



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Minnesota Department of Transportation

Internal Controls and Compliance Audit

July 2011 through January 2013

August 9, 2013

Report 13-19

FINANCIAL AUDIT DIVISION
Centennial Building – Suite 140
658 Cedar Street – Saint Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: legislative.auditor@state.mn.us
Web site: <http://www.auditor.leg.state.mn.us>
Through Minnesota Relay: 1-800-627-3529 or 7-1-1



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

August 9, 2013

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Charles Zelle, Commissioner
Minnesota Department of Transportation

This report presents the results of our internal controls and compliance audit of selected financial activities of the Minnesota Department of Transportation for the period July 1, 2011, through January 31, 2013.

We discussed the results of the audit with the Minnesota Department of Transportation's staff on July 31, 2013. This audit was conducted by Jim Riebe, CPA (Audit Manager) and Tracy Gebhard, CPA (Auditor-in-Charge), assisted by auditors Jordan Bjonfald, CPA, Jessie Hon, Natalie Mehlhorn, Tracia Polden, and Kathy Rootham.

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

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
Report Summary	1
Agency Overview	3
Objective, Scope, and Methodology	5
Conclusion	7
Finding and Recommendations.....	9
1. The Minnesota Department of Transportation incorrectly charged about \$2.1 million in expenses to an appropriation for state road construction.....	9
Agency Response.....	11

Report Summary

Conclusion

The Minnesota Department of Transportation's internal controls over the financial activities included in the scope of our audit were generally adequate to ensure compliance with finance-related legal provisions. However, the department had some weaknesses in its internal controls to ensure appropriate funding of certain expenditures.

The Minnesota Department of Transportation generally complied with significant finance-related legal requirements. However, there were some specific instances of noncompliance related to the eligibility of expenditures charged to the state road construction portion of a Trunk Highway Fund appropriation.

The Minnesota Department of Transportation implemented two recommendations included in our prior audit report that were relevant to this audit by improving internal controls over its receipt process and by protecting not public data.¹

Finding

- The Minnesota Department of Transportation incorrectly charged about \$2.1 million in expenses to an appropriation for state road construction. ([Finding 1, page 9](#))

Audit Objectives and Scope

Objectives

- Internal controls
- Legal compliance

Period Audited

July 1, 2011, through January 31, 2013

Programs Audited

- Trunk Highway Fund expenditures (payroll, highway construction expenditures for "design bid build" construction projects, and architect and engineer services contracts)²
- System security
- Intergovernmental grant receipt revenue

¹ Office of the Legislative Auditor, Financial Audit Division Report 10-30, *Minnesota Department of Transportation*, issued September 16, 2010. This audit report cited five findings; however, only two findings were relevant to this audit. Our scope did not include employee expenses, cell phone expenses, or fixed assets.

² Our scope included the Trunk Highway Fund Expenditure Table in the Annual Report on Major Highway Projects submitted to the Legislature in accordance with *Minnesota Statutes* 2012, 174.56.

Minnesota Department of Transportation

Agency Overview

The Minnesota Department of Transportation (MnDOT) is the principal state agency responsible for developing and implementing policies, plans, and programs for highways, railroads, commercial waterways, aeronautics, public transit, and motor carriers. State statutes govern MnDOT operations.³

Appointed by Governor Dayton on December 15, 2012, the department's commissioner is Charles Zelle. Prior to Charles Zelle's appointment, Thomas Sorel was the commissioner. The department is organized with a central office located in Saint Paul and eight regional district offices in Duluth, Bemidji, Brainerd, Detroit Lakes, Rochester, Mankato, Willmar, and the Minneapolis/Saint Paul metropolitan area. The central office manages the administration of MnDOT, and the regional district offices manage the majority of MnDOT's day-to-day operations, including highway construction projects, maintenance, and highway right-of-way issues. MnDOT employs about 5,000 staff.

MnDOT receives funding through federal, state, and local sources. Table 1 summarizes MnDOT's state appropriations for fiscal years 2012 and 2013.

