

**DEPARTMENT OF TRANSPORTATION
DULUTH AND VIRGINIA DISTRICTS**

FINANCIAL AUDIT

FOR THE THREE YEARS ENDED JUNE 30, 1991

October 1992

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

92-74

DEPARTMENT OF TRANSPORTATION DULUTH AND VIRGINIA DISTRICTS

FINANCIAL AUDIT FOR THE THREE YEARS ENDED JUNE 30, 1991

Public Release Date: October 9, 1992

No. 92-74

OBJECTIVES:

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

CONCLUSIONS:

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

- Department purchase orders should not be authorized until all required purchasing information is recorded. Also, per unit prices should be posted to purchase orders prior to the order being placed.
- Staff independent of the inventory center should conduct periodic spot checks of the inventory. The districts should develop a cycle count schedule to ensure that all items are counted at least once per year.

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. James N. Denn, Commissioner
Department of Transportation

Mr. Dave Ekern, District Engineer
Department of Transportation - District 1A, Duluth

Mr. James Miner, Assistant District Engineer
Department of Transportation - District 1B, Virginia

Audit Scope

We have conducted a financial related audit of the Department of Transportation, Districts 1A and 1B, as of and for the three years ending June 30, 1991. Our audit was limited to only that portion of the State of Minnesota financial activities attributable to the transactions of the Department of Transportation, Duluth 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 1A and 1B in effect as of April 1992.

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 1A and 1B 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 1A and 1B'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 1A and 1B 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

Representative Ann Rest, Chair
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Page 2

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:

- 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,
- consumable inventory, and
- supplies.

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 and 2 involving the internal control structure of the Department of Transportation, Duluth and Virginia districts. 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.

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Page 3

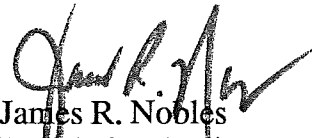
A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial activities being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe none of the reportable conditions described above is a material weakness.

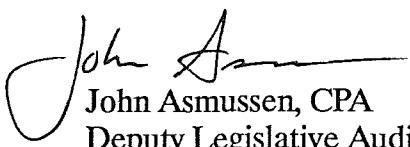
We also noted other matters involving the internal control structure and its operations that we reported to the management of the Department of Transportation, Districts 1A and 1B, at the exit conferences held on May 22 and June 4, 1992.

The results of our tests indicate that, with respect to the items tested, the Department of Transportation, Districts 1A and 1B, 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 1A and 1B 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 1A and 1B. This restriction is not intended to limit the distribution of this report, which was released as a public document on October 9, 1992.

We would like to thank the Department of Transportation, Districts 1A and 1B staff for their cooperation during this audit.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 5, 1992

Report Signed On: October 2, 1992

**Department of Transportation
Duluth/Virginia Districts**

Table of Contents

	Page
Introduction	1
Current Findings and Recommendations	2
Agency Response	4

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
Patrick Ryan	Auditor-in-Charge
Christina Weiss	Staff Auditor

Exit Conferences

The findings and recommendations in this report were discussed with the following staff of the Mn/DOT District 1A on May 22, 1992 at Duluth:

Jim Laumeyer	Administrative Manager
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The findings and recommendations in this report were discussed with the following staff of the Mn/DOT District 1B on June 4, 1992 at Virginia:

Lyle Herzog	Business Manager
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Department of Transportation Duluth/Virginia Districts

Introduction

The Minnesota Department of Transportation (Mn/DOT) has established the Duluth office as part of a nine district system. The district offices provide for the construction and maintenance of state trunk and interstate highways. The district is divided into two areas: the Duluth office is an "A" district office, with a subdistrict "B" office located in Virginia. The district engineer directs the entire district operation, with the Virginia subdistrict under the direct supervision of the assistant district engineer. Eleven truck stations are located within the district. The district is responsible for 3,787 miles of highway.

Both the Duluth and Virginia maintenance buildings operate inventory centers. Stock items include supplies, materials, and fuels used by highway maintenance, shop, and garage staff housed in each facility. The truck stations throughout the district also have a limited amount of inventory and stockpile materials on hand. The June 30, 1991 inventory valuations for the Duluth and Virginia districts were \$1,024,847 and \$523,020 respectively.

