
Financial Audit Division Report

Department of Transportation
Fiscal Year 2005

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.

This document can be made available in alternative formats, such as large print, Braille, or audio tape, by calling 651-296-1235 (voice), or the Minnesota Relay Service at 651-297-5353 or 1-800-627-3529.

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

Table of Contents

	Page
Report Summary	1
Management Letter	2
Status of Prior Audit Issues	7
Department of Transportation Response	8

Audit Participation

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

Cecile M. Ferkul, CPA, CISA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Laura Peterson, CPA	Auditor-in-Charge
Marc Bahnsen	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 6, 2006:

Carol Molnau	Lieutenant Governor/Commissioner
Doug Differt	Deputy Commissioner
Raymond Rought	Office of Aeronautics Director
Richard Stehr	Director of Engineering Services Division
Jerry Holland	Director of Administration – District Operation Division
Rick Arnebeck	OST Division
Nelrae Succio	District Engineer – District 6 Rochester
Kevin Gray	Director of Finance and Administration
Scott Peterson	Director of Finance
Terry Lemke	Office of Finance
Dennis Herzog	Financial Reporting Supervisor
Dan Kahnke	MnDOT Office of Audit Director
Larry Kienitz	MnDOT Office of Audit – Internal Audit Manager
Dave Christensen	MnDOT Office of Audit – Auditor

Report Summary

Audit Findings:

- The department did not ensure the accuracy of the infrastructure balance in the state's annual financial statements. (Finding 1, page 3)
- The department did not adequately follow certain project oversight procedures. (Finding 2, page 4)
- The department did not ensure that bituminous testing requirements were met for certain airport improvement projects. (Finding 3, page 5)
- The department did not reconcile its federal billing to the Federal Highway Administration's project status report. (Finding 4, page 5)

The audit report contained one finding relating to the state's *Comprehensive Annual Financial Report* and three findings related to federal legal compliance. The department resolved one of two 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 2005.

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 \$6.7 billion in state highway infrastructure and right of way assets. During the fiscal year ended June 30, 2005, expenditures for infrastructure and right of way were \$466 million and \$98 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 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, 2005. 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, 2005. 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, 2005, were free of material misstatements.

Table 1
Department of Transportation
Programs Material to the State's Financial Statements
Fiscal Year 2005 (in thousands)

<u>Assets:</u>	<u>Amount</u>
Infrastructure	\$5,519,129
Right of Way	1,226,026
<u>Expenditures:</u>	
Infrastructure Capital Outlay ⁽¹⁾	465,960
Right of Way Capital Outlay ⁽¹⁾	98,435

(1) The 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 2005* 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. Our work was performed in conjunction with the MnDOT Office of Audit.

Department of Transportation

Table 2
Major Federal Programs Administered by MnDOT
Fiscal Year 2005 (in thousands)

<u>Program Name</u>	<u>CFDA</u> ^(Note 1)	<u>Expenditures</u>
Highway Planning and Construction	20.205	\$433,966
Airport Improvement Grants	20.106	\$ 61,486

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 2005.

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

Our November 18, 2005, report included an unqualified opinion on the State of Minnesota's basic financial statements included in its *Comprehensive Annual Financial Report* for the year ended June 30, 2005. In accordance with *Government Auditing Standards*, we also issued our report, dated November 18, 2005, 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 2006, 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 certain weaknesses in internal control and instances of noncompliance with federal regulations, which we discuss in the following findings.

Findings and Recommendations

1. The departments of Transportation and Finance did not ensure the accuracy of the infrastructure balance in the state's financial statements.

The departments of Transportation (MnDOT) and Finance did not reduce the infrastructure balance on the state's preliminary financial statements for the reimbursements MnDOT received from other governments. Periodically, MnDOT agrees to manage and pay for entire construction projects involving work done for both the state and other governmental entities. For example, MnDOT may manage all aspects of a construction project involving the intersection of a state trunk highway and a county road, including improvements to the county road. In these circumstances, the local governments agree to reimburse MnDOT for the local government's share of the project costs. MnDOT and the Department of Finance did not reduce the state's infrastructure balance for these types of reimbursement costs.

