



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Transportation
Fiscal Year Ended June 30, 2004



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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All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

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:

| | |
|------------------------|----------------------------|
| Claudia Gudvangen, CPA | Deputy Legislative Auditor |
| Tom Donahue, CPA | Audit Manager |
| Laura Peterson, CPA | Auditor-in-Charge |
| George Deden, CPA | Senior Auditor |
| Patrick Phillips, CPA | Senior Auditor |
| Nisha Bhattarai | Intern |

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 7, 2005:

| | |
|-----------------|---------------------------|
| Carol Molnau | Commissioner |
| Douglas Differt | Deputy Commissioner |
| Scott Peterson | Office of Finance |
| Terry Lemke | Office of Finance |
| Denny Herzog | Financial Reporting |
| Michael Hagerty | Budget Director |
| Dan Kahnke | Director, Office of Audit |
| Larry Kienitz | Office of Audit |

Report Summary

Audit Findings:

- The department was unable to provide the appropriate type of required infrastructure budgetary information to the Department of Finance for inclusion in the state's annual financial statements. (Finding 1, page 3)
- The department should improve certain project oversight procedures. (Finding 2, page 4)

The audit report contained two audit findings relating to the state's *Comprehensive Annual Financial Report* and legal compliance. The department resolved two of the three 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 2004.

Selected Audit Areas:

- Infrastructure and Right of Way: Capital Outlay
- County State-Aid Highway Grants
- Municipal State-Aid Highway Grants
- Fuel & Motor Vehicle Tax Distributions
- Federal Highway Planning and Construction Grants (CFDA #20.205)
- Federal Airport Improvement Grants (CFDA #20.106)

Background:

The Department of Transportation maintains over \$6.4 billion in state highway infrastructure and right of way assets. During the fiscal year ended June 30, 2004, expenditures for infrastructure and right of way were \$504 million and \$80 million, respectively. These costs are funded in part by federal grant funds.



Senator Ann H. Rest, Chair
 Legislative Audit Commission

Members of the Legislative Audit Commission

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

We have preformed 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, 2004. 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's (OMB) *Circular A-133 Compliance Supplement* that were applicable to the department for the year ended June 30, 2004. We emphasize that this has not been a comprehensive audit of the Department of Transportation.

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's 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, 2004, were free of material misstatements.

Table 1
Department of Transportation
Programs Material to the State's Financial Statements
Fiscal Year 2004 (in thousands)

| <u>Assets:</u> | <u>Amount</u> |
|--|---------------|
| Infrastructure | \$5,113,949 |
| Right of Way | 1,130,977 |
| <u>Expenditures:</u> | |
| Infrastructure Capital Outlay ⁽¹⁾ | 504,287 |
| Right of Way Capital Outlay ⁽¹⁾ | 79,993 |
| County State-Aid Highway Grants | 413,991 |
| Municipal State-Aid Street Grants | 141,921 |
| <u>Transfers:</u> | |
| Fuel & Motor Vehicle Tax Distribution | 1,324,964 |

(1) The capital outlay amounts include ancillary type costs.

Source: State of Minnesota's *Comprehensive Annual Financial Report* and the Minnesota Accounting and Procurement System for fiscal year 2004.

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

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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 2004 (in thousands)

| <u>Program Name</u> | <u>CFDA</u> | <u>Expenditures</u> |
|-----------------------------------|-------------|---------------------|
| Highway Planning and Construction | 20.205 | \$492,592 |
| Airport Improvement Grants | 20.106 | \$ 67,812 |

Source: Minnesota Accounting and Procurement System for fiscal year 2004.

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.

Conclusions

We issued an unqualified audit opinion, dated November 19, 2004, on the State of Minnesota's basic financial statements for the year ended June 30, 2004. In accordance with *Government Auditing Standards*, we also issued our report, dated November 19, 2004, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. In March 2005, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our financial statement audit work and the federal compliance review performed by the MnDOT Office of Audit, we identified an internal control weakness over financial reporting and instances of noncompliance with federal regulations, which we discuss in the following findings.

- 1. The department was unable to provide the appropriate type of required infrastructure budgetary information to the Department of Finance for inclusion in the state's annual financial statements.**

The Department of Transportation (MnDOT) did not identify annual budgeted amounts for infrastructure preservation and maintenance measured on the same basis as actual costs. Instead, the department used its State Transportation Investment Plans (STIP) to provide the estimated budgetary amounts. These amounts represented budgeted expenditures for construction projects starting in the current year and expected to be completed over future years. The actual amounts, on the other hand, represented current year costs for construction projects that MnDOT may have budgeted for in prior years.

The Governmental Accounting Standards Board (GASB) Statement 34 requires entities using the modified approach for reporting infrastructure to present a five-year comparison between the

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estimated annual amount to maintain and preserve their infrastructure assets and the actual amounts expensed during each of these five years. This information is presented in the Required Supplemental Information (RSI) section of the state's annual financial report. The Department of Finance and MnDOT acknowledged that the budgetary amounts did not provide a meaningful comparison to the actual amounts and added the following explanation to the RSI:

Mn/DOT projects may span several years. Project costs are budgeted in the first year but spent throughout the life of the project. This process does not allow an accurate comparison of the amounts budgeted and spent within the fiscal year due to funding carryover between two or more fiscal years. Therefore, this timing difference does not allow a true comparison of amounts budgeted and spent within a given year.

