on the analysis and business case of the previous recommendation, if the decision is reached to pursue this business process change, legal restrictions on GDOT requiring the availability of the total contract amount at the time of contract award should be changed. This would enable GDOT to manage funds needed based on a rigorous projection of its cash flow.
Financial Activity Subsequent to the 2005 North Highland Report

Subsequent to North Highland's issuance of the November 2005 draft report, financial activities at GDOT indicate that management implemented significant business process changes involving its AC Program.

As discussed earlier, GDOT historically maintained AC balances from $400 million to $1.2 billion, based on its long-standing unwritten policy. As indicated in Exhibit 13, GDOT’s AC balances began to significantly increase beyond its normal upper limit of $1.2 billion in FY 06.

EXHIBIT 13

![GDOT Federal AC Balances](image)

Source: Federal Highway Administration’s Fiscal Management Information System

Based on our understanding, GDOT previously limited the amount of AC projects it could enter into because of the Georgia Constitution’s prohibition against debt. This built-in control helped ensure that GDOT did not enter into a contract for which it did not have funds available at the time of the contract. A careful analysis indicates GDOT’s authorized AC balances with FHWA had grown to approximately $3.9 billion as of June 30, 2007. GDOT had obligations of approximately $2.23 billion of the authorized AC balance as of June 30, 2007.

GDOT Treasurer may have Overridden GDOT AC Internal Controls

Despite GDOT’s acknowledgement that it cannot enter into a contract without having sufficient funds at the time of entering into the contract (Exhibit 4 on page 20 and in Exhibit 5 on page 21), it ended FY 2007 with a State Motor Fuel fund deficit of $2.2 billion. This over-obligation appears to be related to cash flowing projects utilizing AC balances well beyond its established AC upper limit of $1.2 billion.
In an interview with Mr. Mahfuz, he indicated that he (the GDOT Treasurer) did not control the financial limits of the GDOT construction program; rather he claimed that the Statewide Transportation Improvement Program (STIP) established such limits.

In separate interviews with former commissioner Harold Linnenkohl, former commissioner Gena Abraham (Evans), board member David Doss, and former board member Mike Evans, each indicated that they relied on the GDOT Treasurer to ensure that GDOT was operating within its financial limitations. Also, in separate interviews, four GDOT employees working under the Treasurer position believed Mr. Mahfuz was responsible for preventing GDOT from obligating more funds than it had available.

We were unable to find any evidence to suggest that the decision to cash flow GDOT’s ‘total program’ in FY 2006 and FY 2007 was an upper management ‘group’ decision. In fact, (then) Deputy Commissioner Buddy Gratton made no mention of ‘cash flow forecasting’ when he described GDOT’s funding process to the Joint Study Committee on Transportation Funding on July 10, 2007. Mr. Gratton rather told the Study Committee, as indicated in Exhibit 4 on page 20, that GDOT could not enter into a contract without having the funds on hand at the time of contract.

We also reviewed GDOT Board minutes and were not able to find any discussion in open meetings suggesting that the Board was officially involved in this apparent decision. However, as will be discussed in greater detail in Question 4 beginning on page 34, board member David Doss indicated that he understood that GDOT had cash flowed projects since 2000 and that he believed that AG Opinion 2001-10 provided GDOT with the legal basis to do so.

**Were additional internal controls disregarded?**

In December 2007, Gena Abraham (Evans) became the GDOT Commissioner. Commissioner Abraham (Evans) was immediately concerned that GDOT was entering into contractual obligations without funds available, thereby violating the Georgia Constitution. Being familiar with the debt principles of the Georgia Constitution, as described on pages 6 and 7 of this report, Commissioner Abraham (Evans) instituted additional internal controls requiring the GDOT Treasurer to sign a written statement for each pending contract indicating that GDOT had ‘funds available’ before she would sign any GDOT contract.

Our investigation found that Mr. Mahfuz, as per the new requirement, did provide in writing to the Commissioner that GDOT had sufficient funds available for each pending contract prior to forwarding the contract to the Commissioner for final execution. Exhibit 14 on page 32 is an example of a signed statement provided to Commissioner Abraham (Evans), in which Mr. Mahfuz certified “funds are allotted and available”. Based on the results of the FY 2008 financial statement audit (statutory basis), we documented that GDOT was in a deficit of at least $839 million at the time he signed the statement (April 9, 2008), shown in Exhibit 14.
suggesting that Mr. Mahfuz may have made false written statements to the Commissioner. The fact that Mr. Mahfuz knew that GDOT was cash-flowing its ‘total program’, which he admitted in an interview (see page 36), at the time he signed the statement further suggests that he may have made false written statements to Commissioner Abraham (Evans) regarding fund availability for the contracts shown in Exhibit 14.