Selected Fiscal Year 1991 expenditures were as follows:

<u>Activity</u>	<u>Duluth</u>	<u>Virginia</u>	<u>Totals</u>
Payroll	\$14,052,763	\$3,812,091	\$17,864,854
Supplies and Materials	1,954,618	1,434,117	3,388,735
Other	<u>1,358,276</u>	<u>399,094</u>	<u>1,757,370</u>
Totals	<u>\$17,365,657</u>	<u>\$5,645,302</u>	<u>\$23,010,959</u>

Source: Managers Financial Report as of September 3, 1991.

Current Findings and Recommendations

1. Purchasing and disbursement procedures need improvement.

Duluth district departmental purchase orders are sometimes signed in advance of completing the order. Also, per unit prices are not always recorded on purchase orders prior to placing the order. The per unit prices are often not recorded onto the purchase order until the invoice is received.

We reviewed the Duluth districts open purchase orders and found that of approximately 90 orders:

- 24 did not have per unit prices for goods ordered; and
- 26 had per unit prices posted from the vendors invoice.

In addition, we found 18 blank departmental purchase orders signed in advance.

Purchase orders provide a valuable control tool. They provide a means to determine outstanding liabilities. Matching the per unit prices on the purchase order against the amount on the invoice ensures the district that the vendor is correctly pricing the items based on the contract or bid agreement.

Recommendations

- *Departmental purchase orders should not be authorized until all required purchasing information is recorded.*
- *Per unit prices should be posted to purchase orders prior to the order being placed.*

2. Consumable inventory controls need improvement.

There is an inadequate separation of duties over consumable inventories at the Duluth office. Inventory center personnel perform the inventory cycle counts and adjust the inventory records based on the results of the counts. An employee independent of the inventory center should perform the physical inventory counts. The Duluth district could assign someone independent of the inventory center to assist with the counts or to complete periodic spot checks and reconcile the results to the inventory records.

Department of Transportation Duluth/Virginia Districts

The Duluth and Virginia offices have not conducted cycle counts. Cycle counts have not been completed at the Duluth district since July 1991 and have not been done at the Virginia district since October 1991. Both districts should develop a cycle count schedule to ensure that all inventory items are counted at least once per year. Also, at the Virginia district, the results of the cycle counts are not reported to district management. The business manager should give prior approval to all adjustments to the inventory records based on the results of the counts.

Recommendations

- *The Duluth district should assign staff independent of the inventory center to conduct periodic spot checks of the inventory.*
- *The Duluth and Virginia districts should develop a cycle count schedule to ensure that all items of inventory are counted at least once per year.*
- *The results of cycle counts and related inventory adjustments should be reported to and approved by the district business manager at the Duluth and Virginia districts.*



Minnesota
Department of Transportation
Transportation Building
395 John Ireland Boulevard
Saint Paul, Minnesota 55155

September 16, 1992

Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Building
St. Paul, Minnesota 55155

RE: Legislative Audit

Dear Mr. Nobles:

This letter is in response to your preliminary audit report for the Department of Transportation, Duluth and Virginia Districts, for the three years ending on June 30, 1992.

The Duluth District staff would first like to acknowledge the professionalism of both Patrick Ryan and Christina Weiss. They found them to be considerate and non-threatening which made the audit an enjoyable and educational experience.

The District staff also concurs with both of the current findings and recommendations.

Finding 1 indicated purchase orders were signed in advance. This has now been corrected by expanding Delegation of Authority to include more individuals so someone is always available to sign the orders. These delegations were approved by Mn/DOT on August 25, 1992, and submitted to John Gunyou, Commissioner of the Department of Finance on August 27, 1992.

The second part of Finding 1 was the need to post prices on the purchase orders prior to the order being placed. On July 2, 1992, a memorandum was sent to the Inventory Control Supervisor indicating this need. A subsequent spot check of the orders on August 17, 1992, by Lyle Herzog indicated that prices were now being recorded prior to the order being placed.

Finding 2 indicated a need to improve the separation of duties regarding cycle counts and adjustments.

Mr. James Nobles
September 16, 1992
Page Two

By September 20, 1992, someone from either the Duluth Business Office or the Virginia Inventory Center will be chosen to perform the cycle counts and make the proper adjustments.

These actions would resolve these findings. Lyle Herzog, the Office Manager in Virginia, will be responsible for these implementations.

Sincerely,



Edwin H. Cohoon
Deputy Commissioner
Bureau of Modal and Resource Management

cc: Commissioner James Denn
Darryl Durgin, Deputy Commissioner,
Bureau of Engineering & Operations
Patrick Hughes, Assistant Commissioner, Operations Division
Jeanne Chasteen, Director of Administration, Operations Div.