

O L A

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Transportation
Fiscal Year Ended June 30, 2006



March 23, 2007

07-09

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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If you have comments about our work, or you want to suggest an audit, investigation, or evaluation, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

Department of Transportation

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Laura Peterson, CPA	Audit Coordinator
Carl Otto, CPA, CISA	Team Leader

Exit Conference

We discussed the results of the audit with the following staff of the Department of Transportation at an exit conference held on March 15, 2007:

Lisa Freese	Deputy Commissioner
Rick Arnebeck	Division Director
Kevin Gray	Division Director
Terry Lemke	Office of Finance
MnDOT Office of Audit:	
Daniel Kahnke	Audit Director
Larry Kienitz	Internal Audit Manager
Dave Christensen	Principal Auditor
Dave Wolvert	Internal Audit Supervisor

Report Summary

Audit Findings:

- The department did not follow certain project oversight procedures.
(Finding 1, page 4)
- The department did not correctly code certain highway construction costs as nonparticipating in federal funding.
(Finding 2, page 5)

The report contained two findings relating to federal legal compliance. The department resolved two of four findings included in our prior audit report and one is repeated in this report.

Audit Scope:

Programs material to the State of Minnesota's financial statements and to federal program compliance for fiscal year 2006

Selected Audit Areas:

- Infrastructure and Right of Way - Capital Outlay
- Federal Highway Construction and Planning Grants (CFDA #20.205)
- Federal Airport Improvement Grants (CFDA #20.106)

Background:

The Department of Transportation maintains over \$7.3 billion in state highway infrastructure and right of way assets. During the fiscal year ended June 30, 2006, expenditures for infrastructure and right of way were \$452 million and \$110 million, respectively. These costs are funded in part by federal grant funds.



OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Carol Molnau, Lieutenant Governor/Commissioner
Department of Transportation

We have performed certain audit procedures at the Department of Transportation (MnDOT) as part of our audit of the basic financial statements of the State of Minnesota as of and for the year ended June 30, 2006. We relied, in part, on the work of the MnDOT Office of Audit to ensure the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that were applicable to the department for the year ended June 30, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States. We emphasize that this has not been a comprehensive audit of the Department of Transportation.

The Department of Finance is primarily responsible for statewide financial reporting. The department prepares the *Comprehensive Annual Financial Report* that contains the state's basic financial statements and our opinion on those statements. The Department of Finance also annually prepares the *Minnesota Financial and Compliance Report of Federally Assisted Programs*. This report provides the federal government with information about the state's use of federal funds and its compliance with federal program requirements. The report includes the results of our audit work, conclusions on the state's internal controls over and compliance with federal programs, and findings about control and compliance weaknesses detected.

Table 1 identifies the financial activities within the department that were material to the state's financial statements. We performed certain audit procedures on the department programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2006, were free of material misstatements.

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Table 1
Department of Transportation
Programs Material to the State's Financial Statements
Fiscal Year 2006 (in thousands)

<u>Assets:</u>	<u>Amount</u>
Infrastructure	\$5,965,253
Right of Way	1,335,403
<u>Expenditures:</u>	
Infrastructure Capital Outlay	451,935
Right of Way Capital Outlay	110,010

Source: *State of Minnesota's Comprehensive Annual Financial Report* for fiscal year 2006 and the Minnesota Accounting and Procurement System.

Table 2 identifies the State of Minnesota's major federal programs administered by the Department of Transportation. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with federal requirements. We performed our work in conjunction with the MnDOT Office of Audit.

Table 2
Major Federal Programs Administered by MnDOT
Fiscal Year 2006 (in thousands)

<u>Program Name</u>	<u>CFDA</u> ^(Note 1)	<u>Expenditures</u>
Highway Planning and Construction	20.205	\$488,847
Airport Improvement Grants	20.106	\$ 79,246

Note 1: The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs.

Source: Minnesota Accounting and Procurement System for fiscal year 2006.

Conclusions

We issued an unqualified audit opinion,¹ dated December 14, 2006, on the State of Minnesota's basic financial statements for the year ended June 30, 2006. In accordance with Government Auditing Standards, we also issued our report, dated December 14, 2006, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. Our audit work at the Department of Transportation discovered errors in the department's process for determining additions to infrastructure and right of way capital asset balances. Because the Department of Finance is primarily responsible for the state's financial reporting process, we included this

¹ An unqualified audit opinion means that we concluded that the state fairly presented its financial data in its basic financial statements.

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concern in our report to the Department of Finance issued in March 2007 ([Legislative Audit Report #07-04](#)).

Except for the following findings, the Department of Transportation complied with and had controls to ensure compliance with certain provisions of laws, regulations, contracts, and grants applicable to its major federal programs for fiscal year 2006.

1. Prior Audit Finding Partially Resolved: The Department of Transportation did not adequately follow certain project oversight procedures.