**EXHIBIT 14**

![Project Financial Report](image)

In spite of Commissioner Abraham’s (Evans) directives to bring GDOT back into compliance with the Georgia Constitution, Mr. Mahfuz was apparently still directing cash flow activities over GDOT’s ‘total program’, as documented in an excerpt of an August 28, 2008 email (Exhibit 15 on page 33) from cash flow manager, Larry Landrum. It is important to note that funding source codes 41553 and 41561 corresponds to General Obligation (GO) bond sources, not SRTA bond sources, which further substantiates the fact that GDOT was cash flowing its ‘total program’. 
Conclusion

The decision to cash flow GDOT's 'total program' utilizing its AC program appears to be the cause of the spike in GDOT expenditures in FY 2007. We were unable to find any evidence to suggest that the decision to cash flow GDOT's 'total program' in FY 2006 and FY 2007 was an upper management 'group' decision. We also reviewed GDOT Board minutes and were not able to find any discussion in open meetings suggesting that the Board was officially involved in this apparent decision.

From our understanding of the duties and responsibilities of the GDOT Treasurer, the information we gathered in our investigation, and the lack of direct evidence to the contrary, there are indications that (then) GDOT Treasurer Earl Mahfuz may have been solely responsible for the decision to override GDOT's established (unwritten) AC internal controls in order to cash flow GDOT's 'total program' in FY 2006 and FY 2007.
Question 4

Is ‘Cash Flow Forecasting’ permitted under the Georgia Constitution?

‘Cash Flow Forecasting’ - Definition
‘Cash Flow Forecasting’ is a process by which GDOT maximizes its capacity to enter into contracts while ensuring that it has sufficient cash on hand to pay invoices received from construction contractors and consultants. This GDOT business process disregarded the requirement that State agencies must have the total amount of funds on hand at the time they enter into a contract with a private party (AG Opinion 74-115). In other words, cash flow forecasting’s objective was to make better use of the continually high State Motor Fuel Treasury cash balances and sought to ensure only that GDOT had sufficient cash on hand to pay bills when due.

‘Cash Flow Forecasting’ – Accounting Methodology

Payables/Expenditures
During the time period that GDOT was cash flowing its ‘total program’, we found that it would appropriately record the full amount of each contractual obligation at the time of execution (except for FY 2008 audit finding No. 9). For example, a $60 million contract that would take three years to complete would be recorded in GDOT’s accounting records at the full $60 million at the time of execution.

Receivables/Revenues
As discussed in Finding No. 2 of the GDOT FY 2008 financial statement (statutory basis) audit report, improper revenue recognition criteria were utilized by GDOT during the time period it was cash flowing projects. For example, when GDOT finalized its FY 2007 financial statements, it set up accounts receivables, via journal entry, for amounts it expected to eventually obtain on the unearned portion of executed contracts from other sources (i.e., Federal, GARVEE bond proceeds, G.O. Bond proceeds). At June 30, 2007, however, approximately $2.23 billion of the unearned obligations were advanced construction contracts, meaning that they were to be funded by State Motor Fuel funds until the other funding sources became available at future dates. GDOT has never had $2.23 billion in State Motor Fuel funds on deposit at the State Treasury at any point in time.

For Advanced Construction projects to comply with the Georgia Constitution, sufficient ‘unobligated’ funding was required to be ‘on hand’ at the time the contracts were executed. In order to balance its books as of June 30, 2007, knowing that it did not have sufficient State Motor Fuel funds on hand to cover the AC projects, GDOT accrued revenues/receivables from the other sources (i.e., Federal, GARVEE bond proceeds, G.O. Bond proceeds) beyond the amounts currently available, but up to the amounts it anticipated would be available to them in subsequent fiscal years. These overstated receivables were corrected during the FY 2008 financial statement audit.

AG Opinion 2001-10
In an interview conducted for this investigation, David Doss, a GDOT board member, indicated that he understands that AG Opinion 2001-10 provided GDOT the legal authority to cash flow its ‘total program’. Based on our understanding of AG Opinion 2001-10, we believe that:
• GDOT could legally enter into designated SRTA bond-funded transportation contracts “with all or a portion of the financial backing for the contracts coming from a contractual promise from the State Road and Tollway Authority to borrow and provide money to DOT as and when needed to expend on [the] projects”, as specified in an intergovernmental agreement(s) between SRTA and GDOT; however,

• AG Opinion 2001-10 does not supplant AG Opinion 74-115, which requires the full amount of funds to be on hand at the time of a contract.

During this investigation we learned that GDOT envisioned entering into a monetarily uncapped agreement with SRTA that would provide needed funding in the event that GDOT became over-obligated while cash flowing construction projects. GDOT believed that an uncapped agreement from SRTA to provided funding when needed would remedy any constitutional debt concerns.

