

**DEPARTMENT OF TRANSPORTATION
MANAGEMENT LETTER
FISCAL YEAR 1988**

FEBRUARY 1989

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Mr. Leonard W. Levine, Commissioner
Department of Transportation
411 Transportation Building
St. Paul, Minnesota 55155

Dear Commissioner Levine:

We have reviewed certain accounting procedures and controls for your department as part of our statewide audit of the State of Minnesota's fiscal year 1988 financial statements and federal programs. The scope of our work was limited to:

- those aspects of your department which have a material impact on any of the state's various funds and account groups shown on the financial statements;
- federal programs as cited in the Catalog of Federal Domestic Assistance (CFDA) included in the single audit scope as follows:

<u>CFDA #</u>	<u>PROGRAM NAME</u>
12.106	Flood Control Projects
20.106	Airport Improvement
20.205	Highway Planning and Construction

- the status of prior audit recommendations.

We emphasize that this has not been a complete financial and compliance audit of all programs within your department. The work conducted in your department is a part of our annual statewide financial and federal compliance audit (single audit). The single audit coverage satisfies the federal government's financial and compliance audit requirements for all federal programs administered by your department in fiscal year 1988.

Your internal audit unit was responsible for specific single audit compliance requirements. We have evaluated and accepted their work as required by the AICPA Professional Standards. Their audit report is included as Attachment I. Finding 1 from our fiscal year 1987 audit has been resolved.

The current recommendation included in this letter is presented to assist you in resolving the audit finding and improving accounting procedures and controls. Progress on resolving this finding will be reviewed during our audit next year.

1. The Minnesota Department of Transportation (Mn/DOT) does not include all applicable costs in their consumable inventory valuation.

Mn/DOT has a computerized record system to maintain their consumable inventory activity. Inventory is valued using the weighted average cost method and amounted to \$13,109,339 at June 30, 1988. Generally accepted accounting principles (GAAP) require all direct costs of acquisition to be included in inventory. Direct costs of acquisition are all costs associated with delivering goods to the buyer and converting such goods to a salable condition. This would include sales tax, fuel tax, transportation charges and discounts, all of which are currently excluded by Mn/DOT.

As of June 1, 1987, state agencies are required to pay sales tax on all purchases thereby making sales tax a direct cost of acquisition. Currently, Mn/DOT records sales tax as a "direct purchase" transaction on their consumable inventory system. This results in Mn/DOT expensing the sales tax immediately. In addition to sales tax, Mn/DOT does not include fuel tax, transportation charges, nor discounts in their valuation of consumable inventory as required by GAAP. During fiscal year 1988, Mn/DOT recorded expenses of \$830,829, \$56,714, \$80,580, and \$44,702, on sales tax, fuel tax, transportation charges, and discounts, respectively.

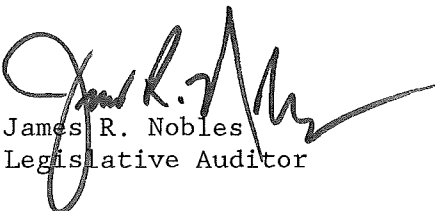
By not including all applicable costs, Mn/DOT is understating ending inventory and overstating expenses. If all inventory purchased during the year was available at year end, inventory would be understated by \$1,012,825. It is not feasible to determine the actual understatement, however, since extensive work would be required to determine what items were on hand at June 30, 1988 and what costs were associated with each item.

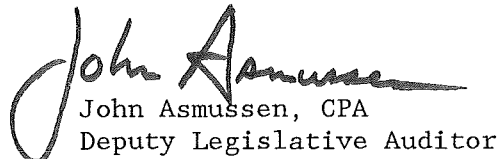
RECOMMENDATION

- Mn/DOT should properly value their consumable inventory by including all direct costs of acquisition.

Thank you for the cooperation extended our staff during this audit.

Sincerely,


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

Attachment

February 21, 1989

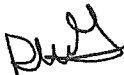
DEPARTMENT : Mn/DOT - Audit
1959 Sloan Place

STATE OF MINNESOTA

Office Memorandum

DATE : January 5, 1989

TO : Leonard W. Levine, Commissioner
Douglas H. Differt, Deputy Commissioner

FROM : Ronald W. Gipp 
Audit Director

PHONE : 296-3254

SUBJECT : Audit of OMB Circular A-128, Single Audit Compliance
Supplement Requirements for Fiscal Year 1988
Audit Report No. 89-800-57

As agreed upon with the Office of the Legislative Auditor, we have reviewed the procedures and controls followed by Minnesota Department of Transportation (Mn/DOT) personnel concerning the Single Audit Compliance Supplement requirements for the following programs:

Highway Research, Planning and Construction	CFDA 20.205
Airport Improvement Program (AIP)	CFDA 20.106
Flood Control Projects	CFDA 12.106

Mn/DOT received approximately \$269,000,000.00 in Federal funds for the Highway Research, Planning and Construction Program, CFDA 20.205, approximately \$12,500,000.00 in Federal funds for the Airport Improvement Program (AIP), CFDA 20.106, and approximately \$6,000,000.00 in Federal funds for Corps of Engineers Flood Control Projects, CFDA 12.106 in Fiscal Year 1988.

