

STATE OF WEST VIRGINIA

FULL PERFORMANCE EVALUATION OF THE

**Department of Transportation
Division of Highways**

**Division of Highways Should Consider
Using Electronic Fund Transfer to Pay Vendors,
Which Could Potentially Save the State Money
and Eliminate the Potential for Fraud**

**OFFICE OF LEGISLATIVE AUDITOR
Performance Evaluation and Research Division
Building 1, Room W-314
State Capitol Complex**

**CHARLESTON, WEST VIRGINIA 25305
(304) 347-4890**

August 2001

PE001-11-210

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August 2001

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John Sylvia
Director

August 19, 2001

The Honorable Edwin J. Bowman
State Senate
129 West Circle Drive
Weirton, West Virginia 26062

The Honorable Vicki V. Douglas
House of Delegates
Building 1, Room E-213
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0470

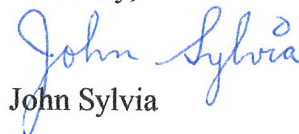
Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a draft copy of the Full Performance Evaluation of the Department of Transportation, *Division of Highways*, which will be presented to the Joint Committee on Government Operations on Sunday, August 19, 2001. The issue covered herein is the "Division of Highways Should Consider Using Electronic Fund Transfer to Pay Vendors, which could Potentially Save the State Money and Eliminate the Potential for Fraud."

We delivered draft copies to the Department of Transportation and the Division of Highways; State Auditor's Office; Treasurer's Office; and the Department of Administration. We conducted exit conferences with the agencies between July 31, 2001 and August 3, 2001. We received the Division of Highways response on July 31, 2001.

Let me know if you have any questions.

Sincerely,


John Sylvia

JS/wsc

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Executive Summary

The Division of Highways within the Department of Transportation is responsible for planning, engineering, right-of-ways acquisition, construction, reconstruction, traffic regulation and maintenance of more than 34,000 miles of state roads. Additional duties include highway research, outdoor advertising contiguous to state roads, roadside development, safety and weight enforcement and dissemination of highway information.

The Division of Highways currently sends all payments to vendors and reimbursement for employee travel by drafting paper checks, and then delivering the check to the individual. Due to advances in technology, Electronic Fund Transfer (EFT) offers the Division of Highways many advantages over its current process. These benefits include cheaper transaction costs, savings on postage, elimination of mail delays and losses, limited need for stop payments, reduced account reconciliation, and greatly reduces fraud. **The Legislative Auditor estimates that the Division of Highways could save from \$47,920 to \$78,300 by using EFT rather than a paper warrant.**

Review Objective, Scope and Methodology

The Full Performance review of the West Virginia Division of Highways is required and authorized by the West Virginia Sunset Law, Chapter 4, Article 10, Section 4 of the West Virginia *Code*, as amended. The Division of Highways is responsible for planning, engineering, right-of-ways acquisition, construction, reconstruction, traffic regulation and maintenance of state roads.

The **objective** of this review was to determine the extent to which the Division of Highways could save money by utilizing Electronic Transfer of Funds. The **scope** of this report examined current costs and potential savings for the Division of Highways in the use of electronic funds transfer.

The **methodology** included interviews with staff of the Division of Highways, the West Virginia Treasurer's Office, as well as the West Virginia Auditor's Office. This performance evaluation complied with **Generally Accepted Government Auditing Standards**.

Issue 1: The Division of Highways Should Consider Using Electronic Fund Transfer to Pay Vendors, Which Could Potentially Save the State Money and Eliminate the Potential for Fraud.

The Division of Highways currently sends all payments to vendors and reimbursement for employee travel by drafting a paper check, and then delivering the check to the individual. Other than direct deposits of employee paychecks and payments to other state agencies, payments by the Division are made through this method. Electronic Fund Transfer (EFT) has advanced in the past few years to allow for the transfer of funds from bank account to bank account without the use of a paper check. Utility companies, credit card companies, and others have begun to use EFT for its convenience and cost savings. **The Legislative Auditor estimates that the Division of Highways could save from \$47,920 to \$78,300 by using EFT rather than a paper warrant.**