The MnDOT Office of Audit's federal compliance report for fiscal year 2006 identified various concerns and issues where project management oversight could be strengthened or improved. The MnDOT Office of Audit's report also describes some best practices for making improvements in compliance from the previous fiscal year. The office identified the following issues for the federal Highway Planning and Construction Program (CFDA #20.205), based on 21 highway construction projects audited:

- Although improvements were noted, compliance with state and federal environmental requirements was a continuing problem. Documented weekly inspections of erosion control effectiveness are required for permit coverage under the National Pollutant Discharge Elimination System. MnDOT Office of Audit identified nine projects where contractors did not complete and submit all required permit inspection logs to project personnel every two weeks as required. The MnDOT Office of Audit also identified five projects where retainage from contractor payments were not withheld to ensure erosion control. For two projects involving building demolitions, notices of intent to perform a demolition were not submitted to the Minnesota Pollution Control Agency, and formal inspections of building materials were not documented as required, and for a third project, the notice was submitted late. For the above projects, the MnDOT Office of Audit's report questioned \$165,000.
- The MnDOT Office of Audit recommended additional management attention for bituminous and concrete production documentation and materials testing requirements. The report indicated that some testing and documentation requirements were not met or not properly documented for six bituminous projects.² For these projects, the MnDOT Office of Audit's report questioned \$4,241,000. In addition, the MnDOT Office of Audit questioned \$4,890,000 for two projects in which concrete testing requirements were not followed.

² The unmet requirements related to supporting quality control/quality assurance issues, testing summary sheets, paving restrictions, ticket information, and plant diaries.

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Recommendation

- *The department should continue to strengthen its project oversight procedures to ensure compliance with federal and state requirements.*

2. The department erroneously coded a payment under a supplemental agreement as participating in federal funding.

The MnDOT Office of Audit's federal compliance report for fiscal year 2006 identified a supplemental agreement payment of \$1.9 million that was inappropriately charged to the Highway Planning and Construction Program on August 31, 2005. The supplemental agreement was coded as participating in federal funding when, in fact, it should have been coded as nonparticipating in federal funding. Department files clearly showed that the \$1.9 million should have been coded as nonparticipating. However, the error was not corrected until September 18, 2006, after MnDOT Office of Audit identified the error.

Recommendation

- *The department should ensure that highway construction costs are charged to the proper funding source.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Transportation. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 23, 2007.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: February 2, 2007

Report Signed On: March 19, 2007

Status of Prior Audit Issues
As of February 2, 2007

March 16, 2006, Legislative Audit Report 06-12 examined the department's activities and programs material to the *State of Minnesota's Comprehensive Annual Financial Report* and the Single Audit for the year ended June 30, 2005. The scope included the state's infrastructure and right of way assets and capital outlay expenditures for infrastructure and right of way, federal highway construction grants (CFDA #20.205), and federal airport improvement grants (CFDA #20.106). The report contained four findings. The department resolved two issues concerning compliance with material testing requirements for the Airport Improvement Program and reconciling federal billings to the Federal Highway Administration's project status reports. The department did not fully resolve two issues: The first issue, concerning working with the Department of Finance to accurately report infrastructure assets in the state's financial statements, is addressed in Finding 4 of our current audit report to the Department of Finance (Legislative Audit Report 07-04). The second issue, concerning improvement in certain project oversight procedures, is repeated as Finding 1 in our current report.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as the metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.



March 15, 2007

James R. Nobles
Legislative Auditor
100 Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles,

Thank you and your staff for taking the time to review the audit report for fiscal year ended June 30, 2006. My staff and I appreciate your work and are committed to satisfactory resolution of the Findings. Following are Mn/DOT's responses to your findings and recommendations.

Finding 1 – Prior Audit Finding Partially Resolved: The Department of Transportation did not adequately follow certain project oversight procedures.

Auditor's Recommendation: The department should continue to strengthen its oversight procedures to ensure compliance with federal and state requirements.

Response: This finding deals primarily with issues of erosion control, permit compliance, asbestos abatement, and building demolition. To date, several actions have occurred, among them:

- District Construction staff will emphasize the importance of correct use of logs with all project personnel and with the contractor during pre-construction conferences.
- Compliance with environmental regulations was reviewed at various construction staff meetings.
- Letters have been sent to district field personnel to clarify understanding of the requirements of NPDES permits.
- Districts conducted reviews of procedures for inspections of bridges for hazardous materials.
- Mn/DOT's Office of Environmental Services will be conducting a follow-up to help resolve this issue.
- Preparation and distribution of a memo reminding district staff of the importance of compliance with environmental requirements.

Responsible People: Rick Arnebeck, Engineering Services Division Director; Robert Winter, Operations Division Director.

Implementation Date: Spring 2007 and on-going.

Finding 2- The department erroneously coded a payment under a supplemental agreement as participating in federal funding.

Auditor's Recommendation: The department should ensure that highway construction costs are charged to the proper funding source.

Response: Mn/DOT's Finance Office along with the Construction Office have met and determined an approach that will ensure that supplemental agreements will be correctly classified as participating/non-participating on all construction payments. Procedures will be written as to how federal supplemental agreements should be handled in the future to prevent a re-occurrence of this issue.

Responsible Person: Kevin Z. Gray, Finance and Administration Division Director.

Implementation: January 2007, (The procedures will be completed and implemented by July 2007.

Thank you for the opportunity to respond to your findings and recommendations. Mn/DOT continues through a variety of means to keep abreast of requirements and procedures and to ensure communication to responsible individuals at all level. We will be monitoring the implementation of these recommendations. Please contact Terry Lemke at 651-366-4876 for follow-up information and activity.

Sincerely,

/s/ Carol Molnau

Carol Molnau
Lieutenant Governor/Commissioner of Transportation