However, by not providing an accurate comparison of the budget to actual amounts, the data in the RSI does not comply with the intent of the GASB requirement.

Recommendation

- *The Department of Transportation should work with the Department of Finance to develop budgetary information that is measured on the same basis as actual expenditures for the preservation and maintenance of infrastructure assets.*

2. Prior Audit Finding Not Resolved: The department should improve certain project oversight procedures.

The MnDOT Office of Audit single audit report for fiscal year 2004 identified various concerns and issues where project management oversight could be strengthened or improved. The office identified the following issues for the federal Highway Planning and Construction Program (CFDA #20.205), based on 20 highway construction projects audited.

- The MnDOT Office of Audit recommended additional management attention for bituminous and concrete materials testing requirements. The report indicated that some testing requirements were not met or not properly documented for six bituminous projects and two concrete projects. The report also noted five projects in which testing results fell outside of specification tolerances and required retests, which should have been performed, but were not. One project had 11 instances where testing results fell outside specification tolerances and retests were not performed.
- MnDOT Office of Audit identified three projects where district state engineers inappropriately signed seven delegated contract process project supplemental agreements. These projects were supervised and administered by counties, and the district state engineers should not sign the delegated contract process project supplemental agreements.

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- Compliance with state and federal environmental requirements is a continuing problem. Documented weekly inspections of erosion control effectiveness are required for permit coverage under the National Pollutant Discharge Elimination System. The MnDOT Office of Audit report indicated that required documentation for weekly inspections of erosion control effectiveness were not met for 8 of 18 construction projects reviewed. Also, testing and documentation requirements were not met for two bridge lead paint blasting residue projects.
- The MnDOT Office of Audit identified one city project in which the projects quality control/quality assurance language appeared contrary to federal regulations. The project language appeared to require contractors to perform quality assurance verification testing. Federal regulations require that verification sampling and testing be performed by the department, not the contractor or vendor.

Recommendation

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

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 17, 2005.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

End of Fieldwork: January 25, 2005

Report Signed On: March 14, 2005

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

Department of Transportation

Status of Prior Audit Issues As of January 25, 2005

March 19, 2004, Legislative Audit Report 04-17 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, 2003. The scope included the state's infrastructure, right of way land, trunk highway federal revenue, county highway and municipal street state-aid grants, federal county road and bridge grants, federal airport improvement grants, and federal nonurbanized area formula transit grants. The report contained three findings, two of which have been resolved. Prior audit Finding 2, concerning improvement in certain project oversight procedures, is shown as Finding 2 in our current report.

Most Recent Audit

August 26, 2004, Legislative Audit Report 04-34 focused on the department's central office and its activities over professional/technical service contract expenditures and use of permanently assigned state vehicles for the period July 1, 2000, through June 30, 2003. The report contained four audit findings. We did not follow up on any of these issues during our current audit.

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.



Minnesota Department of Transportation

Transportation Building
395 John Ireland Boulevard
Saint Paul, Minnesota 55155-1899

March 14, 2005

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 summary audit findings regarding infrastructure budgetary information and oversight procedures. My staff and I appreciate your effort and we are committed to satisfactory resolution of the findings. Following is a list of Mn/DOT staff that will be responsible for working to resolve your findings.

Finding 1 – The department was unable to provide the appropriate type of required infrastructure budgetary information to the Department of Finance for inclusion in the state’s annual financial statements. (This is a national issue that may not lend itself to quick resolution. Mn/DOT’s efforts may involve researching other states’ practices.)

Auditor’s Recommendation: The Department of Transportation should work with the Department of Finance to develop budgetary information that is measured on the same basis as actual expenditures for preservation and maintenance of infrastructure assets.

Responsible People: Kevin Z. Gray, Finance and Administration Division Director; Scott Peterson, Finance Office Director; in conjunction with, as yet, unnamed staff from the Department of Finance.

Resolution Date: March 2005 begin resolution actions.

Finding 2 – Prior Audit Finding Not Resolved: The department should improve certain oversight procedures. (Increasing numbers of projects at all levels (state, city, county), increasing complexity of work, and evolving requirements are an on-going challenge. Mn/DOT continues through a variety of efforts to keep abreast of requirements and procedures and ensure communication to responsible individuals at all levels.)

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

Responsible People: Robert Winter, District Operations Division Director; Richard Stehr, Engineering Services Division Director; Julie Skallman, State Aid for Local Transportation division Director.

Resolution Date: January 2005 and on-going.

Thank you for the opportunity to respond to your audit. We will be monitoring the progress to resolve your findings. Please contact Terry Lemke at 651-296-7070 for follow-up information and activity.

Sincerely,

/s/ Carol Molnau

Carol Molnau
Lieutenant Governor/Commissioner of Transportation

cc: Doug Differt, Kevin Gray, Bob Winter, Richard Stehr, Julie Skallman, Marthand Nooklala, Dan Kahnke