Currently, the West Virginia Treasurer's Office uses Electronic Fund Transfer by depositing state employee's wages into their bank account via direct deposit. This is not only a convenience to state employees by not having to visit their financial institution, but it also ensures employees that their wages will be available on payday and eliminates the potential for lost checks. According to the Treasurer's Office, which used information prepared in a 2000 National Automated Clearing House Association report, there are many advantages to the use of EFT rather than a paper check, which are as follows:

- **Cheaper Transaction Cost** - The Federal Reserve Bank determined the average cost of a check at \$3.00 and the cost of an EFT at \$1.47 (\$1.53 savings). While the actual costs will differ from entity to entity, there is a cost savings.
- **EFT Costs Less to Send and Receive** - No printing costs, no postage costs, and reduced bank fees on the sending side. No mail or checks to deposit on the receiving end.
- **Elimination of Mail Delays and Losses** - Companies can control when vendors receive payments using the funds settlement date in the system and no lost check issues.
- **Limited Stop Payments** - 95% of stop payments in the State are due to lost checks - this is a costly and time-consuming process.
- **Reduced Account Reconciliation** - With no outstanding checks all payments are settled on a specific day.
- **Fraud** - Payment directly to bank eliminates the potential for diversion.

Opinions from State Agencies

The Legislative Auditor contacted three state entities that are involved in Electronic Fund Transfer for their opinion on whether EFT is beneficial. Agencies providing responses were: the State Auditor; the Department of Administration; and the Treasurer's Office. Each entity stated that EFT would save the state money over the drafting of a paper check, in addition to other benefits.

Following are excerpts of comments made by each entity:

Treasurer's Office

"It is our opinion that there are substantial cost savings when payments are made by EFT."

State Auditor's Office

"The cost to the State for drafting a paper check is anecdotal at best. While the cost of the paper warrant is negligible, the equipment and personnel to produce paper warrants including the signing, sealing and postage by the State Treasurer's Office, is significantly greater."

"...there are tremendous soft dollar savings by converting to EFT. First of all, the infrastructure already exists to take any file and create electronic warrants. To that end, I do not believe that there would be any additional costs to convert the Division of Highways."

Regarding the elimination of fraud, the Auditor's Office stated:

"The fraudulent activities associated with paper checks are completely eliminated with EFT. No more lost or stolen checks or the need for reissue as a result thereof."

Department of Administration

"Given the state's volume of checks, EFT could represent a significant savings to the State."

"Regarding fraud, EFT would eliminate the opportunity for a check to be diverted to an unauthorized party."

Thus, with the opinions of these divisions of state government, the Legislative Auditor has determined that the Division of Highways could benefit by switching to EFT. Other than convenience and other benefits, the two biggest advantages to EFT are cost savings and the elimination of fraud, which will be discussed below.

Cost Savings

All three state entities interviewed stated that there would be a cost savings by using EFT, although there was some difference in estimating how much. Each entity estimated that the cost of producing a paper check was \$3.00. These estimates were gathered from the National Automated Clearing House Association and the Federal Reserve Bank. The Department of Administration and the State Treasurer both estimated that the cost of an EFT is \$1.47 per payment, which is a savings of \$1.53 per payment, while the State Auditor estimated that the cost of an electronic warrant is \$0.50 per transaction which is a \$2.50 savings per transaction. As of May 31, 2001, the Division of Highways has drafted 31,320 vendor checks for FY2001. Assuming that the \$3.00 per transaction cost for drafting a paper warrant is accurate, the cost for 31,320 checks would be \$93,960. The estimated total cost for 31,320 EFT's with the \$1.47 per payment would be \$46,040 for an estimated savings of \$47,920. With the State Auditor's estimate, the savings would be \$78,300 (Estimated savings are displayed in Table 1). While the Legislative Auditor does not know the **exact** savings of EFT, opinions and estimates of three separate state entities do show that the Division of Highways could cut the cost of their payment processing at least in half.

