



FINANCIAL AUDIT DIVISION REPORT

Department of Transportation

Federal Compliance Audit

Fiscal Year 2011

March 27, 2012

Report 12-08

FINANCIAL AUDIT DIVISION

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

March 27, 2012

Representative Michael Beard, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Tom Sorel, Commissioner
Minnesota Department of Transportation

This report presents the results of our audit of certain federal financial assistance programs administered by the Department of Transportation during fiscal year 2011. We conducted this audit as part of our audit of the state's compliance with federal program requirements. We emphasize that this has not been a comprehensive audit of the Department of Transportation.

We discussed the results of the audit with the department's staff at an exit conference on March 19, 2012. This audit was conducted by Jim Riebe, CPA (Audit Manager), Thom Derus (Senior Auditor), and Melissa White (Staff Auditor).

This report is intended for the information and use 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 27, 2012.

We received the full cooperation of the department's staff while performing this audit.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Department of Transportation generally complied with and had controls to ensure compliance with provision of laws, regulations, contracts, and grants applicable to the major federal programs we audited for fiscal year 2011. However, the department had weaknesses in reporting federal program expenditures and the status of prior audit findings, and did not issue written management decisions on subrecipient audit findings. In addition, the department had other program findings included in a separate report issued by the Department of Transportation's Office of Audit.

Findings

- Prior Finding Not Resolved: The Department of Transportation did not accurately report financial activity on the Schedule of Expenditures of Federal Awards. ([Finding 1, page 5](#))
- The Department of Transportation did not accurately report the status of prior audit findings in the Summary Schedule of Prior Audit Findings. ([Finding 2, page 6](#))
- The Department of Transportation did not issue written management decisions on audit findings in subrecipient single audit reports. ([Finding 3, page 7](#))

Other Program Findings

The Department of Transportation's Office of Audit separately reported other federal program findings and questioned costs in Report 12-800-53, dated February 16, 2012, and our report should be read in conjunction with their report.¹ Their report included four repeat findings on internal control weaknesses that resulted in noncompliance with materials control and bridge and building removal requirements.

Audit Scope

Our scope included the following programs that were material to the State of Minnesota's federal program compliance for fiscal year 2011: Airport Improvement (CFDA 20.106) and Highway Planning and Construction Cluster (CFDA 20.205).

¹ The Department of Transportation Office of Audit Report 12-800-53 can be found at: http://www.dot.state.mn.us/const/tools/docs/2011SingleAuditRpt_Resp-FINAL.pdf

Department of Transportation

Federal Program Overview

The Department of Transportation administered federal programs that we considered major federal programs for the State of Minnesota and, therefore, subject to audit under the federal Single Audit Act.² Table 1 identifies these major federal programs.

Table 1
Major Federal Programs
Department of Transportation
Fiscal Year 2011
(in thousands)

<u>CFDA</u> ¹	<u>Program Name</u>	<u>Federal Expenditures</u>	<u>Federal ARRA</u> ² <u>Expenditures</u>	<u>Total Federal Expenditures</u>
20.106	Airport Improvement	<u>\$ 50,094</u>	<u>\$ 2,722</u>	<u>\$ 52,816</u>
	<u>Highway Planning and Construction Cluster</u>			
20.205	Highway Planning and Construction	\$603,098	\$163,143	\$766,241
20.205	Highway Planning and Construction			
	Research and Development	12,651	0	12,651
20.219	Recreational Trails Program ³	<u>1,455</u>	<u>0</u>	<u>1,455</u>
	Total Highway Planning and Construction Cluster	<u>\$617,203</u>	<u>\$163,143</u>	<u>\$780,347</u>

¹ The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs. Some federal programs are clustered if they have similar compliance requirements. Although the programs within a cluster are administered as separate programs, they are treated as a single program for the purpose of meeting the audit requirements of the U.S. Office of Management and Budget's Circular A-133.

² American Recovery and Reinvestment Act.

³ Administered by the Department of Natural Resources.

Source: Minnesota Accounting and Procurement System.