We also reviewed the Single Audit Compliance Supplement General Requirements that applied to our areas of audit coverage. The review covered the period from July 1, 1987 through June 30, 1988. The scope of our review was mainly concerned with compliance with applicable Federal rules and regulations, although compliance with applicable State rules and regulations is also considered.

Our audit was conducted in accordance with generally accepted government auditing standards. Accordingly, the audit was designed to provide assurance that financial operations were properly conducted, financial data was presented fairly and all applicable laws, regulations and administrative requirements have been complied with.

We also considered whether the department was managing or utilizing its resources in an economical and efficient manner and whether the department was effective in achieving its program objectives.

Leonard W. Levine, Commissioner
Douglas H. Differt, Deputy Commissioner
January 5, 1989
Page 2

In our opinion, financial operations were properly conducted, financial data was presented fairly and department personnel have generally complied with applicable laws, regulations and administrative requirements concerning the Single Audit Compliance Supplement with the exception of several areas in need of attention. These are detailed in Findings I-III and Observations I-IV attached to this report.

This report contains our recommendations developed during this review. We also reviewed the status of the audit recommendations contained in our previous report on the Single Audit Compliance Supplement Requirements. Attachment I to this report is a summary of the progress towards implementation of the recommendations we developed during the Fiscal Year 1987 review.

cc: L. F. McNamara
D. E. Durgin
E. E. Ofstead
E. H. Cohoon
R. B. Keinz
W. N. Yoerg
R. J. Dineen
G. M. Fay
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J. R. Nobles/M. M. Jenniges, OLA ✓
D. L. Pederson, DOF
C. E. Foslien, FHWA
File

Audited by:
David Wolvert
Connie Garrahy
Debra Didier
Sharon Ahrens
Phillip Taylor
Nancie DeGroat

FINDINGS

The following findings are considered financial and compliance in nature. Findings are intended to assess if financial operations were properly conducted, if financial data was presented fairly and if all applicable laws, regulations and administrative requirements were complied with.

FINDING I--NEED TO MONITOR SUBMITTAL OF CONTRACTORS' PAYROLLS

Contractor payrolls were not being obtained in a timely manner in the Duluth district construction office for S.P.'s 6982-194 and 6982-189, as well as Ramsey County S.P. 62-668-18. This was because there was no system for monitoring which weeks the contractors worked and which weeks payrolls had been received for those who worked.

The Mankato district construction office had a good payroll monitoring system which identified which payrolls were missing for S.P.s 7202-13, 5212-13, and 0713-62, however, follow up actions to obtain missing payrolls apparently are not done until the projects are complete.

As a result, payrolls were missing as far back as May, 1985, when we did our reviews in October and November, 1988.

The Davis-Bacon Act is a federal compliance requirement which states that laborers and mechanics employed by contractors and subcontractors on federally-assisted construction projects be paid wages not less than the minimum established by the Secretary of Labor for the locality of that project. Checking contractor and subcontractor payrolls is one method of helping to determine if the Davis-Bacon Act is being complied with.

Federal regulations as well as Section 5-591.342 of the Construction Manual require weekly submission of payrolls. This was emphasized in Construction Memorandum 84-14-c-1, which stated that pre-construction conferences call to the contractors' attention that "contracts do not require submission of weekly payrolls; rather, they require the submission of payrolls weekly and this requirement must be met."

If contractors are not required to submit payrolls in a timely manner, the following problems may occur:

1. Payrolls may not be available after a long period of time, due to poor record retention by the contractor.
2. Errors may be difficult to resolve due to the length of time between the date they occurred and the date of discovery.

Duluth district construction office personnel stated that they recently started using a form to keep track of which contractors worked, which contractors had submitted payrolls, and which payrolls were still missing. If this form is used in the future, it should correct the problem of late and/or missing payrolls.

Ramsey County personnel agreed that the use of a form to monitor who was required to submit a payroll and who had submitted a payroll for each week was a good idea.

Mankato district construction office personnel have a system in use which is adequate to monitor submittal of payrolls. If a phone call or memo is used within a reasonable length of time to remind the contractor that a payroll is required (rather than waiting until the project is complete), this system would be adequate to ensure that required payrolls are received.