During our investigation we obtained and analyzed all known existing agreements between GDOT and SRTA. Based on our analysis, none of the agreements appeared to be uncapped, rather they were all for specified dollar amounts. See Exhibit 16 for a listing of the GDOT/SRTA agreements pertaining to bond issuances.

**EXHIBIT 16**

| Georgia Department of Transportation/State Road and Tollway Authority Agreements |
|:---:|:---:|:---:|:---:|:---:|
| Form of Agreement | Dates Signed | Issuance* Date | Type | Total Bond Issuance Amount |
| Joint Resolution | November 15, 2001 | December 1, 2001 | GRB Series 2001** | 350,000,000 $ |
| Joint Resolution | September 10, 2003 | October 1, 2003 | GRB Series 2003 | 309,140,000 $ |
| Joint Resolution | June 15, 2006 | August 8, 2006 | GARVEE Series 2006*** | 450,000,000 $ |
| Joint Resolution | February 21, 2008 | April 15, 2008 | GARVEE Series 2008 | 600,000,000 $ |
| Intergovernmental Agreement | June 30, 2008 | March 4, 2009 GARVEE Series 2009 | 600,000,000 $ |

* - TRUST INDENTURE DATE
** - GUARANTEED REVENUE BONDS
*** - GRANT ANTICIPATED REVENUE BONDS
**** - Intergovernmental agreement between GDOT and SRTA corresponds to GARVEE Series 2009 bond sale on March 4, 2009.

**Is Cash Flow Forecasting Permitted?**

It does not appear AG Opinion 2001-10 provides for ‘Cash Flow Forecasting’ of SRTA bond projects as GDOT has claimed. Regarding SRTA bond projects:

1. GDOT could enter into contractual obligations after it had obtained a “promise to pay” from SRTA in an intergovernmental agreement. This option did not relieve GDOT of exercising good cash management practices. GDOT should have minimized the amount of time between paying a contractor for services performed and drawing reimbursement from SRTA.

2. GDOT could advance construct designated SRTA bond projects with available State Motor Fuel Funds until such time as it had obtained a “promise to pay” from SRTA in an intergovernmental agreement.
As previously discussed, we also found evidence that GDOT began cash flowing its ‘total program’ in FY 2006/2007. In addition to SRTA bond funds, the ‘total program’ includes State Motor Fuel Funds, G.O. Bond Funds, and Federal Program Funds. ‘Cash Flow Forecasting’ is deemed to be improper in that it results in unconstitutional debt to the State of Georgia.

In our investigation, we did not find that GDOT publicly disclosed that it had transitioned its operation to cash flow forecasting. Rather, we found that GDOT continued to assert, even during the time when it was apparently cash flowing the ‘total program’, that it was required to have funds on hand at the time it entered into any contract as per the Georgia Constitution and AG Opinion 74-115 (See Exhibit 4 on page 20).

Our investigation found the following with regard to GDOT’s implementation of cash flow forecasting for its ‘total program’:

- We were unable to find discussion of this change in business process in any GDOT Board minutes.

- Gena Abraham (Evans) told us that she had never heard of ‘cash flow forecasting’ as a business process at GDOT in spite of serving as the GDOT commissioner from December 1, 2007 until February 26, 2009.

- Board member David Doss told us that he believed that GDOT had been cash flowing its ‘total program’ since 2000, a business process that he frequently referred to during the FY 2008 financial audit as the ‘accrual basis’. It is important to note that the time period mentioned by Mr. Doss is prior to the release of AG Opinion 2001-10, which was issued on December 14, 2001.

- In an initial interview, former Treasurer Earl Mahfuz told us that GDOT did cash flow its SRTA bond programs, but did not admit to cash flowing GDOT’s ‘total program’. However, in a subsequent interview conducted on July 2, 2009, Mr. Mahfuz admitted that GDOT was cash flowing its ‘total program’ during FY 2006/2007.

- Former Treasurer Earl Mahfuz told us that State of Georgia Chief Financial Officer Thomas Hills was aware that GDOT had been cash flowing projects. However, when interviewed Mr. Hills indicated to us that he was not familiar with the process of cash flowing projects.
Question 5

Were there other attempts to mislead the public about GDOT’s financial position at June 30, 2007 or 2008?

Our objective of this investigation was to seek, find and report the truth regarding GDOT’s financial position. During the course of this investigation, we obtained and reviewed thousands of email messages; inspected many computer hard drives/network files; and conducted numerous interviews of GDOT employees (present and former), members of the Governor’s staff (present and former), and others.