Table 1
Estimates of EFT Savings

	Paper Warrant	EFT Estimate by Treasurer and Dept. of Administration	EFT Estimate by State Auditor
Number of payments	31,320	31,320	31,320
Cost per payment	\$3.00	\$1.47	\$0.50
Total Cost	\$93,960	\$46,040	\$15,660
Total Savings		\$47,920	\$78,300

Elimination of Potential Fraud

Electronic Fund Transfer as mentioned previously eliminates the potential for fraud. In 1997, the Division of Highways experienced fraudulent activities due to paper check processing. An employee of the Division created false invoices totaling over \$40,000. The employee along with his spouse opened a false bank account, and intercepted the checks before they could be mailed to an actual vendor. The employee obtained \$28,000 before the scheme was discovered by the Commission on Special Investigations. **Electronic Fund Transfer would have prevented this fraudulent activity from occurring.** The U.S. Department of the Treasury reported that EFT is safer because in 1997 the federal government experienced \$60 million in forged checks, \$2 million

in counterfeit checks, and \$3 million in altered checks. EFT lessens the number of individuals involved in the processing of checks. In addition, "special handling" checks which are requested by state agencies are not mailed to the vendor but returned to the agency and then made available to the vendor. The potential for fraud is high with these kind of transactions, and was identified in a February 2000 report for the Department of Administration by Ernst & Young as substantially increasing the risk of fraud. The report stated that in a seven month period, 21% of vendor checks were designated special handling, and recommended that the use of special handling checks be significantly reduced because of the potential increase for fraud. While the potential for fraud by individuals submitting fake invoices would probably not be eliminated by EFT, the potential for someone diverting a paper check into their personal account would be diminished. With the high dollar transactions that the Division of Highways is paying contractors and other vendors, the Legislative Auditor recommends that the Division consider EFT to eliminate potentially fraudulent activities.

Conclusion

Electronic Fund Transfer has the potential to not only save the Division of Highways and the State of West Virginia money in its vendor payment processing, but also eliminate the potential of some fraudulent activities. Three state agencies involved directly in the payment process - the State Auditor, the Treasurer's Office, and the Department of Administration - have opined that there are advantages to EFT, and provided estimates on the cost savings. The Legislative Auditor estimates that according to figures provided by the State Auditor's Office, the Division of Highways could save as high as 80% with EFT over the use of paper check warrants.

Recommendation 1:

The Legislative Auditor recommends that the Division of Highways consider the use of Electronic Fund Transfer in the payment of vendors.

APPENDIX A:

**Transmittal Letters to: Department of Transportation and Division of
Highways; State Auditor's Office; State Treasurer's Office; and
Department of Administration**

WEST VIRGINIA LEGISLATURE
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John Sylvia
Director

July 25, 2001

Fred Van Kirk, P.E., Cabinet Secretary
West Virginia Department of Transportation and
Commissioner of the Division of Highways
Building 5, Room A-109
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0430

Dear Mr. Van Kirk:

This is to transmit a draft copy of the Full Performance Evaluation of the Department of Transportation, Division of Highways. If you have questions related to factual errors or need clarification on any part of the report, please let me know at the Exit Conference scheduled for July 31, 2001 at 10:00 A.M., in our Conference Room W-330. We would appreciate your written response by August 3, 2001 in order for it to be included in the final report.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Denny Rhodes".

Denny Rhodes
Senior Research Analyst

JS/wsc

c: Danny Ellis, Business Manager
Division of Highways

Joint Committee on Government and Finance

WEST VIRGINIA LEGISLATURE
Performance Evaluation and Research Division

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Charleston, West Virginia 25305-0610
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John Sylvia
Director

July 31, 2001

Glen B. Gainer, III, State Auditor
State Auditor's Office
Building 1, Room W-100
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0230

Dear Mr. Gainer:

This is to transmit a draft copy of the Full Performance Evaluation of the Department of Transportation, Division of Highways. The Exit Conference is scheduled for August 1, 2001 at 10:00 A.M., in our office. We would appreciate your written response by August 8, 2001 in order for it to be included in the final report.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Denny Rhodes".

