

Financial Audit Division Report

**Minnesota Department of
Transportation
Federal Program Compliance
Year Ended June 30, 2007**



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



Financial Audit Division Report

**Minnesota Department of
Transportation
Federal Program Compliance
Year Ended June 30, 2007**

March 28, 2008

08-13

FINANCIAL AUDIT DIVISION

Centennial Building – Suite 140

658 Cedar Street – Saint Paul, MN 55155

Telephone: 651-296-4708 • Fax: 651-296-4712

E-mail: auditor@state.mn.us • Web site: <http://www.auditor.leg.state.mn.us>

Through Minnesota Relay: 1-800-627-3529 or 7-1-1

Minnesota Department of Transportation Federal Program Compliance

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Audit Participation

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

Cecile Ferkul, CPA, CISA
Tom Donahue, CPA

Deputy Legislative Auditor
Audit Manager

Exit Conference

We discussed the results of the audit with the following staff of the Minnesota Department of Transportation at an exit conference held on March 17, 2008:

Robert McFarlin
Lisa Freese
Kevin Gray
Julie Skallman
Scott Peterson
Mary Prescott
Daniel Kahnke
Larry Kienitz

Acting Commissioner
Deputy Commissioner
Division Director, Finance & Administration
Division Director, State Aid
Director, Office of Finance
Manager, Fiscal & Administrative Services
Audit Director
Auditor Principal Supervisor

Department of Transportation Federal Program Compliance

Report Summary

Conclusion:

The Minnesota Department of Transportation (MnDOT) generally complied with federal requirements for the administration of federal programs. However, the department had some weaknesses in its internal controls and compliance with federal financial activity, which resulted in the following findings repeated from our prior audit report:

Findings:

- MnDOT did not adequately follow certain project oversight procedures. ([Finding 1, page 4](#))
- MnDOT erroneously coded change orders as participating in federal funding. ([Finding 2, page 5](#))

Audit Scope:

Programs material to the State of Minnesota's financial statements and to federal program compliance for fiscal year 2007:

- 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 Minnesota Department of Transportation maintains over \$7.7 billion in state highway infrastructure and right of way assets. During the fiscal year ended June 30, 2007, expenditures for infrastructure and right of way were \$404 million and \$94 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

Mr. Robert McFarlin, Acting Commissioner
Minnesota Department of Transportation

We have preformed certain audit procedures at the Minnesota 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, 2007. 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 *Circular A-133 Compliance Supplement* that were applicable to the department for the year ended June 30, 2007. 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 MnDOT.

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 on 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, 2007, were free of material misstatements.

Minnesota Department of Transportation

Federal Program Compliance

Table 1
Programs Material to the State's Financial Statements
Fiscal Year 2007 (in thousands)

<u>Assets:</u>	<u>Amount</u>
Infrastructure	\$6,351,250
Right of Way	\$1,426,450
<u>Expenditures:</u>	
Infrastructure Capital Outlay ¹	\$ 403,537
Right of Way Capital Outlay ¹	\$ 94,321

¹The capital outlay amounts include ancillary type costs, such as realtor fees and temporary easements.

Source: State of Minnesota's *Comprehensive Annual Financial Report* for fiscal year 2007 and the Minnesota Accounting and Procurement System.

Table 2 identifies the State of Minnesota's major federal programs administered by MnDOT. 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. Our work was performed in conjunction with the MnDOT Office of Audit.

Table 2
Major Federal Programs Administered by MnDOT
Fiscal Year 2007 (in thousands)

<u>Program Name</u>	<u>CFDA</u>	<u>Expenditures</u>
Federal Highway Construction and Planning Grants	20.205	\$587,995
Federal Airport Improvement Grants	20.106	\$ 70,598

Source: Minnesota Accounting and Procurement System for fiscal year 2007.

Conclusions

We issued an unqualified audit opinion, dated December 7, 2007, on the State of Minnesota's basic financial statements for the year ended June 30, 2007. In accordance with *Government Audit Standards*, we also issued our report, dated February 11, 2008, 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 MnDOT noted that the department was not identifying adjustments to capital outlay expenditures and providing those adjustments in the amounts reported to the Department of Finance. Because the Department of Finance is primarily responsible for the state's financial reporting process, we included this concern in our report to the Department of Finance, issued in February 2008 (Legislative Audit [Report 08-02](#)).

Minnesota Department of Transportation Federal Program Compliance

MnDOT generally 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 2007. However, the department had the following weaknesses:

1. Prior Audit Finding Not Resolved: MnDOT did not adequately follow certain project oversight procedures.

The MnDOT Office of Audit's federal compliance report for fiscal year 2007 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 Construction and Planning Grants Program (CFDA 20.205), based on 19 highway construction projects audited:

- The MnDOT Office of Audit continues to report concerns over materials control. Three of its six findings address a lack of planning, conducting, or documenting the testing of concrete, bituminous, or grading and base materials to ensure they will perform as designed. A total of 12 out of 19 state projects audited were cited for issues related to materials control. The report identified one project concerning concrete production documentation and materials testing requirements; five projects concerning bituminous production documentation and materials testing requirements; and ten projects concerning grading and base production documentation and materials testing requirements. For the above projects, the MnDOT Office of Audit's report questioned approximately \$15.6 million.
- Although some best practices were noted, compliance with state and federal environmental requirements is a continuing problem. MnDOT Office of Audit identified environmental concerns in 68.4 percent or 13 of 19 state projects it reviewed. For example, the MnDOT Office of Audit identified eight projects where contractors did not complete and submit all required erosion control inspection logs to project personnel every two weeks. The MnDOT Office of Audit also identified six projects where MnDOT project personnel did not withhold retainage from contractor payments to ensure erosion control. For one asbestos disposition project and two lead paint removal and disposition projects, MnDOT Office of Audit determined that supporting documentation was not available in project files and could not be located. For the above projects, the MnDOT Office of Audit's report questioned \$469,000.
- MnDOT Office of Audit also questioned one project where seven executed change orders reflecting a net reduction in payments (credit) of \$1.5 million to MnDOT were not applied at the time the change orders were executed. For another project, the audit report questioned \$1.3 million spent for repairs on a newly milled bituminous road after being driven on by bituminous delivery trucks and milling machines.

