

**DEPARTMENT OF TRANSPORTATION
DETROIT LAKES AND MORRIS DISTRICTS
FINANCIAL AUDIT
FOR THE THREE YEARS ENDED JUNE 30, 1991**

OCTOBER 1992

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

92-77

DEPARTMENT OF TRANSPORTATION DETROIT LAKES AND MORRIS DISTRICTS

FINANCIAL AUDIT FOR THE THREE YEARS ENDED JUNE 30, 1991

Public Release Date: October 16, 1992

No. 92-77

OBJECTIVES:

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

CONCLUSIONS:

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

- The district staff should conduct monthly spotchecks of the State Sign Shop inventory. The business office should review all adjustments of the State Sign Shop inventory records.
- Morris business office staff should improve the variety of inventory items counted in the monthly spotchecks. Morris inventory center staff should conduct a periodic inventory of truck stations and aggregate locations.

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 Smilonich, District Engineer
Department of Transportation - District 4A, Detroit Lakes

Mr. Jerry Miller, Area Maintenance Engineer
Department of Transportation - District 4B, Morris

Audit Scope

We have conducted a financial related audit of the Department of Transportation, Districts 4A and 4B, 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, Detroit Lakes 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 4A and 4B 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 4A and 4B 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 4A and 4B'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 4A and 4B 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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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 at District 4A (Detroit Lakes).

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, Detroit Lakes 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.

Representative Ann Rest, Chair
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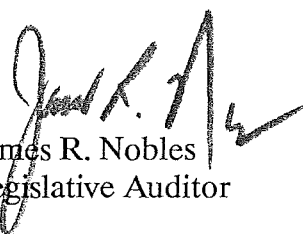
A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial activities being audited may 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 4A and 4B, at the exit conferences held on May 15 and May 22, 1992.

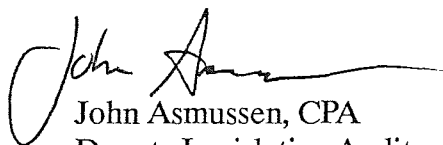
The results of our tests indicate that, except for the weaknesses reported in findings 1 and 2, with respect to the items tested, the Department of Transportation, Districts 4A and 4B, complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing came to our attention that caused us to believe that the Department of Transportation, Districts 4A and 4B 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 4A and 4B. This restriction is not intended to limit the distribution of this report, which was released as a public document on October 16, 1992.

We would like to thank the Department of Transportation, Districts 4A and 4B staff for their cooperation during this audit.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: May 22, 1992

Report Signed On: October 8, 1992

**Department of Transportation
Districts 4A and 4B**

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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
John Wicklund, CPA	Auditor-in-Charge
Melissa Gamble	Staff Auditor

Exit Conferences

The findings and recommendations in this report were discussed with the following staff of the Mn/DOT District 4A on May 15, 1992 at Detroit Lakes:

Daniel Swanson	District Business Manager
Fern Brown	Office Manager
Bud Wamre	Inventory Control Supervisor
Norman Krump	State Sign Shop Maintenance Supervisor
Merle Sagen	State Sign Shop Supervisor

The findings and recommendations in this report were discussed with the following staff of the Mn/DOT District 4B on May 22, 1992 at Morris:

Donald Goracke	Office Manager
Mike Larson	Inventory Control Supervisor

Department of Transportation Districts 4A and 4B

Introduction

The Minnesota Department of Transportation (Mn/DOT) has established the Detroit Lakes 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 Detroit Lakes office is an "A" district office, with a subdistrict "B" office located in Morris. The district engineer directs the entire district operation, with the Morris subdistrict under the direct supervision of the area maintenance engineer. Both locations direct maintenance and construction operations. Mn/DOT has also based a State Sign Shop at Detroit Lakes to serve the entire northern part of the state. Seventeen truck stations are located within the district. The district is responsible for 3,779 miles of highway.

Both the Detroit Lakes and Morris 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 May 8, 1992 inventory valuations for the Detroit Lakes and Morris districts were \$751,757 and \$771,899 respectively. The inventory valuation for the State Sign Shop at Detroit Lakes was \$351,710 as of May 8, 1992.