As previously discussed, this investigation initially focused on three primary areas of concern not fully addressed in the FY 2008 financial statement audit. The three areas were:

1. The causes of the spike in 2007 expenditures/deficit fund balances
2. Submission of improper budget amendments
3. Unrecorded contracts and supplemental agreements

As we pursued these three primary areas subject to our investigation, we became acutely aware that factual and transparent accounts of GDOT’s financial position were not always presented. In fact, we became aware of certain cases in which the truth about certain matters was well concealed and was difficult for us to obtain.

We found two primary areas in which we believe the truth was concealed regarding GDOT’s financial position:

1. GDOT’s financial position as of May 31, 2007 was materially misrepresented to the Joint Study Committee on Transportation Funding.

2. Two FY 2007 budget amendments were submitted by GDOT and approved by the Office of Planning and Budget (OPB) after the end of the fiscal year, which concealed a massive budget over-expenditure.

Presentation to the Joint Study Committee on Transportation Funding

On July 10, 2007, (then) Deputy Commissioner Buddy Gratton made a presentation to the Joint Study Committee on Transportation Funding. Mr. Gratton’s presentation was an overview of the transportation funding process in Georgia.

Most of the information Mr. Gratton presented to the Study Committee was an accurate account of the many ‘moving parts’ involved in GDOT’s finances. In fact, Mr. Gratton’s account of the funding processes was consistent with positions taken by the Department of Audits and Accounts regarding critical accounting matters raised during the FY 2008 financial statement audit in spite of the fact that certain GDOT Board Members have publicly disagreed with some of our accounting positions.

Despite correctly describing individual components of GDOT’s funding processes, Mr. Gratton presented a materially inaccurate financial statement to the Joint Study Committee
regarding GDOT’s State Motor Fuel balances. This analysis, shown in **Exhibit 17**, purportedly was a measure of GDOT’s State Motor Fuel balance as of May 31, 2007.

**EXHIBIT 17**

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<td>Amounts to Reserve for Encumbrances by Type</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Motor Fuel Encumbrances</td>
<td>487,421,989.49</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Fund Encumbrances</td>
<td>19,619,007.74</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Advanced Construction Encumbrances</strong></td>
<td><strong>365,194,200.00</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Reserve for Encumbrances</strong></td>
<td><strong>872,235,187.29</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserve for payments made in Advance of Reimbursements (Maximum)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SRTA - Average Billing in FY 2007</td>
<td>12,705,293.62</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GSFiC - Average Billing in FY 2007</td>
<td>24,701,327.71</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal - Average Billing in FY 2007</td>
<td>37,200,871.55</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Billings - Highest Billing in FY 2007</td>
<td>221,973.87</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Reserve for Future Reimbursements</strong></td>
<td><strong>74,375,485.75</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTALS OF ACCOUNTS</strong></td>
<td><strong>1,086,373,447.59</strong></td>
<td><strong>947,071,284.04</strong></td>
<td><strong>139,302,263.55</strong></td>
</tr>
</tbody>
</table>

* Note: These funds will be used for current operating expenses and current year contracts.

Source: Mr. Buddy Gratton’s PowerPoint Presentation July, 10, 2007 – Slide No. 20

A careful analysis of **Exhibit 17** indicates that the “Advanced Construction Encumbrances” amount was reported as $365,194,200; however, GDOT had actually incurred obligations (encumbrances) on approximately $1.53 billion of its authorized AC balance, which was in excess of $3 billion as of May 31, 2007. If the correct AC encumbrance balance had been used in this analysis, GDOT’s financial position would have reflected a large deficit. When confronted with this material misstatement of fact to the Joint Study Committee, Mr. Gratton informed us that this Financial Statement, as well as the PowerPoint slides, had been prepared by personnel of the Financial Section under the control of Treasurer Earl Mahfuz. Mr. Gratton also informed us that he had not confirmed any of the amounts included in the Financial Statement for accuracy before using them in his presentation; however, he assumed the amounts were correct. Rather than a positive fund balance of $139 million as reflected above, GDOT was actually in a $1.79 billion deficit (approximate). See **Exhibit 18** on page 39 for further details.

Mr. Gratton’s presentation was an accurate account of the manner in which GDOT was supposed to operate. He made no reference, however, to Cash Flow Forecasting even though Mr. Mahfuz admitted that GDOT was cash flowing its ‘total program’ during FY 2006 and 2007 (see page 34). Therefore, Mr. Gratton’s presentation was a misleading account of the
manner in which GDOT was actually operating.

In our final interview with Mr. Mahfuz, we questioned him about the inconsistency of Mr. Gratton's presentation with the actual manner of GDOT's operations. Mr. Mahfuz claimed that he had never seen or reviewed the presentation, including the misleading financial statement (Exhibit 17 on page 38) in spite of the fact that he was in charge of coordinating the agenda of the Joint Study Committee.

