

DEPARTMENT OF TRANSPORTATION
ROCHESTER AND OWATONNA DISTRICTS
FINANCIAL AUDIT
FOR THE THREE YEARS ENDED JUNE 30, 1990

AUGUST 1991

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

DEPARTMENT OF TRANSPORTATION ROCHESTER/OWATONNA DISTRICTS

FINANCIAL AUDIT FOR THE THREE YEARS ENDED JUNE 30, 1990

Public Release Date: August 16, 1991

No. 91-52

OBJECTIVES:

- EVALUATE INTERNAL CONTROL STRUCTURE: payroll; supplies and materials; and consumable inventory.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

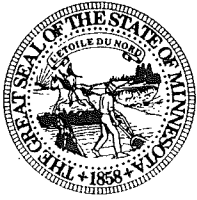
CONCLUSIONS:

We found three areas where the internal control structure needed improvement:

- The Computer Assisted Materials Management System security and access controls need improvement.
- The Rochester district's inventory control functions are not separated properly.
- The Owatonna district's inventory control functions are not separated properly.

We found no departures from finance-related legal provisions.

Contact the Financial Audit Division for additional information.
(612) 296-1730



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. John Riley, Commissioner
Department of Transportation

Mr. Kermit McRae, District Engineer
Department of Transportation - District 6A, Rochester

Mr. Dale Shaw, Area Maintenance Engineer
Department of Transportation - District 6B, Owatonna

Audit Scope

We have conducted a financial related audit of the Department of Transportation, Districts 6A and 6B, as of and for the three years ending June 30, 1990. Our audit was limited to only that portion of the State of Minnesota financial activities attributable to the transactions of the Department of Transportation, Rochester District, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure of the Department of Transportation, Districts 6A and 6B in effect as of March 1991.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial activities attributable to the transaction of the Department of Transportation, Districts 6A and 6B are free of material misstatements.

As part of our study and evaluation of the internal control structure, we performed tests of the Department of Transportation, Districts 6A and 6B's compliance with certain provisions of laws, regulations, and contracts. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Department of Transportation, Districts 6A and 6B is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws, regulations, and contracts. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

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Mr. John Riley, Commissioner
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Mr. Dale Shaw, Area Maintenance Engineer
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- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and
- transactions are recorded properly on the statewide accounting system in accordance with Department of Finance policies and procedures.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- payroll - regular,
- supplies, materials, and
- consumable inventory control.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Conclusions

Our study and evaluation disclosed the conditions discussed in findings 1-3 involving the internal control structure of the Department of Transportation, Rochester District. We consider these conditions to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial activities

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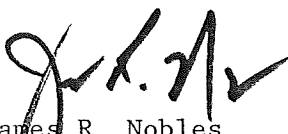
being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe finding 1 is a material weakness.

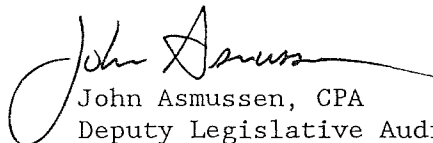
We also noted other matters involving the internal control structure and its operations that we reported to the management of the Department of Transportation, Districts 6A and 6B, at the exit conference held on July 22, 1991.

The results of our tests indicate that, with respect to the items tested, the Department of Transportation, Districts 6A and 6B, complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing came to our attention that caused us to believe that the Department of Transportation, Districts 6A and 6B had not complied, in all material respects, with those provisions.

This report is intended for the information of the Legislative Audit Commission and management of the Department of Transportation, Districts 6A and 6B. This restriction is not intended to limit the distribution of this report, which was released as a public document on August 16, 1991.