Objective, Scope, and Methodology

The objective of our audit was to determine whether the Department of Transportation complied with federal program requirements in its administration of its major federal programs for fiscal year 2011. This audit is part of our broader federal single audit designed to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are

² We defined a major federal program for the State of Minnesota in accordance with a formula prescribed by the federal Office of Management and Budget as a program or cluster of programs whose expenditures for fiscal year 2011 exceeded \$30 million.

applicable to each of its federal programs.³ In addition to specific program requirements, we examined the department's general compliance requirements related to federal assistance, including its cash management practices.

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 of America and with the U.S. Office of Management and Budget's Circular A-133 Compliance Supplement.

We conducted our work in coordination with the Department of Transportation's Office of Audit, including the follow up on findings and recommendations reported in fiscal year 2010.

Conclusion

The Department of Transportation 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 2011. However, the department had weaknesses in reporting federal program expenditures and the status of prior audit findings, and did not issue written management decisions on subrecipient audit findings, as noted in the following *Findings and Recommendations* section. Appendix A on page 9 lists the federal award numbers related to Finding 1.

The Department of Transportation's Office of Audit reported additional findings in its separately issued report dated February 16, 2012, and our report should be read in conjunction with their report.⁴ The report contained four repeat findings on internal control weaknesses that resulted in noncompliance with materials control requirements.

We will report the weaknesses to the federal government in the *Minnesota Financial and Compliance Report of Federally Assisted Programs* for the year ended June 30, 2011, prepared by the Department of Management and Budget. 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.

³ The State of Minnesota's single audit includes both the financial statements and the expenditures of federal awards by all state agencies. We issued an unqualified audit opinion, dated December 20, 2011, on the State of Minnesota's basic financial statements for the year ended June 30, 2011. In accordance with *Government Auditing Standards*, we also issued our report on our consideration of the State of Minnesota's internal controls over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants (Office of the Legislative Auditor's Financial Audit Division Report 12-03, *Report on Internal Control Over Statewide Financial Reporting*, issued February 16, 2012).

⁴ The Department of Transportation, Office of Audit, Report 12-800-53, issued February 16, 2012, is at: http://www.dot.state.mn.us/const/tools/docs/2011SingleAuditRpt_Resp-FINAL.pdf

Findings and Recommendations

Prior Year Finding Not Resolved:⁵ The Department of Transportation did not accurately report financial activity on the Schedule of Expenditures of Federal Awards.

Finding 1

The department overstated Highway Planning and Construction Program (CFDA 20.205) expenditures by \$6.5 million and Highway Research and Program Development Program (CFDA 20.200) expenditures by \$1.6 million. The department understated Highway Planning and Construction Research and Development⁶ and American Recovery and Reinvestment Act⁷ (ARRA) expenditures by \$8.1 million on the Schedule of Expenditures of Federal Awards (SEFA) submitted for audit. Table 2 displays the adjustments to the reported activity.

Table 2
Fiscal Year 2011 Adjustments
To the Department of Transportation's
Schedule of Expenditures of Federal Awards

<u>Program</u>	<u>CFDA</u>	<u>Adjustments</u>	<u>Net Adjustments</u>
Highway Planning and Construction	20.205	+1,600,000 -6,159,987 -2,031,141	(6,591,128)
Highway Planning and Construction Research and Development	20.205 R&D	+6,159,987	6,159,987
Highway Planning and Construction American Recovery and Reinvestment Act	20.205 ARRA	+2,031,141	2,031,141
Highway Research and Program Development	20.200	-1,600,000	(1,600,000)

Source: Auditor created.

These misstatements occurred because of the following internal control weaknesses, each of which contributed to the total amount of the error in the schedule:

⁵ Office of the Legislative Auditor's Financial Audit Division Report 11-11, *Department of Transportation*, issued April 22, 2011.

⁶ OMB Circular A-133.310(b)(1) requires separate reporting of research and development expenditures.

⁷ Title 2 Code of Federal Regulations, Part 215.21, requires disclosure of the financial results of each federally-sponsored project or program.