Information we obtained confirms that Mr. Mahfuz attended Mr. Gratton's presentation. In his presentation (and in his notes to the first slide), Mr. Gratton recognized Mr. Mahfuz's financial expertise and indicated that Mr. Mahfuz would be available to answer any questions he could not answer. When questioned why he did not correct the misinformation being presented to the Joint Study Committee, Mr. Mahfuz stated that he may have left the meeting room during the presentation or perhaps was inattentive.

2007 Budget Amendments
Based on additional analysis of FY 2007 activity, we conclude that GDOT's expenditures would have exceeded its budget without the submission of two invalid budget amendments. As indicated in Exhibit 18, GDOT first entered into a budget deficit during December, 2006.

EXHIBIT 18

<table>
<thead>
<tr>
<th>Month</th>
<th>Approved Budget</th>
<th>YTD Expenditures</th>
<th>(Over) / Under Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>July-2006</td>
<td>$1,850,000,106</td>
<td>$442,046,219</td>
<td>$1,407,953,887</td>
</tr>
<tr>
<td>August-2006</td>
<td>(1) 1,850,363,345</td>
<td>602,605,688</td>
<td>1,247,757,657</td>
</tr>
<tr>
<td>September-2006</td>
<td>1,847,956,177</td>
<td>885,192,315</td>
<td>962,763,862</td>
</tr>
<tr>
<td>October-2006</td>
<td>1,847,956,177</td>
<td>1,180,842,583</td>
<td>667,113,594</td>
</tr>
<tr>
<td>November-2006</td>
<td>1,847,956,177</td>
<td>1,682,451,285</td>
<td>165,504,892</td>
</tr>
<tr>
<td>December-2006</td>
<td>1,847,956,177</td>
<td>2,003,572,247</td>
<td>(155,616,070)</td>
</tr>
<tr>
<td>January-2007</td>
<td>1,847,956,177</td>
<td>2,370,886,252</td>
<td>(522,930,075)</td>
</tr>
<tr>
<td>February-2007</td>
<td>1,847,956,177</td>
<td>2,566,169,092</td>
<td>(718,212,915)</td>
</tr>
<tr>
<td>March-2007</td>
<td>1,847,956,177</td>
<td>3,064,335,226</td>
<td>(1,216,379,049)</td>
</tr>
<tr>
<td>April-2007</td>
<td>1,847,956,177</td>
<td>3,280,603,485</td>
<td>(1,432,647,308)</td>
</tr>
<tr>
<td>May-2007</td>
<td>1,847,956,177</td>
<td>3,642,069,790</td>
<td>(1,794,113,613)</td>
</tr>
<tr>
<td>June-2007</td>
<td>(3) 1,910,037,782</td>
<td>5,131,944,756</td>
<td>(3,221,906,974)</td>
</tr>
<tr>
<td>Close Out Period (July-2007)</td>
<td>5,394,868,142</td>
<td>5,134,829,472</td>
<td>260,038,670</td>
</tr>
</tbody>
</table>

**GDOT FY 2007 Restated Revenues and Expenditures**

| Audit Adjusted Close Out (July-2007) | 3,006,130,083 | 5,134,829,472 | $ (2,128,699,389) |

(1) Amendment # 1 totaling $363,239 was submitted to OPB by GDOT on 8/15/2006
(2) Amendment # 2 submitted to OPB by GDOT on 9/11/2006 reduced the Approved Budget by $2,407,168
   Amendment # 3 was submitted to OPB by GDOT on 9/12/2006 to move amounts between object classes, net effect was zero
(3) Amendment # 4 totaling $62,081,605 was submitted to OPB by GDOT on 6/4/2007
(4) Amendment # 5 totaling $1,945,172,957 was submitted to OPB by GDOT on 7/2/2007
   Amendment # 6 totaling $1,539,657,403 was submitted to OPB by GDOT on 7/25/2007
   Amendments #5 and #6 combined total for Close Out Period (July-2007) was $3,484,830,360
   State Accounting Office adjustment increased expenditures by $2,884,716
(5) Audit adjustment to GDOT's revenue due to a $2,388,738,059 overstatement of its Prior Year Federal Receivable.

Furthermore, GDOT had overspent its budget authority by approximately $3.2 billion as of June 30, 2007. Subsequent to June 30, however, budget amendments #5 (submitted 07/02/07) and #6 (submitted 07/25/07) were submitted by GDOT and approved by the OPB, thereby
ANNUAL OPERATING BUDGET (AOB) AMENDMENT — Revisions to the annual operating budget must be submitted to OPB for approval. Typically, these revisions are due to the receipt of funding not included during the appropriations process, or the transfer of funds from one activity/function to another.