Selected Fiscal Year 1991 expenditures were as follows:

<u>Activity</u>	<u>Detroit Lakes</u>	<u>Morris</u>	<u>Total</u>
Payroll	\$ 7,702,360	\$2,729,378	\$10,431,738
Supplies & Materials	1,865,190	1,010,080	2,875,270
Other	<u>489,114</u>	<u>211,310</u>	<u>700,424</u>
Total	<u>\$10,056,664</u>	<u>\$3,950,768</u>	<u>\$14,007,432</u>

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

**Department of Transportation
Districts 4A and 4B**

Current Findings and Recommendations

1. The State Sign Shop should have independent spot checks of its inventory records.

Staff at the State Sign Shop in Detroit Lakes are operating an inventory system without any independent review. Serving the northern part of Minnesota, the State Sign Shop reclaims used signs. State Sign Shop staff conduct an annual inventory at the end of each fiscal year. However, district Mn/DOT staff do not participate in or review count results. Also, no formal spot checks are performed during the year.

Several inventory stock item amounts did not agree with the control system amounts as of our audit count dates. Of the 10 items counted, we could not reconcile 7 items (70%) to the inventory records. The discrepancies included both overages and shortages. For example, our count of green scotchlite sign covering was 43 square feet short, overstating inventory valuation by \$146.

The sign shop had not conducted a complete inventory since June 1991. The State Sign Shop stocks many items of inventory which move quickly. Therefore, more frequent counts should be performed. At June 30, 1992, State Sign shop staff conducted a full inventory. Inventory was overstated by \$48,624 (14%) of the total valuation of \$347,578. The district business office should help reconcile this difference by reviewing the accuracy and propriety of adjustments.

Mn/DOT has not properly separated State Sign Shop duties among available district personnel. State Sign Shop staff share key custodial duties, thus impairing their independence as sole reviewers of inventory records. This weakness increases the likelihood that inventory counts and valuations are inaccurate. State Sign Shop staff should monitor the inventory. However, monthly random spot checks by other district staff will provide independent verification of the inventory records.

Recommendations

- *The district business office should review all adjustments of the State Sign Shop inventory records.*
- *The district staff should conduct monthly spot checks of State Sign Shop inventory.*

Department of Transportation Districts 4A and 4B

2. Morris District consumable inventory controls need improvement.

Inventory controls at Morris are weak in two respects. First, the Morris business office needs to improve its procedures for the monthly spot checks of inventory items. Second, Morris inventory center staff need to conduct on-site reviews of inventory located at truck stations.

Business office staff count about 30 inventory items per month. However, our review of the past year shows staff are repeatedly counting the same type of items. The business office has not recently spot-checked items such as signs, paints, and tires. Spot checks are most effective when a representative sample of items are selected for testing. Without the element of variety, some items of inventory may never be verified by staff independent of the inventory process.

Inventory center staff also need to conduct on-site inventory verification of truck stations and remote aggregate locations. Inventory staff have not performed any independent review of these inventory items in two years. Approximately 41 percent or \$319,144 of the inventory valuation of the Morris district is located at truck stations and other remote locations. Periodic verification of these items is essential for accurate presentation of the district inventory records.

Recommendations

- *Morris business office staff should improve the variety of inventory items counted in the monthly spot checks.*
- *Morris inventory center staff should conduct a periodic inventory of truck stations and aggregate locations in the district.*



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

September 25, 1992

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

Re: Legislative Audit - Mn/DOT Detroit Lakes and Morris District

Dear Mr. Nobles:

This letter is in response to the preliminary audit report for the Department of Transportation, Detroit Lakes and Morris District, for the three years ended June 30, 1991.

This District staff concurs with both findings, and has already initiated actions to satisfy the intent of the recommendations as follows:

FINDING 1

Effectively immediately, personnel from the Detroit Lakes Business Office will perform a monthly spot check of Sign Shop inventory, based on random item selection. In addition, Sign Shop personnel, with the help of the Inventory Control Supervisor, will initiate and pursue a cycle counting program. Finally, in the future, the Business Office and the Inventory Control Supervisor will review all adjustments to the Sign Shop inventory records. Daniel Swanson, the District Administrative Manager, will ensure implementation of these processes.

FINDING 2

The Morris Maintenance area has initiated a system to select inventory items for monthly spot checks via a computer generated system (similar to the one used in Detroit Lakes). The system randomly selects inventory items to spot check. This method of selection presents a variety of items to be spot checked which is representative of the total inventory. The inventory of truck station inventory has been completed, and is scheduled to be completed every year. The Inventory Control Supervisor at Morris is responsible for implementation and maintenance of these plans.

I believe the above actions will successfully resolve the findings of this audit.

Sincerely,

Edwin H. Cohoon
Deputy Commissioner