RECOMMENDATIONS

1. Duluth district construction office and Ramsey County personnel use a form or other type of system to determine which weeks each contractor or subcontractor worked, and whether a payroll has been submitted. The District State Aid Engineer work with Ramsey County personnel on implementing this.
2. Mankato district construction office personnel follow up on missing payrolls as soon as possible, rather than waiting until the project is complete.

FINDING II--NEED TO CHECK PAYROLLS FOR PROPER WAGE RATES

Several wage underpayments to contractors' employees were noted on the first and/or second payrolls submitted on S.P. 33-603-17 (Kanabec County) and S.P. 62-668-18 (Ramsey County). Construction office personnel apparently were not checking that the wages on the payrolls met the minimum wages set forth in the proposal, to comply with the Davis-Bacon Act.

Construction Manual 5-591.342 states that the first two contractor payrolls should be checked in their entirety. Then, if no underpayments are found, subsequent payrolls may be spot-checked.

The fact that underpayments were discovered by audit on the first two payrolls raises the question of whether any of the payrolls were adequately checked, since all employees should have been checked on the first two payrolls. If payrolls are not checked for proper wage rates, the contractors and subcontractors may not be complying with the Davis-Bacon Act, a requirement for federally-assisted construction projects.

RECOMMENDATION

The appropriate District State Aid Engineers provide guidance to Kanabec County and Ramsey County personnel working on federally-assisted construction projects so that they comply with the requirements to check the first two payrolls from each contractor, and, if no underpayments are noted, to spot check subsequent payrolls.

FINDING III--NEED TO DETERMINE IF GRANT REIMBURSEMENTS ARE DEPOSITED CORRECTLY

As part of our Single Audit work, we review cash management practices for disbursing Federal funds to grantees for airport development. We compare Federal funds on hand to project needs. This is to determine compliance with Code of Federal Regulations, Title 31, Part 205, Section 4, which requires that cash advances to a recipient organization shall be limited to the minimum amounts needed, and the timing and amount of cash advances shall be as close as administratively feasible to the actual disbursements.

Since the letter-of-credit method of requesting Federal funds has been used, there are generally no Federal funds on hand for more than several days, but we do have questions on several projects. Per the Office of Aeronautics' records, the following projects had a balance of "federal receipts" on hand:

<u>Federal Project No.</u>	<u>Project</u>	<u>FY</u>	<u>Balance</u>	<u>Date of Receipt</u>
3-27-0117-01	Litchfield	8	\$136,830.23	11-13-87
3-27-0041-01	Chisholm	5	2,731.88	2-27-86
3-27-0068-02	Mora	5	3,822.42	4-23-87

The City of Litchfield project appeared to have a large amount of Federal funds on hand for more than a year. However, after further review of project records, we determined that the "federal receipts" were a reimbursement of \$153,242.75 of State funds paid for preliminary costs, prior to the Federal Aviation Administration's (FAA) decision to participate in the project. The State originally paid the preliminary costs from Fund 22-Airports. Therefore, this is State funds. When the reimbursement was received, it was deposited into Fund 30--Federal. The reimbursement has been used for more improvements to Litchfield airport.

A total of \$16,412.52 was disbursed to Litchfield between 12/87 and 12/88, leaving a balance of \$136,830.23 in the Federal fund. Since these are State monies, we question if they should be kept in the Federal fund. We have discussed our questions with Mn/DOT budget personnel who have agreed to help resolve this issue. Also, we understand that deposits into Fund 30 do not earn interest income for Mn/DOT, but interest earned on Fund 22 is returned to the airports fund.

The second project is the City of Chisholm. The Chisholm project also has a balance of State funds in the Federal fund. Although the project is complete, it is being held open because there is a potential for receiving additional federal money through an amendment to the grant. The FAA has yet to approve the amendment.

The third project is the City of Mora. It is our understanding that only the Mora project has a balance of Federal funds and the City is currently working on closing out this project. There may be additional costs eligible for reimbursement under this contract and Mn/DOT cannot release the funds until all documents are submitted by a consulting firm hired by the City of Mora to help close the project. We do not have any questions on this project.

RECOMMENDATION

Aeronautics personnel work with the budget office to resolve the question of which fund the Litchfield, Chisholm, and any future grant reimbursements of this type should be deposited.

OBSERVATIONS

The following observations are considered performance/operational in nature. Observations are intended to assess the economy and efficiency of operations and program effectiveness - the extent to which program objectives are being met.