Department of Transportation

According to the generally accepted accounting principles, governments should typically include only those construction costs that apply to the infrastructure assets the government owns. MnDOT and the Department of Finance overstated the infrastructure asset balance in the state's preliminary financial statements by \$62.3 million: \$24.5 million for reimbursements received in fiscal year 2005 and \$37.8 million for prior years.

Recommendation

- *The departments of Transportation and Finance should work together to accurately report the infrastructure balance in the state's financial statements by reducing the balance for reimbursements received for joint construction projects.*

2. Prior Audit Finding Not Resolved: The department did not adequately follow certain project oversight procedures.

The MnDOT Office of Audit's Single Audit report for fiscal year 2005 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 17 highway construction projects audited.

- The MnDOT Office of Audit recommended additional management attention for bituminous, concrete, and grading and base production documentation and materials testing requirements. The report identified 12 projects tested in which either reductions in payments were not taken, bituminous and concrete testing, grading and base material control, mix design, or test summary sheets requirements were not followed, or bituminous ticket information was not completed as required. In 3 of 12 projects, the report identified a need to hold the contractor and MnDOT project personnel accountable to follow the requirements. In addition, for 5 of the 12 projects either the contractor quality control testing was not done independently from agency quality assurance and verification testing, or quality control test results were missing or suggested retesting was not done. For the above projects, the MnDOT Office of Audit's report questioned \$9.075 million.
- Although MnDOT Office of Audit noted improvements from last year, compliance with National Pollutant Discharge Elimination System permit requirements is a continuing problem. Documented weekly inspections of erosion control effectiveness are required for coverage under the permit. The MnDOT Office of Audit report identified five projects where contractors did not complete and submit all required permit Inspection Logs to project personnel every two weeks as required. In addition, MnDOT Office of Audit questioned costs totaling \$1,300 for two building demolitions not being properly documented and one project for \$119,000 for allowing a contractor to ship

Department of Transportation

hazardous waste to a disposal facility not authorized by the contracts special provisions.

- The MnDOT Office of Audit also questioned a \$2.7 million increase in project costs on a project as a result of an inadequate geotechnical investigation. In addition, for another project, the audit report questioned \$640,000 paid for work done that was determined and documented as unacceptable by project personnel. Finally, the audit report questioned a \$33,000 duplicate payment made on another project.

Recommendation

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

3. The department did not ensure compliance with material testing requirements for the Airport Improvement Program (CFDA #20.106).

The MnDOT Office of Audit identified numerous instances where bituminous testing requirements were not met for one airport improvement project. The project was managed by a Metropolitan Airports Commission consultant, who hired another consultant to perform material testing. The MnDOT Office of Audit had concerns as to whether specified tests were performed and whether affected material met requirements in accordance with Federal Aviation Administration guidelines. For example, test summary sheets for bituminous did not detail quality assurance tests and, therefore, there was no documented comparison for allowable tolerances between quality control and quality assurance tests. In addition, test summary sheets were not signed by the contractor or agency representatives, other tests were not documented, and no mix design sheet was available for the bituminous surface mix.

As a result of these documentation concerns, the MnDOT Office of Audit questioned \$151,000 of the bituminous mixture affected.

Recommendation

- *The department should communicate with the Metropolitan Airports Commission to ensure that bituminous testing requirements are met.*

4. The department did not reconcile its federal billing to the Federal Highway Administration's (FHWA) project status report.

The MnDOT Office of Audit's Single Audit report determined that the reconciliation between the MnDOT Federal Billing and the Federal Highway Administration's project status report had not been done since February 2003. The report indicated that under the Letter of Agreement and Stewardship Plan between FHWA and MnDOT, MnDOT is required to reconcile one third of the affected apportionment codes monthly. The plan identifies this reconciliation as a prime accounting control to be exercised by MnDOT.