Table 1
Minnesota Department of Transportation
State Appropriations
By Fiscal Year
(in thousands)

	<u>2012</u>	<u>2013</u>
General Appropriation	\$ 15,837	\$ 15,837
Airports	19,609	21,384
County State Aid Highways	545,109	572,773
Municipal State Aid Highways	145,455	153,484
Trunk Highways	<u>1,566,510</u>	<u>1,298,047</u>
Total	<u>\$2,292,520</u>	<u>\$2,061,525</u>

Source: Laws of Minnesota 2011, First Special Session, Chapter 3, Article 1, Section 3, Subd. 1.

During fiscal years 2012 and 2013, MnDOT received over half of its total state appropriations from the Trunk Highway Fund. The Minnesota Constitution created the Trunk Highway Fund for the purposes of constructing, improving, and maintaining the state's trunk highway system and paying principle and interest on

³ *Minnesota Statutes* 2012, Chapter 174.

any bonds issued for trunk highway purposes.⁴ The Legislature identified types of expenditures eligible to be charged to the Trunk Highway Fund, including operations and maintenance, program planning and delivery, and state road construction.

The department charges a variety of expenditures to the Trunk Highway Fund, including the following:

- Payroll Expenditures – The department employs approximately 5,000 staff between its central office and eight regional district offices and pays 95 percent of its payroll costs from the Trunk Highway Fund.
- Architect and Engineering Service Expenditures – The department contracts with various vendors to provide the technical services necessary for a multitude of projects, including the design of trunk highways and bridges, as well as rest areas and other building-type structures found near or along trunk highways.
- Construction Expenditures – These costs are associated with the construction, reconstruction, or maintenance of trunk highway roads and bridges.

Table 2 presents the payroll, architect and engineering service, and construction expenditures incurred and charged to the Trunk Highway Fund during fiscal years 2012 and 2013, through January 31, 2013.

Table 2 Minnesota Department of Transportation Selected Trunk Highway Fund Expenditures Fiscal Years 2012 and 2013 Through January 2013		
	<u>2012</u>	<u>2013¹</u>
Payroll	\$318,889,480	\$202,755,202
Architect and Engineering Services	41,823,764	35,006,545
Construction ²	<u>608,157,875</u>	<u>527,279,977</u>
Total	<u>\$968,871,119</u>	<u>\$765,041,724</u>

¹ Fiscal year 2013 includes data through January 31, 2013.

² Our scope included construction expenditures for "design-bid-build" projects. We excluded "design-build" projects from our scope because those expenditures went through a different control cycle.

Source: State of Minnesota Accounting System.

⁴ *Minnesota Constitution*, Article XIV, sections 2, 6, and 11.

The department also collects a variety of revenue, some of which is deposited into the Trunk Highway Fund. MnDOT collected \$63.6 million in intergovernmental grant revenue for fiscal years 2012 and 2013 (through January 31, 2013). Local units of government often partner with MnDOT on highway construction and maintenance projects. Sometimes, MnDOT initially finances these joint projects and then collects from the local government its share of the project's construction costs.⁵

In 2010, we issued a report that cited weaknesses in the department's assessment of risks and internal controls related to its receipt process for several revenue types including intergovernmental grant revenue.⁶ In response to that report, the department developed, implemented, and documented its risk assessment and corresponding controls related to its intergovernmental grant receipts. The department has also created a strong control environment and comprehensive risk assessment since our last audit that it documented and branded 'Safeguarding MnDOT.' This document is available to all department staff and is the subject of various training courses offered to staff.

Objective, Scope, and Methodology

Our audit of the Minnesota Department of Transportation covered intergovernmental grant revenues, system access and the following Trunk Highway Fund expenditures: architect and engineering services, construction, and payroll.

The objective of this audit was to answer the following questions for the period July 1, 2011, to January 31, 2013:

- Did MnDOT have adequate internal controls over intergovernmental grant revenues and Trunk Highway Fund expenditures to ensure that it safeguarded financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data?
- Did MnDOT comply with significant finance-related legal requirements?
- Did MnDOT implement prior audit recommendations?⁷

To meet the audit objective, we performed a variety of procedures, including the following:

⁵ *Minnesota Statutes* 2012, 174.02.

⁶ Office of the Legislative Auditor, Financial Audit Division Report 10-30, *Minnesota Department of Transportation*, issued September 16, 2010.