- The department's financial reporting unit did not include expenditures related to projects that closed during the fiscal year on the schedule of expenditures because it was not aware that other department staff changed where it stored that information in the accounting system.
- The department's data gathering process to determine federal expenditure amounts was not complete; it did not include some transactions coded in the state's accounting system as research and development.
- The financial reporting unit did not separately report federal award payables coded in the state's new accounting system as ARRA expenditures because it was not familiar with the system's new data format.

Recommendation

- *The department should improve internal controls over the preparation of its Schedule of Expenditures of Federal Awards by:*
 - *Communicating to the financial reporting unit changes in the financial data processing and storage procedures;*
 - *Documenting and maintaining an understanding of accounting system fields and codes of key importance to the federal award financial reporting process; and*
 - *Incorporating secondary reviews and approvals to ensure the accuracy of the information used to prepare the schedule.*

Finding 2

The Department of Transportation did not accurately report the status of prior audit findings in the Summary Schedule of Prior Audit Findings.

The department reported it had resolved all prior audit findings; however, current year single audit results indicated that all prior findings remained either not corrected or only partially corrected. Although the department developed and implemented corrective action plans to address prior findings, it had not verified that the corrective actions had effectively resolved the underlying internal control weakness that had caused the noncompliance reported in prior findings. In addition, management did not consider the results of the fiscal year 2011 single audit when it determined if it had resolved the prior findings. The department is

responsible for follow-up and corrective action on all audit findings and preparing a Summary Schedule of Prior Audit Findings.⁸

Recommendations

- *To ensure the accuracy of the federal Summary Schedule of Prior Audit Findings, the department should:*
 - *Monitor the effectiveness of its corrective actions to determine whether it resolved the prior audit findings; and*
 - *Consider the results of the current year single audit to determine if similar findings occurred.*

The Department of Transportation did not issue written management decisions on audit findings in subrecipient single audit reports.

Finding 3

The department did not comply with federal requirements to issue written management decisions for subrecipients' audit findings.⁹ The department, considered a pass-through entity, receives federal awards and then subgrants the funds to other entities, referred to as subrecipients, to carry out federal programs. Part of a pass-through entity's responsibilities include monitoring the subrecipient's compliance with federal program requirements by reviewing, following up, and issuing management decisions on findings included in subrecipient single audit reports.¹⁰ The federal government requires written management decisions to ensure subrecipient compliance with federal requirements. Although the department ensured that subrecipients had audits, assessed corrective action plans to resolve findings, and followed up on instances of continued noncompliance, it did not issue written management decisions on 3 material weaknesses and 10 significant deficiencies identified in 9 of 48 subrecipient audit reports for calendar year 2010.

Recommendation

- *The department should comply with federal requirements by issuing written management decisions on audit findings of its federal award recipients.*

⁸ OMB Circular A-133.315(a).

⁹ OMB Circular A-133.400(d)(5).

¹⁰ OMB Circular A-133.105 provides definitions of pass-through entity, subrecipient, and management decision.

Appendix A
Department of Transportation
Fiscal Year 2011

Highway Planning and Construction (CFDA 20.205)
Research and Development Federal Awards¹¹