OBSERVATION I--NEED TO VERIFY THAT RECOMMENDATIONS HAVE BEEN IMPLEMENTED PRIOR TO RESPONDING TO A FHWA REVIEW

During our review we found that Mn/DOT's response to a Federal Highway Administration (FHWA) review recommendation was incorrect. FHWA Review 1988-7, Leases of Airspace, recommended that Mn/DOT withdraw credits given to Federal funds on an airspace lease. A memo was sent by the Office of Right of Way and Surveys to inform the Office of Financial Operations of the need to withdraw credits to Federal funds on this particular lease. The memo was dated June 14, 1988 and there was no further correspondence with the Office of Financial Operations. On September 12, 1988 the Office of Right of Way sent a response to the FHWA stating that Mn/DOT has withdrawn credits given to Federal funds on this lease. During our review in November, we discovered that credits were not yet withdrawn.

Anytime a FHWA review makes a recommendation to Mn/DOT a response is requested. This response enables the FHWA to determine whether or not appropriate action was taken on the recommendations made. It is Mn/DOT's responsibility to make certain that our response is accurate. Any time a corrective action must be taken there is always the possibility of errors being made. Verification of the action taken to implement a recommendation would be adequate internal control to assure that it was properly done.

When the Office of Right of Way and Surveys responded to the FHWA review, they had notified the Office of Financial Operations of the need to withdraw credits on this airspace lease. The Office of Financial Operations did attempt to follow the directions of the memo by taking steps to assure that Federal funds would no longer be credited as income on the lease. However, there were no retroactive adjustments made for Federal funds already credited on this lease. Although a copy of the review was sent to the Office of Financial Operations with the memo, the review never stated the amount or time period involved. The Office of Financial Operations did not contact Right of Way to verify the amount or time period involved. This resulted in a misunderstanding on the need to make a retroactive adjustment. The Office of Financial Operations has since made the retroactive adjustment to withdraw Federal credits on the lease. The adjustment resulted in an additional \$19,679.62 of income to the State.

RECOMMENDATION

The Office of Right of Way and Surveys develop a procedure to verify that recommendations have been correctly and fully implemented before responding to FHWA reviews or any type of audit requiring a response.

OBSERVATION II--NEED TO MONITOR LEASES OF BUILDINGS TO FORMER OWNERS

The relocation advisor for S.P. 8202, parcel 5, arranged to lease property to the former owner for two months, June and July of 1988. On June 14, 1988 the lease was mailed to the owner at the leased property but it was not signed and returned as of September 1988. A letter was sent from the Central Office Property Management Unit on September 6, 1988, asking that the former owner sign and return the lease. Another letter was sent from the district relocation advisor to the former owner on September 14, 1988, stating that the lease must be returned and rent paid before relocation payments could be made. On September 29, 1988 the former property owner called the Central Office Property Management Unit and claimed that he wasn't informed of when he had to move out or of the fact that he had to pay rent for the two months. There was documentation in the lease file dated in June indicating that the relocation advisor had verbally quoted rent of \$350.00 per month for several additional months while the tenant constructed their new home. Payment for the rent due was received on October 10, 1988.

The Right of Way Manual (5-491.502.2) states that upon written request from the former owner the real estate may be leased to the requesting party without advertising for bids. A written request would ensure that the former property owner was aware of rental provisions. Another effective means of proper notification would be to have required the lease to be signed and returned promptly.

A discussion with the relocation advisor revealed that on short-term leases to former displaced owners a written request to lease the property isn't usually required. Furthermore, the signed lease isn't returned to the District relocation advisor but is sent to the Central Office Property Management Unit. The District isn't always aware of leases not being signed and returned until collection procedures begin. These procedures don't begin until after the rent is delinquent for two months. The agreement to lease and its provisions should be acknowledged before payments become delinquent two months. This may prevent claims against the Mn/DOT.

There was no documentation in the file regarding efforts to contact the tenant prior to the time delinquent payment collection procedures began. The Property Management section of the Right of Way Manual is now currently being revised to address this situation. Procedures will require follow up on instances where leases are not promptly returned. Relocation advisors are being reminded to get the written request from former owners to lease back the property. Accordingly, no recommendation will be made.

OBSERVATION III--TYPES OF ERRORS NOTED WHEN REVIEWING PARTIAL ESTIMATE PAYMENTS

During our reviews of construction projects, we noted various math errors in the Item Record Account (IRA) entries and/or the source document totals. Except in one instance, such errors were generally minor in nature and/or corrected within a short time.

We did field reviews of IRA entries and payment documents on 17 projects. Exhibit 1 on the next page is a list of projects we reviewed. Included in the 17 projects were 7 county/city projects and 2 Corps of Engineers projects in Mankato.

While we note that the payments we reviewed are partial estimates and that pay quantities are double checked before submission of the final estimate, one error of a rather large quantity and dollar amount warranted mentioning.