⁷ *Ibid.*

- We reviewed legal requirements and documents related to compliance with finance-related legal requirements, including the State Constitution, state statutes, statewide policies and procedures, and MnDOT's policies, procedures, and contracts.
- We interviewed staff at the department to gain an understanding of our program areas and MnDOT's control environment and internal risk assessment. We used that information to evaluate the risk of errors in the accounting records and noncompliance with relevant legal requirements.
- We analyzed accounting data to identify unusual trends or significant changes in financial operations.
- We reconciled expenditures and encumbrances included in the 2012 Annual Report on Major Highway Projects⁸ to the state's accounting system. State statute requires the department to classify into prescribed categories and report to the Legislature its Trunk Highway Fund expenditures for major highway projects annually.⁹ In addition, we verified the accuracy of the classification of those expenditures and encumbrances.
- We reviewed system security for several MnDOT systems used in the processing of payroll, architect and engineering services, construction expenditures, and the state's accounting and payroll systems. We gained an understanding of how access is granted, changed and removed, if any roles are incompatible, and how access is monitored. For a sample of employees, we tested to ensure access was necessary for an employee's job duties and, if applicable, tested to ensure no incompatible duties existed without mitigating controls.
- We selected a sample of intergovernmental grant receipts and reviewed supporting documentation to test whether the controls, such as proposals, agreements, contracts, approvals, and reconciliations, were effective and if the transactions complied with laws, statutes, policies, and contract provisions. In addition, we verified, for the sample of intergovernmental grant receipts, that the department appropriately deposited the receipts into the Trunk Highway Fund or other applicable funds.¹⁰
- We selected a sample of expenditure transactions and reviewed supporting documentation to test whether the controls, such as requests for proposals, contracts, invoices, timesheets, and approvals, were effective and if the transactions complied with laws, regulations, policies, and contract provisions. In addition, we verified, for a sample of expenditure

⁸ <http://www.dot.state.mn.us/govrel/reports.html>.

⁹ *Minnesota Statutes* 2012, 174.56.

¹⁰ The other applicable funds included the Special Revenue Fund and Federal Fund.

transactions, that the expenditure was appropriately charged to the Trunk Highway Fund.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

We used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate the department's internal controls.¹¹ We used state statutes and contracts, as well as policies and procedures established by the departments of Management and Budget and Administration and MnDOT's internal policies and procedures as evaluation criteria over compliance.

Conclusion

The Minnesota Department of Transportation's internal controls over the financial activities included in the scope of our audit were generally adequate to ensure compliance with finance-related legal provisions. However, the department had some weaknesses in its internal controls to ensure appropriate funding of certain expenditures.

The Minnesota Department of Transportation generally complied with significant finance-related legal requirements. However, there were some specific instances of noncompliance related to the eligibility of expenditures charged to the state road construction portion of a Trunk Highway Fund appropriation.

The Minnesota Department of Transportation implemented two recommendations included in our prior audit report that were relevant to this audit by improving internal controls over its receipt process and by protecting not public data.¹²

The following *Finding and Recommendations* section further explains the department's weakness in internal controls and noncompliance.

¹¹ The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

¹² Office of the Legislative Auditor, Financial Audit Division Report 10-30, *Minnesota Department of Transportation*, issued September 16, 2010. This audit report cited five findings; however, only two findings were relevant to this audit. Our scope did not include employee expenses, cell phone expenses, or fixed assets.

Finding and Recommendations

The Minnesota Department of Transportation incorrectly charged about \$2.1 million in expenses to an appropriation for state road construction.

Finding 1

The department did not comply with state law when it used about \$2.1 million appropriated from the Trunk Highway Fund for road construction to pay for four special projects unrelated to that purpose. State law required MnDOT to use the money for construction, reconstruction, or improvement of trunk highways, including contracts and consultant services to support these contracts.¹³

Overall, the department spent \$3.3 million from the state road construction account from July 2011 through January 2013 for 33 special projects.¹⁴ Our review identified four projects that did not appear to comply with the purpose of the state road construction account. The four projects were pilot programs and/or studies to (1) evaluate intersection warning systems in rural areas, (2) determine the feasibility of user-based mileage fees as a source of funding, (3) determine transit incentives for drivers to optimize the use of trunk highways, and (4) study how to increase multi-modal transportation use on Snelling Avenue in St. Paul. We pointed out the funding errors to MnDOT staff, and they agreed that expenses for these special projects should have been paid from other accounts.