27Q5500001038004, 27Q5500001038027, 27Q5500001038088,
27Q5600001038004, 27Q5600001038027, 27Q5600001038088,
27Q5500001039004, 27Q5500001039014, 27Q5500001039018,
27Q5500001039023, 27Q5500001039027, 27Q5500001039043,
27Q5500001039048, 27Q5500001039059, 27Q5500001039065,
27Q5500001039077, 27Q5500001039079, 27Q5500001039088,
27Q5600001039004, 27Q5600001039014, 27Q5600001039018,
27Q5600001039023, 27Q5600001039027, 27Q5600001039043,
27Q5600001039048, 27Q5600001039059, 27Q5600001039065,
27Q5600001039077, 27Q5600001039079, 27Q5600001039088,
2708600001040004, 2708600001040011, 2708600001040016,
2708600001040018, 2708600001040023, 2708600001040027,
2708600001040032, 2708600001040033, 2708600001040048,
2708600001040049, 2708600001040055, 2708600001040059,
2708600001040069, 2708600001040073, 2708600001040077,
2708600001040079, 2708600001040085, 2708600001040088,
27Q5500001040004, 27Q5500001040011, 27Q5500001040016,
27Q5500001040018, 27Q5500001040023, 27Q5500001040027,
27Q5500001040032, 27Q5500001040033, 27Q5500001040048,
27Q5500001040049, 27Q5500001040055, 27Q5500001040059,
27Q5500001040069, 27Q5500001040073, 27Q5500001040077,
27Q5500001040079, 27Q5500001040085, 27Q5500001040088,
27Q5600001040004, 27Q5600001040011, 27Q5600001040016,
27Q5600001040018, 27Q5600001040023, 27Q5600001040027,
27Q5600001040032, 27Q5600001040033, 27Q5600001040048,
27Q5600001040049, 27Q5600001040055, 27Q5600001040059,
27Q5600001040069, 27Q5600001040073, 27Q5600001040077,
27Q5600001040079, 27Q5600001040085, 27Q5600001040088,
27Q2208800058088, 27Q5500001041009, 27Q5500001041014,
27Q5500001041016, 27Q5500001041023, 27Q5500001041027,

¹¹ The federal award number format is “SSRRRRPPPPPPCCC” where:

- SS = State Code
 - RRRR = Program Code
 - PPPPPP = Project Number
 - CCC = County Code
-

**Highway Planning and Construction (CFDA 20.205)
Research and Development Federal Awards (Continued)**

27Q5500001041030, 27Q5500001041033, 27Q5500001041043,
27Q5500001041044, 27Q5500001041048, 27Q5500001041049,
27Q5500001041053, 27Q5500001041055, 27Q5500001041056,
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27Q5500001042005, 27Q5500001042009, 27Q5500001042011,
27Q5500001042013, 27Q5500001042014, 27Q5500001042018,
27Q5500001042027, 27Q5500001042029, 27Q5500001042030,
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27Q5600001042018, 27Q5600001042027, 27Q5600001042029,
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27Q5500001043005, 27Q5500001043010, 27Q5500001043011,
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27H240IT03545088, 27QT80IT03545088, 27H240IT03720088,
27QT80IT03720088, 27H5500001044003, 27H5500001044005,
27H5500001044010, 27H5500001044011, 27H5500001044018,

**Highway Planning and Construction (CFDA 20.205)
Research and Development Federal Awards (Continued)**

27H5500001044029, 27H5500001044038, 27H5500001044043,
27H5500001044049, 27H5500001044052, 27H5500001044069,
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27H5600001044010, 27H5600001044011, 27H5600001044018,
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27L560MPR6003088, 27Q560MPR6003088, 27H560MPR6015086,
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27H560MPR6008088, 27L56EMPR6008088, 27H560MPR6019,
27L560MPR6019, 27L56EMPR6019, 27H560MPR6021088,
274L10MPR6022088, 27H560MPR6022088, 27L560MPR6022088,
27L560MPR6024086, 27L560MPR6024088, 27L560MPR6027086,
27L560MPR6027088, 2737P0MPR6029088, 27L560MPR6029088,

**Highway Planning and Construction (CFDA 20.205)
Research and Development Federal Awards (Continued)**

27QD40MPR6029088, 27QR50MPR6029088, 27Q240IT07610088,
27QT80IT07610088, 27Q240IT07613088, 27QT80IT07613088,
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27H560TPF5165088, 27L560TPF5165086, 27L560TPF5165088,
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27L00E0001050025, 27L00E0001050027, 27L00E0001050031,
27L00E0001050040, 27L00E0001050045, 27L00E0001050052,
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27L00E0001050085, 27L00E0001050088, 27L55E00010500,
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27L55E0001050013, 27L55E0001050025, 27L55E0001050027,
27L55E0001050031, 27L55E0001050040, 27L55E0001050045,
27L55E0001050052, 27L55E0001050062, 27L55E0001050064,
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27L55EMPR0001088, 27L560MPR6032088, 27L56EMPR9004,
2737T08805113088, 27L5500001051088, 27L55E0001051088,
27L55ECR11001002, 27L55ECR11001004, 27L55ECR11001013,
27L55ECR11001025, 27L55ECR11001027, 27L55ECR11001036,
27L55ECR11001039, 27L55ECR11001045, 27L55ECR11001064,
27L55ECR11001083, 27L55ECR11001085