Department of Transportation

Recommendation

- *The department should reconcile its Federal Billings to the FHWA's project status report on a monthly basis as required under the Letter of Agreement.*

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 16, 2006.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

End of Fieldwork: January 25, 2006

Report Signed On: March 10, 2006

Department of Transportation

Status of Prior Audit Issues As of January 25, 2006

March 17, 2005, Legislative Audit Report 05-20 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, 2004. The scope included the state's infrastructure, right of way land, county highway and municipal street state-aid grants, fuel and motor vehicle tax distribution, federal highway construction grants (CFDA #20.205), and federal airport improvement grants (CFDA #20.106). The report contained two findings. The department resolved the finding regarding the reporting of the required infrastructure budgetary information contained in the state's annual financial statements. Prior audit Finding 2, concerning improvement in certain project oversight procedures, is shown as Finding 2 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.



Minnesota Department of Transportation

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

March 08, 2006

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 report for fiscal year ended June 30, 2005. My staff and I appreciate your effort and are committed to satisfactory resolution of the findings. Following are Mn/DOT's responses to your findings and recommendations.

Finding 1 – The department did not ensure the accuracy of the infrastructure balance in the state's annual financial statements.

Auditor's Recommendation: The departments of Transportation and Finance should work together to accurately report the infrastructure balance in the state's CAFR by reducing the balance for reimbursements received for joint construction projects.

Response: Mn/DOT has worked with the Department of Finance to resolve this issue. In the future Mn/DOT will adjust the infrastructure costs for reimbursements from local units of government for project costs on infrastructure owned by local governments.

Responsible Person: Kevin Gray, Finance and Administration Division Director

Implementation Date: January 2006

Finding 2 – Prior Audit Finding Not Resolved: The department did not adequately follow certain project oversight procedures.

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

Response: Increasing numbers of projects at all levels (state, county, city), increasing complexity of work, and evolving requirements are a continuing 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. Some of the actions in response to this finding include:

- Discussion among project staff to clarify and mutually agree to specification understanding.
- High level discussions with the Concrete Engineer who determined that all tests for State Project 7380-0206 were within tolerance.
- District State Aid Engineer met with a county engineer and county attorney to resolve out of tolerance tests and appropriate penalty assessment.
- Multi-agency training of construction project staff (state, city, and county) as well as consultant staff regarding inspection and environmental regulations.
- Creation of a new policy for retesting of Bulk Specific Gravity failures for use by lab staff.
- Multi-agency distribution of a Memo instructing cities, counties, and districts to comply with state and federal environmental requirements.
- Metro Materials has merged into one unit resulting in more efficient use of available manpower. A scoping committee has been formed to review all plan changes that will result in better evaluation of project scope earlier in a project.

For this finding, these are a few of the actions Mn/DOT is taking to resolve audit issues on an on-going basis

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

Implementation Date: Immediately and ongoing.

Finding 3 – The department did not ensure compliance with material testing requirements for the Airport Improvement Program (CFDA #20.106).

Auditor's Recommendation: The department should communicate with the Metropolitan Airports Commission to ensure that bituminous testing requirements are met.

Response: Mn/DOT's Aeronautics Office has communicated with the Metropolitan Airports Commission (MAC) and the Federal Aviation Administration (FAA) reminding them that quality control and assurance is the responsibility of the airport sponsor's engineer. MAC has indicated to the Aeronautics Office that

they will work with their construction engineers and inspectors to assure that this testing is completed according to specifications.

Responsible Person: Randy Halvorson, Program Management Division Director

Implementation: January 2006

Finding 4 – The department did not reconcile its federal billing to the Federal Highway Administration's (FHWA) project status report.

Auditor's Recommendation: The department should reconcile its Federal Billing to the FHWA's project status report on a monthly basis as required under the Letter of Agreement.

Response: Mn/DOT's Office of Finance was unable to perform the reconciliation between FHWA M25A and the federal bill of a problem with the data in the Federal Management Information System (FMIS). The data in FMIS has been fixed and the office has been performing reconciliation since October 2005.

Responsible Person: Kevin Gray, Finance and Administration Division Director

Implementation Date: Resolved October 2005.

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

Sincerely,



Carol Molnau
Lieutenant Governor/Commissioner of Transportation