We would like to thank the Department of Transportation, Districts 6A and 6B staff for their cooperation during this audit.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: May 16, 1991

REPORT SIGNED ON: August 12, 1991

DEPARTMENT OF TRANSPORTATION
ROCHESTER DISTRICT

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AUDIT PARTICIPATION

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

John Asmussen, CPA	Deputy Legislative Auditor
Margaret Jenniges, CPA	Audit Manager
Steve Pyan, CPA	Auditor-in-Charge
Chris Buse, CPA	Auditor

EXIT CONFERENCE

The findings and recommendations of this report were discussed with the following officials of the Department of Transportation, Rochester District at the conference held on July 22, 1991:

Kermit McRae	District Engineer
Dale Shaw	Owatonna Area Maintenance Engineer
Lucille Farrel	Administrative Manager
Avis Kravosky	Owatonna Business Office Manager
Arnold Johnson	Rochester Inventory Control Supervisor
Pete Klugherz	Owatonna Inventory Control Supervisor

DEPARTMENT OF TRANSPORTATION
ROCHESTER DISTRICT

I. INTRODUCTION

The Minnesota Department of Transportation (MN/DOT) has established the Rochester office as part of a nine district system. The district is divided into two areas, the Rochester office is an A district office. The B district office is in Owatonna. Maintenance operations are directed out of both locations, while a construction unit is housed in the Rochester facility. The district engineer directs the entire district operation with the Owatonna sub-district being under the direct supervision of the area maintenance engineer. In addition, there are 23 truck stations located throughout the district. There are 1,676 lane miles within the district.

The March 31, 1991 inventory stock on hand in Rochester and Owatonna was \$674,300 and \$797,679 respectively.

Selected Fiscal Year 1990 expenditures were as follows:

<u>Activity</u>	<u>Rochester</u>	<u>Owatonna</u>	<u>Totals</u>
Payroll-Regular	\$8,858,958	\$4,063,323	\$12,922,281
Supplies, Materials	1,823,444	1,551,979	3,375,423
Other	<u>1,874,506</u>	<u>751,923</u>	<u>2,626,429</u>
Totals	<u>\$12,556,908</u>	<u>\$6,367,225</u>	<u>\$18,924,133</u>

Source: September 1, 1990 Managers Financial Report.

DEPARTMENT OF TRANSPORTATION
ROCHESTER DISTRICT

II. CURRENT FINDINGS AND RECOMMENDATIONS

Consumable Inventory - Background

Inventory centers are maintained at both the Rochester and Owatonna maintenance buildings. Items kept in stock include supplies, materials and fuels used by highway maintenance staff, as well as the shop and garage repair staff housed in each facility. Certain truck stations have a limited amount of fuel and stockpile materials on hand. Both centers are staffed by a inventory control supervisor, who is assisted by 2 or 3 full-time parts technicians.

Since the middle of 1989 all purchases, issuances, and quantities on hand have been recorded on an fully automated inventory control system. The system is titled "The Computer Aided Materials Management System" or (CAMMS).

Our review of both the physical and system controls produced the following concerns.

1. The Computer Assisted Materials Management System security and access controls need improvement.

Security and access controls are weak for several reasons. First, employee passwords are not being kept confidential. Second, the system is not consistently logged off between periods of input activity. Finally, certain employees are assigned greater security access than necessary. These weaknesses substantially increase the system's operational control risks.

All employees have been assigned security numbers which clear them for performing certain types of transactions. The basic level of security clearance allows the user to enter receipts or issuance. Higher levels allow the user to edit the master file, alter the overall security file and add users. Rochester staff have been cleared for most, if not all of the higher level functions. Staff security levels should be reevaluated and reassigned. Clearance should be limited to only those functions necessary for employees to perform their assigned duties.

Some inventory control employees have taped their terminal identification codes and personal passwords on their computer work stations. A principal control of the system is that each transaction is traceable to the user responsible for inputting that transaction. That control is based primarily on the assignment of unique access codes for each individual. The effectiveness of the control is voided when individual access codes and passwords are not kept confidential.

RECOMMENDATIONS

- Inventory center employees should keep passwords and terminal identification numbers confidential.
- Employees system access should be limited to only those functions necessary to perform their duties.

DEPARTMENT OF TRANSPORTATION
ROCHESTER DISTRICT

2. The Rochester district's inventory control functions are not separated properly.

Inventory control staff, who are responsible for controlling inventory stock also perform the physical cycle counts. The control center supervisor and his three parts technicians all are assigned duties in each inventory function. These employees purchase, receive and maintain accounting records for consumable inventory items.

A monthly reconciliation between statewide accounting transactions and the inventory system is completed by business office staff. The procedure provides an accounting control to partly offset the inadequate physical controls. However, the reconciliation should be supplemented by another independent check because the inventory staff conduct the physical counts. The person performing the count reports his results without significant oversight. The control risk under the current system would be reduced if staff independent of the inventory center would perform or assist with the inventory counts.