On Duluth District S.P. 6982-189, a partial estimate total of 1,027,218 lbs. on the bottom of one IRA sheet was carried to the next IRA sheet and added to 145,422 lbs. to arrive at a quantity of 1,726,640 lbs., an error of 554,000 pounds. 1,726,640 lbs. @ .40 were paid on the partial estimate. This resulted in an overpayment to the contractor of \$221,600 for approximately three months until it was corrected and credited on another partial estimate. A check of arithmetic may have prevented the error.

Exhibit 2 lists the errors of this type that we found. Errors resulting in an over or under payment of less than \$100 are not included on the list. The Exhibit is intended for management's information and no particular recommendation is suggested at this time.

EXHIBIT 1
(Observation III)

Construction Projects Reviewed
F.Y. 1988

State Project Number	District	Construction Office City or County	Project Engineer	Total Contract Amount	Work Done F.Y. 88
Trunk Highway Projects					
6982-194	1	Duluth	Davidson	\$4,827,170	\$1,399,879
1201-25	8	Willmar	Erickson	622,031	136,847
1403-22	4	Detroit Lakes	Gjovik	3,962,735	871,802
6008-11	4	Detroit Lakes	Gjovik	209,575	171,852
2785-9751	5	Golden Valley	Thompson	14,131,947	5,370,140
6982-189	1	Duluth	Davidson	14,523,978	1,888,117
6911-27	1	Duluth	Sexton	8,568,572	5,055,178
7202-13	7	Mankato	Keenen	4,854,619	48,546
County/City Projects					
27-632-12	5	Hennepin	V. Genzlinger	2,028,848	1,515,424
33-603-17	3	Kanabec	G. Nikodym	227,659	226,988
118-118-02	1	St. Louis	Carlson	854,200	64,796
62-668-18	9	Ramsey	J. Weltzin	3,651,954	2,261,962
07-608-06	7	Blue Earth	Regenscheid	352,146	335,596
40-605-02	7	LeSueur	R. Sandvik	222,039	223,908
84-618-01	4	Wilkin	T. Richels	569,780	492,966
Corps of Engineers Projects					
5212-13	7	Mankato	Keenen	12,241,367	83,218
0713-62	7	Mankato	Keenen	9,261,560	6,248,097

EXHIBIT 2
(Observation III)

Types of errors found when checking Item Record Account,
Source documents, and partial estimate quantities

State Project Number	Bid Item Number	Description	Number of Units in Error	Dollar Amount of Error ¹	Reason for Error
1201-25	2105.522	Select Granular Borrow Mod.	200	\$210	Paid for wrong bid item, should have been Select Granular Borrow (cv)
6982-189	2506.516	Casting Assemblies	1	\$250 CR	Voucher and IRA don't match
	2506.516	Casting Assemblies	3	\$750	Voucher and IRA don't match
	2401.541	Reinforcement Bars	554,000	\$221,600	Math error in IRA
7202-13	2575.505	Sodding	6,036	\$5,734	Math error in IRA and math error in source document
27-632-12	2521.501	4" Concrete Walk	5,489	\$7,685	Entry of 44 changed to 55. Amount of 5,544 added into partial estimate quantity
62-668-18	2401.501	Structure Con- crete 3Y43	7	\$2,051	Quantity on voucher was 7 cu. yd. more than IRA quantity
07-608-06	2452.507	CIP Concrete Piling Delivered 12"	40	\$520 CR	Held back on estimate
5212-13	2211.502	Aggregate Base Class 5	140	\$1,050	Should have been paid on next voucher per dates in IRA

¹ CR indicates underpayment to contractor. All others are overpayments.

OBSERVATION IV - NEED FOR INCREASED SUPERVISORY CONTROLS ON CERTAIN COST ACCOUNTING SYSTEM RECONCILIATIONS AND ADJUSTMENTS

The Minnesota Department of Transportation (Mn/DOT) generates the progress billings to the Federal Highway Administration (FHWA) for costs incurred under the Federal-aid Highway Program through a current billing system. The system produces a weekly billing for costs incurred during the week on each active Federal-aid project. The Costs billed are abstracted from Mn/DOT's Cost Accounting System (CAS) and are summarized on the current billing by Federal appropriation codes by functional classes of work. The current billings are paid by FHWA on the basis of assurances set forth in a current billing Memorandum of Understanding between Mn/DOT and FHWA.

The Memorandum of Understanding provides for accounting controls to be exercised by Mn/DOT over the consolidated billings. The following, but not necessarily limited thereto, are the prime accounting controls to be exercised by the Mn/DOT:

Reconciliation A

Reconciliation of Daily Control Reports (103-CG-DA) to Weekly Control Reports - Explosion Control Report (106-CG-WK), Federal Project Master File Update Control Report (111-CG-WK) to the Federal Aid Billing Report (21 WK), which includes reconciliation of the current week's Report 21 to the previous week's Report 21 (Weekly).