The two invalid amendments exceeded actual funds available that GDOT could obligate by $2,388,738,059. In total, amendments #5 and #6 increased GDOT’s AOB by 182%. Exhibit 19 on page 41 graphically depicts the relationship between GDOT’s AOB increase and its expenditures.

Our investigation revealed that the two amendments consisted primarily of “prior year Federal funds”. However, the Federal Highway Administration confirmed that the amount of unobligated money submitted in the two amendments did not exist.

retroactively increasing GDOT’s obligation authority by $3,484,830,360. Exhibit 18 also provides a detailed analysis of GDOT’s fiscal year 2007 budget amendments and expenditures.
GDOT FY 2007 Budget Amendment and Expenditure Analysis

Amendments Made After Fiscal Year End (FYE) 6/30/2007
- Budget Amendment #5 on 7/10/2007 for $1,945,172,957
- Budget Amendment #6 on 7/26/2007 for 1,539,657,403

Approved Budget At FYE 6/30/2007: $1,910,037,782
Total Amended Budget At FYE 6/30/2007: $5,394,868,142

GDOT’s Expenditures exceed the Budget
In our discussion with GDOT staff, we learned that the normal budget process began by setting an AOB at the beginning of the year; however, GDOT divisions frequently operated outside of their individual budgets. Consequently, budget overages at the end of the fiscal year, if any, would commonly be cured by amending in “prior year Federal funds”. GDOT’s Budget Office reported to us that it never confirmed with the Federal Highway Administration that such funds were actually available before submitting amendments.

OPB is authorized to approve agencies’ budget amendments when additional Federal or Other Funds become available during the course of the fiscal year. OPB either approves or denies the amendment request after conducting its review. OPB’s review procedures, however, do not constitute an audit of each request. At the time GDOT submitted its invalid budget amendments, the OPB review process relied on a certain level of “trust” in the submitting agency. Through the submission and approval of amendment #5 and #6, GDOT appeared to meet the State of Georgia Constitutional requirements of ending the year with a balanced budget.

In our interview with Tim Connell, former Director of the OPB, the timing (after fiscal year-end) and amounts of the submitted amendments were not typical of the traditional amendment process.

As a result of the invalid budget amendments, the June 30, 2007 federal accounts receivable balance was overstated by $2,388,738,059.41.
Question 6

What were the consequences of the unauthorized change in business process to ‘Cash Flow Forecasting’ during FY 2006/2007?

GDOT’s unauthorized change in business process during FY 2006/2007 to ‘Cash Flow Forecasting’ impacted 4 main areas:

1. GDOT Treasury Cash Balances
2. Interest Earnings on GDOT Treasury Cash Balances
3. Invalid Budget Amendments/Accounts Receivable
4. Risk to the State’s Financial Stability

1. GDOT Treasury Cash Balances

Large cash balances are an important indicator that GDOT is operating within the confines of the Georgia Constitution. As indicated in Exhibit 20, GDOT maintained large cash balances, with year-end (June 30) balances generally increasing year over year through fiscal year 2005.

EXHIBIT 20

Given the Constitutional requirements regarding the prohibitions against debt, GDOT is expected to maintain large cash balances because its construction projects typically take 2 to 4 years on average to complete. At June 30 of each fiscal year, GDOT cash balances are substantially committed to on-going projects, and, therefore, are not available for obligation for new projects.

On July 10, 2007, Deputy Commissioner Buddy Gratton addressed the Joint Study Committee regarding GDOT’s cash balances at the State Treasury. Mr. Gratton’s comments are in agreement with the Department of Audits and Accounts’ position that GDOT will maintain large cash balances because they are required to have the funds on hand for all executed contracts. Exhibit 21 on page 44, shows a PowerPoint slide (with accompanying Notes) from Mr. Gratton’s presentation where he indicated that GDOT’s Treasury cash balance generally fluctuated from $800 million to $1.2 billion.
EXHIBIT 21

Treasury Balance

- GDOT projects often span more than a single fiscal year because of the nature of the Department’s planning, designing, and constructing of roads and bridges.

- The average payout schedule for a construction project is 39 months.

So, because our projects span multiple FY years due to our type of work activities and because we are required to have the funds on hand for all active contracts, there will always be a balance in the treasury. Typically, the balance will fluctuate from $800 million to $1.2 billion and from the lettings that we have had the last 2 years, it is anticipated that this number will grow.

Source: Mr. Buddy Gratton’s PowerPoint Presentation July, 10, 2007 – Slide No. 19

We also concur with Mr. Gratton’s remarks that large lettings equate to increased cash balances at the State Treasury, assuming GDOT is complying with the Georgia Constitution. On the date (July 10, 2007) Mr. Gratton made this remark to the Joint Study Committee, GDOT’s approximate cash balance at the State Treasury was $1.027 billion. In the 10 months following Mr. Gratton’s remarks, the Treasury cash balance did not increase as he indicated; rather, it declined sharply. (See Exhibit 22 on page 45) The decline depicts the ‘draining effect’ unfunded construction contracts have on GDOT’s cash balances at the State Treasury.
While we conclude that GDOT appears to have inappropriately cash flowed its ‘total program’, we do not believe that it did so very proficiently based on comments made by GDOT’s cash flow manager, Larry Landrum.