RECOMMENDATION

- Staff independent of the inventory control center should periodically perform or assist with the cycle counts.

3. The Owatonna district's inventory control functions are not separated properly.

Inventory control center staff perform incompatible accounting duties. The center's supervisor and the two parts technicians order or purchase goods, receive goods and record activity in the computerized inventory control system. These employees perform most of the inventory control duties interchangeably. The system is designed to provide adequate controls. However, the Owatonna district staff have not implemented the necessary control procedures.

Each month the supervisor reconciles purchases entered on the inventory system to those paid through statewide accounting. The reconciliation assures that purchased goods were entered onto the system. However, this reconciliation process is weak because the supervisor's work is not reviewed. A particular concern is the supervisor's authority to adjust the inventory system for errors discovered. The task should be shared with business office staff. Also, the office manager should review and sign off on all adjustments made to the system.

The parts technicians are responsible for performing the periodic physical counts. This duty is incompatible with their responsibilities for controlling stock items. Staff independent of the inventory center operation should perform or assist with the periodic cycle counts of stock on hand.

DEPARTMENT OF TRANSPORTATION
ROCHESTER DISTRICT

To provide greater control over the purchasing activity, whenever possible the inventory center supervisor should review and sign purchase orders. This control should reduce the possibility that unusual or unnecessary goods would be purchased.

RECOMMENDATIONS

- The district's inventory control supervisor should be responsible for approving all purchase orders.
- Employees independent of the inventory control center should perform or assist with the physical inventory cycle counts and monthly inventory reconciliations.

DEPARTMENT: of Transportation
Deputy Commissioner's Office

STATE OF MINNESOTA
Office Memorandum

DATE: July 31, 1991

TO: John Asmussen, Deputy Legislative Auditor
Financial Audit Division

FROM: Edwin H. Cohoon, Deputy Commissioner
Department of Transportation

PHONE: 612/296-7942

SUBJECT: **AUDIT OF THE DEPARTMENT OF TRANSPORTATION
DISTRICTS 6A AND 6B FINANCIAL ACTIVITIES**

District 6, Rochester, has reviewed the subject audit report and provides the following as a response to the findings and recommendations made by your office.

1. The Computer Assisted Materials Management System security and access controls need improvement.

Employees in the Inventory Center have been instructed to keep their personal passwords confidential. They have removed their terminal identification codes and passwords from their work stations and have obtained new passwords. The authority to edit the master file, alter the overall security file and add users has been restricted to the Inventory Control Supervisor and one Auto Parts Technician. The Inventory Control Supervisor will be retiring on July 31 and until he is replaced the Auto Parts Technician assigned this additional clearance will be the Acting Supervisor.

2. The Rochester District's Inventory Control functions are not separated properly.

The separation of duties in our Inventory Control Centers has always created a problem because of the lack of sufficient personnel to do that. The Rochester Office has used an individual outside of the Inventory Center to conduct the physical counts on a random basis. To try to reduce the control risk, as suggested by your office, we will assign personnel outside of the Inventory Center to perform or assist with the inventory counts on a regular schedule rather than a random basis.

John Asmussen, Deputy Legislative Auditor
Re: Audit of the Department of Transportation
Districts 6A and 6B Financial Activities
July 31, 1991

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3. The Owatonna District's Inventory Control functions are not separated properly.

At the Owatonna Office we will implement the same procedure as we are at Rochester by assigning personnel outside of the Inventory Center to perform or assist with the inventory counts on a regular schedule rather than a random basis as it currently is done.

The monthly reconciliation process between Statewide Accounting transactions and the inventory system will be assigned to the Business Office Personnel as soon as they can be trained. The Inventory Control Supervisor at Owatonna had assumed this duty when there was a turnover of personnel in the Business Office last year.

The Inventory Control Supervisor or Office Manager will now be responsible for approving all purchase orders.

I believe the action the district is taking should resolve the concerns your office indicated regarding security and control of our inventory.

cc: Larry McNamara
Kermit McRae
Dale Shaw
Lucille Farrell
File