Reconciliation B

Reconciliation of the costs upon which current billings is based with expenditures per Statewide Accounting System (Monthly).

Reconciliation C

Reconciliation of the Agreement Amount per Current Billing with the Federal-aid Agreements Account in the General Ledger (Monthly).

Reconciliation D

Reconciliation of the Adjustment F total, Pending Eligibility Determination, to the Subsidiary ledger (Monthly).

Reconciliation E

Reconciliation of the Federal Aid Billing Report (21 WK) at fiscal year end and the Year-End Special Federal Projects Report (156-CG-YR) which lists only deleted projects to the first Federal Aid Billing Report (21 WK) of the next fiscal year (Annually).

Reconciliation F

Reconciliation of the costs shown on the Right of Way Project Control Cards to the costs claimed on the Current Bill (Semi-Final and Final).

Reconciliation G

Reconciliation of the FHWA 329 Report to Current Bill and Agency Projects for Agreement Amounts and Expended (Federal Share) Amounts (Quarterly).

In addition, the Memorandum of Understanding provides for the elimination of certain costs included in the current billing from the net reimbursement claim. These adjustments are:

- Adjustment A - Costs in excess of project agreement amount.
- Adjustment C - Costs on projects not under agreement.
- Adjustment E - Engineering costs in excess of statutory limitation.
- Adjustment F - Costs pending eligibility determination.
- Adjustment G - Cost recorded or incurred after preparation of the final voucher has started.
- Adjustment H - Changes in distribution of costs by appropriation which do not effect net claims.

The reconciliations have been performed during the period audited. No actual misstatements of costs or reimbursement claims were observed, however, certain control weaknesses do create the potential for such misstatements in the event of erroneous input data to the current bill.

The United States General Accounting Office's Government Auditing Standards (Yellow Book) fourth field work standard for government performance audits states that an assessment should be made of applicable internal controls when necessary to satisfy the audit objectives. Internal control requirements are detailed in the AICPA Professional U.S. Auditing Standards. They state:

Accounting control is within the scope of the study and evaluation of internal control contemplated by generally accepted auditing standards (AU321.01).

EDP accounting control procedures such as application controls relate to specific tasks performed by EDP to provide reasonable assurance that the recording, processing, and reporting of data are properly performed. Application controls can be input controls designed to provide reasonable assurance that data received for processing by EDP have been properly authorized (AU321.08).

The department or unit in which accounting control procedures are performed is less significant than the performance of the procedures by persons having no incompatible functions for accounting control purposes and the effectiveness of the procedures (AU321.09).

Incompatible functions for accounting control purposes are those that place any person in a position both to perpetrate and to conceal errors or irregularities in the normal course of their duties (AU321.11).

A person in a position to make unapproved changes in EDP data files performs incompatible functions (AU321.13).

If individuals involved perform incompatible functions, compensating controls may be applied, such as, provisions for effective supervision (AU321.15).

Management has the responsibility for adopting sound accounting policies, for maintaining an adequate and effective system of accounts, for the safeguarding of assets, and for devising a system of internal control that will, among other things, help assure the production of proper financial statements.

The following are areas of concern:

1. Reconciliation B - No supervisory review has been performed. The CAS TC60 input form is only authorized by the preparer.
2. Reconciliation D - No supervisory review has been performed. The individual performing the reconciliation also maintains the subsidiary ledger. This is an incompatible function.
3. Adjustment F - No supervisory review has been performed. The CAS TC50 input form is only authorized by the preparer. The supplemental agreements are not always date stamped by the receptionist.

Knowledgeable supervision along with a system of authorization is the most effective control to provide reasonable assurance that the reliability of computer applications is not materially and adversely affected and to attest to compliance procedures.

An FHWA report on process review of the current billing system dated June 25, 1986 noted a significant breakdown of internal controls attributable in part to "a lack of supervisory control over the performance of the reconciliations." It was recommended that supervisory controls be established to assure that the reconciliations are properly performed at the specified intervals.

Mn/DOT's response to the FHWA recommendation (dated July 29, 1986) stated that "as the reconciliations are completed either the Control Group Supervisor or the Federal Aid Billing Unit Supervisor will be required to initial each reconciliation for which they are responsible. The purpose of the review will be to attest to compliance procedures, both to timeliness and accuracy. The reconciliations were to be forwarded to the Control Group/Federal Aid Billing Manager and the Assistant Director of the Accounting and Finance Section for their information and review prior to being placed in their respective working files."

Mn/DOT's proposed corrective action on September 3, 1986 was considered to be responsive to the FHWA recommendations and, therefore, acceptable.