In an “interdepartment correspondence” we found on Mr. Landrum’s GDOT computer dated September 22, 2006, Mr. Landrum summarizes GDOT’s cash flow status. See Exhibit 23 on page 46 for selected excerpts of Mr. Landrum’s remarks.

Also, Exhibit 24 on page 47 provides a view of GDOT’s cash balances from FY 2002 through FY 2008. This graph shows the rapid decline in GDOT’s cash balances that occurred during FY 2006, 2007 and 2008. Given the inexperience and technical difficulties in cash flowing it’s ‘total program’, as described by Larry Landrum, it is conceivable that GDOT could have run out of cash or been unable to pay its contractors for work completed in a timely manner.
Attached you will find some of the papers I have developed to assist in the defining of the need for cash forecasting, the basic requirements, the current status of CFF, and instructions of how to update the mapping tables.

**Excerpt:**

Cash Flow Forecasting (CFF) never lived up to its billing due to the requirement that the various data it relied upon was not actively maintained.

**Excerpt:**

Recommendations:

1. Need for a Cash Forecast Team - The concept of cash flow management and forecasting is still an alien concept to the Department. For decision making purposes, cash forecasting and utilization management requires timely and accurate information.

**Excerpt:**

A cash forecasting and utilization section is required to manage all the inputs needed to provide a magic crystal ball into the future that is at best cloudy, but is better than none at all.

**Excerpt:**

2. It still takes analysis of the data and the output by skilled financial personnel to derive the “best guess” of the future based on many factors that can be derived by the data and even the inconstancy of the data.

Source: GDOT Interdepartment Correspondence dated September 22, 2006
FY 1998 - FY 2008

Source: Cash Disbursements to Contractors - GDOT's Transport System.

Source: Cash Equivalents/On-hand at OTFS (State Appropriation Balance) - FY 1998 - FY 2005 is from the Report of the State Auditor (ROSA) and FY 2006 - FY 2008 is from the Budgetary Compliance Report (BCR). ROSA name changed to BCR in FY 2006.

EXHIBIT 24

FY 2002 - FY 2008

Source: Referenced in Graph

What if...
2. Interest Earnings on GDOT Cash Balances

Large cash balances are an important indicator of GDOT’s compliance with the Georgia Constitution and interest earnings on these balances provide a significant revenue stream for GDOT.

As provided by the Georgia Constitution, interest earnings on State Motor Fuel funds on deposit at the State Treasury, under the control and supervision of GDOT, are defined as State Motor Fuel revenues. These interest earnings are calculated and subsequently appropriated, as provided by the Georgia Constitution, for the purpose of providing and maintaining an adequate system of public roads and bridges.

Cash balances in fiscal years 1998 through 2005 showed steady increases, with year-end balances near or well above the $1 billion mark. In FY 2005, GDOT’s average monthly balance at the State Treasury was $1.4 billion. As indicated in Exhibit 24 on page 47, GDOT’s cash balances, however, began a sharp decline in FY 2006, with amounts dropping to as low as approximately $341 million in FY 2008. It is our estimation that had GDOT complied with the Georgia Constitution during FY 2006 and FY 2007, its average cash balances would have equaled or exceeded $1.4 billion in fiscal years 2006 to date.

The decreases in GDOT’s State Motor Fuel cash balances, due to the improper changes in its business processes and untimely reimbursements from SRTA as previously discussed resulted in significant damage to this important GDOT revenue stream. Because GDOT’s current cash balances at the State Treasury are still well below the amounts it should be maintaining, GDOT continues to lose State Motor Fuel interest revenue. Based on the actual monthly rates of interest earned on funds invested at the State Treasury from July 1, 2005 through April 30, 2009, we estimate that GDOT has lost a significant amount of interest earnings. Exhibit 25 is a summary of our conservative estimate of the interest earnings lost:

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Interest Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2006</td>
<td>$6,419,343.21</td>
</tr>
<tr>
<td>FY 2007</td>
<td>27,059,932.11</td>
</tr>
<tr>
<td>FY 2008</td>
<td>41,024,239.51</td>
</tr>
<tr>
<td>FY 2009 (through April 30, 2009)</td>
<td>37,065,131.56</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$111,568,646.39</strong></td>
</tr>
</tbody>
</table>

The estimated losses of State Motor Fuel interest revenues of approximately $111 million through April 30, 2009 are funds that could have been available to fund GDOT road/bridge construction projects. Had these funds been available for use in FY 2009, they could have greatly minimized the recent budget cuts, such as regular operating expenditures.