The department did not have adequate internal controls to ensure staff used the correct funding source for special projects. Although MnDOT staff determined the funding source for each project before the project began, they did not re-evaluate funding when the scope of the projects changed based on contract amendments. In addition, the department may not have adequately trained new staff responsible for funding determinations, on constitutional and legislative restrictions applicable to certain funding sources. Had the department re-evaluated the funding source when it amended projects and adequately trained staff making funding determinations, it may have avoided using money appropriated for state road construction for other purposes.

¹³ *Laws of Minnesota* 2011, First Special Session, Chapter 3, Article 1, Section 3, Subd. 3(c).

¹⁴ Special project expenditures charged to all Trunk Highway Fund accounts totaled \$13 million for 200 special projects from July 2011 through January 2013.

Recommendations

- *The Minnesota Department of Transportation should restore to the state road construction account in the Trunk Highway Fund money spent on projects identified as not eligible for funding with money appropriated for road construction.*
 - *The Minnesota Department of Transportation should strengthen its internal controls to ensure it pays for special project expenses from the correct appropriation.*
-



Minnesota Department of Transportation

395 John Ireland Boulevard
Saint Paul, MN 55155

Date: August 5, 2013

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

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the audit of the Department of Transportation's Internal Controls and Compliance Audit, July 1, 2011 through January 31, 2013. This letter is the Department of Transportation response to the draft report issued by the Office of Legislative Auditor.

Finding 1 – The Minnesota Department of Transportation incorrectly charged about 2.1 million in expenses to an appropriation for state road construction.

Recommendation 1 – The Minnesota Department of Transportation should restore to the state road construction account in the Trunk Highway Fund money spent on projects identified as not eligible for funding with money appropriated for road construction.

***Response** - The department believes strongly in financial integrity and concurs with the finding and recommendation. The department has addressed this issue by making expenditure corrections to restore the state road construction appropriation for the four projects not in compliance with the purpose of the state road construction appropriation. The corrections were made on June 18, 2013. The amount not eligible totaled \$1,686,914.60.*

Recommendation 2 – The Minnesota Department of Transportation should strengthen its internal controls to ensure it pays for special project expenses from the correct appropriations.

***Response** - The Department of Transportation believes strongly in internal controls and concurs with this finding and recommendation. The department is addressing this issue in the following manner:*

The MnDOT Office of Capital Programs and Performance Measures (OCPPM) is developing a process to address funding eligibility for Special Programs and Projects. This process includes the following actions:

- **Program Tracking Form** – A standard decision-making form is being finalized for funding requests for all special programs and projects. This will include sign off of the project scope, work tasks and eligible funding.

- ***Expenditure Tracking Redundancy*** – *The Office of Financial Management will be provided a copy of the current forms to keep with the pay voucher files when receipts come in.*
- ***Program Manager Staffing*** – *OCPPM will have a Program Manager for these special programs to track the progress of the special projects.*
- ***Communication*** – *OCPPM will review the tracking form process and steps required for funding as new special programs are introduced.*

Responsible Staff: Tim Henkel, Modal Planning & Program Management Division Director, Mark Gieseke, Capital Programs and Performance Measures Director, Brian Gage, Program Development and Management Section.

Implementation Date: September, 2013

The MnDOT Office of Financial Management (OFM) is strengthening internal controls with the following actions:

- *OFM will develop and implement a process to routinely review the Program Tracking Form for funding eligibility to ensure it pays expense from the correct appropriations.*
- *OFM will develop and deploy training throughout the department on the appropriate use of available funds within the Trunk Highway appropriation to strengthen its internal controls for Special Programs and Projects.*

Responsible Staff: Sue Stein, Corporate Services Division Director, Duane Leurquin, Controller/Financial Management Director, Kristi Schroedl, Budget Director.

Implementation Date: September, 2013 for Review Process – February, 2014 for Training

Thank you for the opportunity to respond to your finding and recommendations. MnDOT will monitor the implementation to the successful resolution of this finding. Please contact Suzanne Thayer, Safeguarding MnDOT Program Manager, at 651-366-3941 with questions.

Sincerely,



Charles A. Zelle
Commissioner of Transportation