RECOMMENDATIONS

1. Reconciliation B be reviewed each month on a random sample by cost center basis. The review of the reconciliation should include a review of the CAS input documents on a random sample basis. The reconciliation should be signed and dated by both the preparer and the reviewer.
2. Reconciliation D procedures provide for an effective supervisory review. The reconciliation be signed and dated by the preparer and the reviewer.
3. Ensure that the CAS TC50 input document for Adjustment F's are signed and dated by both the preparer and the reviewer.
4. Written instructions be updated as needed for the reconciliations and adjustments indicating the level(s) of supervisory review necessary and specifying the completion time frame(s).

Attachment I

STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND

PROGRESS TOWARD IMPLEMENTATION

From Audit Report No. 88-800-44

(Fiscal Year 1987)

Finding I -

Need to monitor moves and to maintain records when estimates cannot be obtained.

Recommendation No. 1:

The relocation advisor discuss the need to receive advance notice of the move date with displaced business owners.

Recommendation No. 2:

The relocation files include a copy of the advance notice, an inventory of items to be moved, and documentation that items claimed were moved. If surveillance is provided the file should contain the results.

Recommendation Implementation in Progress

Although many relocation files reviewed included advance written notice of the date of the move, some did not. A couple of instances indicated that the displacee planned to notify their relocation advisor after the move instead of in advance. All files now contain a list of inventory to be moved but verification of the inventory isn't always evident. Overall, there is substantial improvement since last fiscal year. Currently FHWA is doing an in-depth review of business relocation which will be followed up on next year.

Recommendation No. 3:

The Relocation Manager notify all relocation personnel of the requirements for monitoring a move when an estimate of moving costs cannot be obtained.

RECOMMENDATION FULLY IMPLEMENTED

There are very few types of moves that estimates cannot be obtained for. The relocation advisors who handle these types of moves were notified of the requirements to monitor these types of moves.

Finding II -

Need for formal training of relocation staff to update themselves on recent changes in regulations.

Recommendation:

Training sessions should be offered to relocation personnel when there are changes in regulations that affect them. The training should be formal in order to reach all appropriate personnel and to give them sufficient information to carry out new regulations.

RECOMMENDATION IMPLEMENTATION IN PROGRESS

A week long training session was conducted May 9-13, 1988. The seminar covered all areas of relocation with emphasis on residential moves. Many changes in business moves won't take effect until April, 1989. Another seminar will be offered before these business regulation changes go into effect.

Finding III -

Need to credit Federally funded projects for retained bid deposits and liquidated damages.

Recommendation:

Procedures be developed to have future bid deposits retained and liquidated damages collected credited to Federally funded projects.

RECOMMENDATION FULLY IMPLEMENTED

Procedures and instructions have been given to appropriate Right of Way Accounting personnel in the Office of Financial Operations so that these type of transactions will be credited to Federal funds. The current audit verified that this procedure was being followed.

Finding IV -

Need to attempt to contact the sign site owner prior to inspection of the site.

Recommendation:

Staff appraisers be encouraged to contact site owners of sign relocation projects to verify lease information and to inform the owner of the valuation. Also, these contacts and/or attempts to make contact should be documented.

RECOMMENDATION FULLY IMPLEMENTED

All staff appraisers are encouraged to contact the sign site owner prior to inspection of the site. The current audit found documentation of these contacts in the parcel files.

Finding V -

Need for compliance with procedures on replacement housing supplement documentation.

Recommendation:

All replacement housing supplement claims have documentation supporting replacement housing purchase cost prior to payment.

RECOMMENDATION FULLY IMPLEMENTED

This finding involved the construction of a new replacement home and was an isolated case as cost records are normally required. In this review, we found another instance of a replacement housing supplement with construction involved and all cost records were present to support the replacement housing supplement claim.

Finding VI -

Need to Complete Fieldmen's Checks on Compliance

Recommendation:

District Engineers more closely monitor that the "Fieldmen's Checks on Compliance" are being completed monthly by construction personnel.

RECOMMENDATION IMPLEMENTATION IN PROGRESS

On February 26, 1988, Construction Engineer Wayne Murphy issued a memo to L.F. McNamara. The memo stated various steps that would be taken in an attempt to correct noncompliance in this area. During our review this year, there was substantial improvement in compliance with the requirement of doing monthly Fieldmen's Checks.



Minnesota
Department of Transportation
Transportation Building
St. Paul, Minnesota 55155

Office of Commissioner

(612) 296-3000

February 21, 1989

Mr. James R. Nobles
Office of the Legislative Auditor
Veterans' Service Building
St. Paul, Minnesota 55155

Dear Mr. Nobles:

We have reviewed the draft management letter which your staff has prepared concerning Department of Transportation accounting procedures and controls for Fiscal Year 1988. We appreciate the professional and constructive nature of the recommendations. Our responses to your recommendations, as well as those having to do with OMB Circular A-128, follow for inclusion in your final report.