Interest earned on SRTA Bond Proceeds at the State Treasury

Our investigation also determined that SRTA bond proceeds were invested at the State Treasury and earned approximately $40.2 million in interest earnings from July 1, 2005 through April 30, 2009. Had GDOT drawn reimbursements from SRTA in a timely manner during this time period, a portion of the $40.2 million in interest earnings would have been earned in the State Motor Fuel accounts. Interest earned on the SRTA bond (GARVEE) proceeds is restricted for use only on SRTA bond (GARVEE) projects upon approval by FHWA. However, had GDOT drawn reimbursements from SRTA in a timely manner, the
additional interest earnings would have been available for State Motor Fuel projects (roads and bridges).

3. Invalid Budget Amendments/Accounts Receivable

The Georgia Constitution requires that the State operate under a balanced budget. In keeping with this requirement, budget units of the State of Georgia, such as GDOT, cannot legally overspend their budgets. Cash flowing GDOT’s operation, except for the limited form of cash flowing SRTA Bond Projects, as described in Question 4 beginning on page 34, is contrary to basic fiscal principles of the Georgia Constitution, which requires that all contractual agreements be backed by available funds at the time the contract is signed.

When the GDOT Treasurer made an apparent decision to cash flow its ‘total program’, its expenditures increased exponentially, which prompted the submission of invalid budget amendments to avoid the appearance of a budget over-expenditure in FY 2007. Cash flowing its ‘total program’ also prompted the recording of invalid Federal revenues/accounts receivable in FY 2007, which gave the appearance, on its statutory financial statements, that GDOT had a positive fund balance when, it was actually in a budgetary deficit.

4. Risk to the State’s Financial Stability

Georgia is one of only seven States to receive a Aaa bond rating from the three major bond rating agencies. Adherence to the Constitution’s conservative fiscal policies by the State has maintained its top bond rating. Material violations of the Constitution’s conservative policies could potentially jeopardize Georgia’s Aaa bond rating.

Over an approximate two year span (primarily FY 2006 and FY 2007), GDOT operated outside of the financial boundaries of the Georgia Constitution. GDOT should not have cash flowed its ‘total program’ in the absence of the adoption of an appropriate Constitutional amendment to allow multi-year financial obligations, as was recognized by North Highland (See Exhibit 12 on page 29).

During FY 2008 and FY 2009, the non-compliance with the Georgia Constitution was identified and corrective actions are being implemented by GDOT.
Question 7

Where did the cash go?

Our investigation revealed that the large increases in GDOT cash disbursements in FY 2006 through FY 2008 went primarily to construction contractors. As indicated in Exhibit 26 on page 51, FY 2008 cash disbursements reached an all-time high, exceeding $2.1 billion, a 25% increase over FY 2007 disbursements. FY 2008 increase in cash disbursements can be partly attributable to the effects of Fast Forward, but is primarily the result of excessive obligations entered into with construction contractors during FY 2007.

A deeper analysis of GDOT’s cash disbursements over the past seven years revealed that from FY 2002 through FY 2005 payments to construction contractors were spread somewhat evenly among the top five contractors. That trend, however, began to change in FY 2006 with three contractors separating themselves from the others. This trend continued to become more exaggerated in FY 2007 and FY2008. As indicated on Exhibit 27 on page 51, the top three construction contractors in terms of cash disbursements received from GDOT during FY 2008 were as follows:

1. C.W. Matthews – $525,199,914.50
2. Archer-Western – $220,725,921.50
3. E.R. Snell - $161,837,934.71
EXHIBIT 26

Cash Disbursements to Contractors FY 2002 - FY 2008

Source: Cash Disbursements to Contractors - GDOT’s Transport System.

EXHIBIT 27

GDOT’s Top Five FY 2002 - FY 2008

Source: GDOT’s Transport System
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The State Government Division (SGD) of the Department of Audits and Accounts (DOAA) is responsible for planning and performing financial and compliance audits, as well as other procedures relating to the issuance of:

**State of Georgia Comprehensive Annual Financial Report (CAFR)**
**State of Georgia Single Audit Report**
**State of Georgia Budgetary Compliance Report**

Pursuant to O.C.G.A. 50-6-4, the SGD performs *special examinations* at the request of the Governor, the Appropriations Committee of the House of Representatives, or the Appropriations Committee of the Senate. The SGD also conducts *investigations* pursuant to O.C.G.A. 50-6-28.

The SGD coordinates the publication of the annual compilation reports:

*Salaries and Travel Supplements*
*Professional Services Supplements*