Minnesota Department of Transportation Federal Program Compliance

Recommendation

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

2. Prior Audit Finding Not Resolved: MnDOT erroneously coded change orders as participating in federal funding.

The MnDOT Office of Audit's report for fiscal year 2007 identified payments totaling \$579,000 for four change orders that were coded as participating in federal funding and should have been coded as nonparticipating in federal funding. Department files clearly showed that the \$579,000 should have been coded as nonparticipating in federal funding.

Recommendation

- *The department should ensure that highway construction costs are coded correctly.*

This report is intended for the information of the Legislative Audit Commission and the management of the Minnesota Department of Transportation. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 28, 2008.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Minnesota Department of Transportation Federal Program Compliance

Status of Prior Audit Issues As of February 1, 2008

March 23, 2007, Legislative Audit Report 07-09 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, 2006. 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 two findings. Finding 1, concerning improvement in certain project oversight procedures, is repeated as Finding 1 in our current report. Finding 2, concerning erroneous coding of payments as participating in federal funding, is repeated as Finding 2.

Other Office of the Legislative Auditor Coverage

November 28, 2007, Legislative Audit Report 07-32 was an investigative report that examined the travel and state-paid expenses of MnDOT's former director of homeland security and emergency management. That report contained two findings. The first finding identified \$11,500 of unauthorized, unreasonable, or inappropriate expenses charged to the state and \$14,500 in salary costs that should have been recorded as personal leave. The second finding concerned the department's lack of supervision over its former director, resulting in state expenses unnecessarily incurred.

February 19, 2008, Legislative Audit Report – State Highways and Bridges, February 2008 was a program evaluation report in which we examined recent trends in the condition of state highways and bridges and evaluated how the Minnesota Department of Transportation has responded. We found that highway surfaces have deteriorated, construction costs have escalated rapidly, and the department has not allocated sufficient resources to maintenance and preservation.



Minnesota Department of Transportation

Office of the Commissioner
395 John Ireland Boulevard, M.S. 110
St. Paul, MN 55155-1899

Office: 651-366-4800
Fax: 651-366-4795

March 18, 2008

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

Dear Mr. Nobles:

My thanks to you and your staff for reviewing the audit report for the fiscal year ended June 30, 2007. My staff and I appreciate your efforts and we are committed to satisfactory resolution of the findings. Following are Mn/DOT's responses to your findings and recommendations.

Finding 1 – Prior Audit Findings Not Resolved: Mn/DOT did not adequately follow certain project oversight procedures.

Auditor's Recommendation – Mn/DOT should continue to strengthen its project oversight procedures to ensure compliance with federal and state requirements.

Mn/DOT's Response: Mn/DOT recognizes the importance of following project oversight procedures and the necessity of complying with federal and state regulations. In addition to being responsible for its transportation projects, Mn/DOT is also responsible, through the State Aid for Local Transportation (SALT) division, for sub-recipient monitoring of city and county projects as well. Strengthening project oversight procedures is a continuous, ongoing effort within the agency. Some of the actions we are implementing in response to this finding include the following.

Materials Control, Environmental Compliance:

- Just-in-time training for cities and counties to identify potential risk areas that may arise.
- SALT communications to cities and counties communicating non-compliance issues and reinforcing the need to comply.
- Training of district staff in the importance of material control testing and reporting.
- Reinforcement of best practices regarding material control and environmental requirements (lead paint removal) issues.
- Contractor hired additional staff to deal with erosion control.

Responsible People: Robert Winter, Operations Division Director; Rick Arnebeck, Engineering Services Division Director; Julie Skallman, State Aid for Local Transportation Division Director.

J. Nobles
March 18, 2008
Page Two

Implementation: March 2008 (and on-going)

Finding 2 – Prior Audit Finding Not Resolved: Mn/DOT erroneously coded change orders as participating in federal funding.

Auditor's Recommendation: The department should ensure that highway construction costs are coded correctly.

Mn/DOT's response: Mn/DOT's Office of Finance relies on payment vouchers to describe costs as participating or non-participating. Change orders should have been coded as non-participating but were coded as participating.

Actions implemented in response to this finding include:

- Office of Construction and Innovative Contracting (OCIC) has developed a process to ensure that design-build projects are properly coded as federal participating/non-participating.
- Supplemental agreements and design-build change orders will be properly coded for participation based on reasonableness and necessity of costs in accordance with A-133 Compliance Supplement.

Responsible People: Robert Winter, Operations Division Director; Rick Arnebeck, Engineering Services Division Director; Kevin Gray, Finance and Administration Division Director.

Implementation: March 2008. The process created by OCIC is developed and will be implemented for the upcoming construction season.

Through a variety of means Mn/DOT continues to keep abreast of requirements and procedures and works to ensure effective communications to responsible individuals at all levels (state, city, county, and when appropriate, the private sector). We will continue to monitor the implementation of these recommendations. Please contact Terry Lemke at 651-366-4876 for follow-up information.

Sincerely,

/s/ Robert J. McFarlin

Robert J. McFarlin
Acting Commissioner