Minnesota Department of Transportation

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March 23, 2012

James R. Nobles
Legislative Auditor
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Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the audit of the Department of Transportation's compliance audit with regards to our major federal programs for the year ended June 30, 2011. This letter is the Minnesota Department of Transportation (MnDOT) response to the draft report issued March 20, 2012, by the Office of the Legislative Auditor.

Finding 1 – Prior Year Finding Not Resolved: The Department of Transportation did not accurately report financial activity on the Schedule of Expenditures of Federal Awards.

Recommendation: The department should improve internal controls over the preparation of its Schedule of Expenditures of Federal Awards by communicating to the financial reporting unit changes in the financial data processing and storage procedures; documenting and maintaining an understanding of accounting system fields and codes of key importance to the federal award financial reporting process; and incorporating secondary reviews and approvals to ensure the accuracy of the information used to prepare the schedule.

Response: MnDOT believes strongly in financial integrity and concurs with this finding. MnDOT is addressing this issue in the following manner:

- *MnDOT finance staff will add a secondary finance office review of federal expenditures to ensure federal awards are accounted for properly.*
- *With the implementation of SWIFT, all appropriations with federal participation are set up with a CFDA number to ensure reporting accuracy.*

Responsible Staff: Tracy Hatch, Chief Financial Officer; Gerald Wood, Accounting Director

Implementation Date: September, 2012

Finding 2 – The Department of Transportation did not accurately report the status of prior audit findings in the Summary Schedule of Prior Audit Findings.

Recommendation: To ensure the accuracy of the federal Summary Schedule of Prior Audit Findings, the department should monitor the effectiveness of its corrective actions to determine whether it resolved the prior audit findings; and consider the results of the current year single audit to determine if similar findings occurred.

Response: MnDOT believes strongly in financial integrity and takes all audit findings seriously. While MnDOT and our local partners accurately reported that we have addressed the specific findings previously identified by the Office of the Legislative Auditor (OLA) and MnDOT's internal audit staff, this finding refers to the overarching issue of repeated findings related primarily to materials testing on individual projects statewide, including projects on the State Aid system, which are performed by local units of government. MnDOT concurs with OLA that repeat findings of a similar nature indicates there is a weakness in the materials testing process. MnDOT has taken steps over the past few years to address this issue statewide and has shown particular improvement on trunk highway projects that are managed by MnDOT, as reported in the 2011 Single Audit Compliance Report 12-800-53. The department will continue to address this issue in the following manner:

- *The agency continues to work with MnDOT staff and local units of government to review and improve existing project oversight and compliance procedures through statewide training and conferences.*
- *The agency has a questioned cost committee in place to deal with single audit issues related to FHWA. This process will continue and the committee role will expand.*

Responsible Staff: Tracy Hatch, Chief Financial Officer; Division Directors

Implementation Date: Fiscal year 2012 and ongoing

Finding 3 – The Department of Transportation did not issue written management decisions on audit findings in sub-recipient single audit reports.

Recommendation: The department should comply with federal requirements by issuing written management decisions on audit findings of its federal award recipients.

Response: MnDOT believes strongly in financial integrity and concurs with this finding. MnDOT is addressing this issue in the following manner:

- *Management will issue written management decisions to sub-recipients on material weaknesses and significant deficiencies.*

Responsible Staff: Tracy Hatch, Chief Financial Officer; Dan Kahnke, Internal Audit; Gerald Wood, Accounting Director

Implementation Date: Fall, 2012

Thank you for the opportunity to respond to your findings and recommendations. MnDOT will monitor the implementation to the successful resolution of these findings. Please contact Gerald Wood, Accounting Director, at 651-366-4904 with any follow-up questions or information.

Sincerely,



Thomas K. Sorel
Commissioner of Transportation