Denny Rhodes
Senior Research Analyst

DR/wsc

c: Ross Guyer

Joint Committee on Government and Finance

WEST VIRGINIA LEGISLATURE
Performance Evaluation and Research Division

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1900 Kanawha Boulevard, East
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John Sylvia
Director

August 2, 2001

John D. Perdue, State Treasurer
State Treasurer's Office
Building 1, Room E-145
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305

Dear Mr. Perdue:

This is to transmit a draft copy of the Full Performance Evaluation of the Department of Transportation, Division of Highways. If there are questions concerning this evaluation, they can be addressed at the Exit Conference scheduled for August 2, at 10:00 A.M., in your office. We would appreciate your written response by August 8, 2001 in order for it to be included in the final report.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Denny Rhodes".

Denny Rhodes
Senior Research Analyst

DR/wsc

Joint Committee on Government and Finance

WEST VIRGINIA LEGISLATURE
Performance Evaluation and Research Division

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John Sylvia
Director

August 2, 2001

Gregory A. Burton, Cabinet Secretary
Department of Administration
Building 1, Room E-119
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0120

Dear Mr. Burton:

This is to transmit a draft copy of the Full Performance Evaluation of the Department of Transportation, Division of Highways. If there are questions concerning this evaluation, they can be addressed at the Exit Conference scheduled for August 2, at 4:00 P.M., in your office. We would appreciate your written response by August 8, 2001 in order for it to be included in the final report.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Denny Rhodes".

Denny Rhodes
Senior Research Analyst

DR/wsc

c: Dorothy V. Yeager, Deputy Secretary

Joint Committee on Government and Finance

APPENDIX B

Agency Response



WEST VIRGINIA
DEPARTMENT OF TRANSPORTATION
1900 Kanawha Boulevard East • Building Five • Room 109
Charleston, West Virginia 25305-0440 • 304/558-0444

Bob Wise
Governor

Fred VanKirk, P. E.
Secretary/Commissioner

July 31, 2001

Mr. Denny Rhodes
Performance Evaluation and Research Division
Building 1, Room W 314
1900 Kanawha Boulevard East
Charleston, West Virginia 25303-0610

Dear Mr. Rhodes:

In response to your draft audit report, the Division of Highways agrees that electronic fund transfer of payments to vendors is more cost effective than the present method of issuing and mailing state warrants. We also agree that it would reduce the potential for fraud.

Attached is a November 29, 2000 letter from myself to Aaron Allred stating our agreement with the benefits of electronically transferring payments to vendors, but also explaining that the State of West Virginia does not have a system in place to make such payments electronically. To our knowledge, the State is not yet able to pay vendors electronically. We request that this letter be incorporated into the audit report as an attachment.

If you have any questions or need additional information, please contact me at 558-2811.

Sincerely,

A handwritten signature in black ink, appearing to read "Danny Ellis".

Danny Ellis
Business Manager

DE:kw

Attachment



WEST VIRGINIA DEPARTMENT OF TRANSPORTATION
Division of Highways

1900 Kanawha Boulevard East • Building Five • Room 110
Charleston, West Virginia 25305-0430 • 304/558-3505

Cecil H. Underwood
Governor

Samuel H. Beverage, P. E.
Acting Secretary
Commissioner of Highways

November 29, 2000

Thomas F. Badgett
Assistant Commissioner

Mr. Aaron Allred
Legislative Auditor
Building 1, Room E-132
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610

Dear Aaron:

As a result of our November 29, 2000 meeting, the Department of Transportation is considering a policy to limit the number of special handled checks that are returned to the Department for further distribution. Under this policy vendor's checks and employee's expense checks would be mailed by the Treasurer's Office, rather than returned to Transportation. Checks for right-of-way acquisition and those concerning legal matters would continue to be special handled as would any other checks with special circumstances.

Although this proposed policy change should not pose a hardship on our employees and the vendor community, we do anticipate some protest from those who routinely choose to pick up their checks rather than have them mailed to their homes or offices. If the State could electronically transfer the money to vendor's bank accounts, the payments would be received promptly and, in our opinion, vendors would no longer choose checks as a means of payment. This would not only ensure quicker payments to the vendors, but would be more cost effective than printing, handling and mailing checks.

We understand that the State Auditor and Treasurer Offices have begun work on an electronic transfer of funds project; however, we are unaware of any timetable for project implementation. Any assistance your office could provide on expediting this project would be appreciated. If you need further information, please contact me at 558-2811.

Sincerely,

Danny Ellis
Business Manager

DE:Fv

RF