Recommendation 1: The Minnesota Department of Transportation (Mn/DOT) should properly value their consumable inventory by including all direct costs of acquisition.

Response: The department is aware of the need to properly value the consumable inventory. A task force is established and is reviewing the ability to account for acquisition costs with the current inventory system, federal participation in these costs, and system enhancement needs. The task force's recommendations should be implemented by July 1, 1989.

AUDIT OF OMB CIRCULAR A-128

FINDING I - NEED TO MONITOR SUBMITTAL OF CONTRACTORS' PAYROLLS

Recommendation 1: Duluth district construction office and Ramsey County personnel use a form or other type of system to determine which weeks each contractor or subcontractor worked, and whether a payroll has been submitted. The District State Aid Engineer work with Ramsey County personnel on implementing this.

Response: The Duluth district construction office is now using a form to determine the weeks contractors and subcontractors worked and whether payrolls have been submitted for those weeks. The State Aid Engineer will work with the District State Aid Engineer to assure that Ramsey County personnel monitor the submittal of contractors' payrolls. A suggested sample form will be provided.

Recommendation 2: Mankato district construction office personnel follow up on missing payrolls as soon as possible, rather than waiting until the project is complete.

Response: The Mankato district construction office will comply with this recommendation.

FINDING II - NEED TO CHECK PAYROLLS FOR PROPER WAGE RATES

Recommendation 1: The appropriate District State Aid Engineers provide guidance to Kanabec County and Ramsey County personnel working on federally assisted construction projects so that they comply with the requirements to check the first two payrolls from each contractor, and if no underpayments are noted, to spot check subsequent payrolls.

Response: The State Aid Engineer has issued a memorandum to all District State Aid Engineers which addressed reviewing the first two payrolls of each contractor for proper wage rates, and to spot check subsequent payrolls on a timely basis.

FINDING III - NEED TO DETERMINE IF GRANT REIMBURSEMENTS ARE DEPOSITED
CORRECTLY

Recommendation 1: Aeronautics personnel work with the budget office to resolve the question of to which fund the Litchfield, Chisholm, and any future grant reimbursements of this type should be deposited.

Response: Aeronautics and Budget personnel will meet to determine which fund this type of grant reimbursement should be deposited in.

OBSERVATION I - NEED TO VERIFY THAT RECOMMENDATIONS HAVE BEEN IMPLEMENTED
PRIOR TO RESPONDING TO A FHWA REVIEW

Recommendation 1: The Office of Right of Way and Surveys develop a procedure to verify that recommendations have been correctly and fully implemented before responding to FHWA reviews or any type of audit requiring a response.

Response: The Office of Right of Way and Surveys, as well as the Right of Way Accounting Unit within Financial Operations will ensure that future responses to federal process reviews and audits will be coordinated with one another. The misunderstanding that resulted regarding lease of airspace is not indicative of our responses. In the future, Financial Operations will respond in writing to directives from the Office of Right of Way and Surveys, indicating what corrective action was taken. This should eliminate any potential for misunderstanding.

OBSERVATION IV - NEED FOR INCREASED SUPERVISORY CONTROLS ON CERTAIN COST
ACCOUNTING SYSTEM RECONCILIATIONS AND ADJUSTMENTS

Recommendation 1: Reconciliation B be reviewed each month on a random sample by cost center basis. The review of the reconciliation should include a review of the CAS input documents on a random sample basis. The reconciliation should be signed and dated by both the preparer and the reviewer.

Recommendation 2: Reconciliation D procedures provide for an effective supervisory review. The reconciliation be signed and dated by the preparer and the reviewer.

Recommendation 3: Ensure that the CAS TC50 input document for Adjustment F's is signed and dated by both the preparer and the reviewer.

Recommendation 4: Written instructions be updated as needed for the reconciliations and adjustments indicating the level(s) of supervisory review necessary and specifying the completion time frame(s).

Response:

Recommendation 1: Reconciliation B will be initialed and dated by supervisor.

Recommendation 2: Reconciliation D will be initialed and dated by supervisor.

Recommendation 3: The TC50 is prepared by Right of Way accounting and Federal Aid accounting personnel. The preparer is authorized to sign. Complete and detailed knowledge would be needed by the reviewer to sign and would not be time efficient.

Recommendation 4: Both review and initial functions specifying the completion time frame will be added to the Workbook at the next update.

Again we wish to thank you for the professional, constructive nature of your recommendations. We will make an effort to ensure that the actions specified in these responses are implemented in a timely manner.

Sincerely,



LEONARD W. LEVINE
Commissioner