

Department of Transportation

Selected Programs

Fiscal Year 1997 Statewide Audit

February 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

98-11



STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Deanna Wiener, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. James N. Denn, Commissioner
Department of Transportation

We have audited selected programs of the Department of Transportation (MnDOT) for the fiscal year ended June 30, 1997, as further explained in Chapter 1. The work conducted in the department is part of our Statewide Audit of the state of Minnesota's fiscal year 1997 financial statements and Single Audit. The Comprehensive Annual Financial Report for the year ended June 30, 1997, includes our report, issued thereon dated December 8, 1997. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1997, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing this report in March 1998. The MnDOT internal auditors assisted in performing Single Audit work and issued a separate report in December 1997. We emphasize that this has not been a complete audit of all financial activities of MnDOT. The following Summary highlights the audit objectives and conclusions. We discuss our concerns more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that MnDOT complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of MnDOT is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of MnDOT. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 27, 1998.

A handwritten signature in cursive script, reading "James R. Nobles".

James R. Nobles
Legislative Auditor

A handwritten signature in cursive script, reading "Claudia Gudvangen".

Claudia Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 5, 1998

Report Signed On: February 20, 1998

SUMMARY

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Department of Transportation

Selected Programs Fiscal Year 1997 Statewide Audit

Public Release Date: February 27, 1998

No. 98-11

Agency Background

The Department of Transportation (MnDOT) is responsible to provide a balanced transportation system in Minnesota. The system includes aeronautics, highways, motor carriers, ports, public transit, railroads, and pipelines. The department funds its activities mainly from Trunk Highway Fund appropriations, federal grants, and bond proceeds. Department expenditures for fiscal year 1997 totaled approximately \$1.4 billion. James N. Denn is the commissioner of the department.

Selected Audit Areas and Conclusions

Our audit scope included those areas material to the state of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1997, and to the Single Audit objectives. It included the Highway Planning and Construction Program (CFDA 20.205), the Airport Improvement Program (CFDA 20.106), County State-Aid Highway Fund grants, Municipal State-Aid-Street Fund grants, and bridge construction.

We found that the Department of Transportation's financial activities for the programs included in the Statewide Audit scope are fairly presented in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1997. The department properly processed and recorded state aid and grant payments to counties and municipalities. The department complied with the material financial-related legal provisions for the items tested.

The Department of Transportation properly recorded financial activities in the state's accounting system for the Highway Planning and Construction Program (CFDA 20.205) and the Airport Improvement Program (CFDA 20.106). We and the MnDOT Internal Audit Section noted the following reportable conditions involving internal control over compliance related to the Highway Planning and Construction Program: 1) The department did not enter the correct record date for certain expenditures for federal/county road and bridge projects. 2) The department did not complete supplemental agreements for some construction projects prior to starting the additional work. 3) The department did not properly monitor compliance with the Davis-Bacon Act nor with specification for product material testing.

The Department of Transportation agrees with the findings in this report. The department has indicated that it has taken steps to resolve these issues.

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Renee Redmer, LPA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Fubara Dapper, CPA	Auditor
Steven Carr	Intern

Exit Conference

The following staff from the Department of Transportation participated in the exit conference held on February 12, 1998:

Ed Cohoon	Deputy Commissioner - Chief Financial Officer
Darryl Durgin	Deputy Commissioner - Chief Engineer
Barbara Sunquist	Director, Finance and Administration Division
Ron Gipp	Audit Director
Larry Kienitz	Internal Audits
Dave Wolver	Internal Audits
Richard Swanson	Director of Financial Management
Bonnie Kollmann	Director of Financial Operations
Douglas Bjornberg	Operations Division
Wayne Murphy	Director of State Construction/Materials Engineer
Khani Sahebjam	State Aid Division

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Chapter 1. Introduction

The Department of Transportation (MnDOT) is responsible to provide a balanced transportation system including aeronautics, highways, motor carriers, ports, public transit, railroads, and pipelines. James N. Denn is the commissioner of the department. MnDOT's statutory goals include the following:

- to provide safe transportation for users throughout the state;
- to provide multimodal and intermodal transportation that enhances mobility and economic development;
- to provide a reasonable travel time for commuters;
- to provide for the economical, efficient, and safe movement of goods to and from markets by rail, highway, and waterway;
- to provide systems that encourage tourism;
- to maximize the benefits received for each transportation investment; and
- to increase high occupancy vehicle use.

The Department of Transportation funds its activities mainly from Trunk Highway Fund appropriations, federal grants, and bond proceeds. Department expenditures for fiscal year 1997 totaled approximately \$1.4 billion.

The primary objective of our Statewide Audit is to render an opinion on the state of Minnesota's financial statements included in its Comprehensive Annual Financial Report for fiscal year 1997. The Statewide Audit is designed to also meet the requirements of the Single Audit Act, relating to federal financial assistance. We have an agreement with the MnDOT internal auditors to complete portions of the audit requirements. Our audit scope focused on selected expenditures of the department as discussed in Chapters 2 and 3. Chapter 2 discusses state aid and grants, and Chapter 3 discusses federal programs.

Chapter 2. State Aid and Grants

Chapter Conclusions

The Department of Transportation properly processed and recorded state aid and grant payments to counties and municipalities. The department complied with the material financial-related legal provisions for the items tested.

The Department of Transportation is responsible for making state aid payments to counties and municipalities for road construction and maintenance. State aid payments to counties during fiscal year 1997 totaled \$350 million, while state aid payments to municipalities totaled \$105 million. The department processes payments for county state aid out of the County State-Aid Highway Fund, while aid to municipalities is paid from the Municipal State-Aid Street Fund. Highway user taxes and investment earnings provide the funding for these activities. The Departments of Revenue and Public Safety deposit fuel tax receipts and motor vehicle registration taxes into the Highway User Tax Distribution Fund. Minnesota Constitution Article XIV requires that the proceeds of the Highway User Tax Distribution Fund be transferred to the Trunk Highway Fund, the County State-Aid Highway Fund, and the Municipal State-Aid Street Fund.

Distributions from the Highway User Tax Distribution Fund for fiscal year 1997 were \$606 million to the Trunk Highway Fund, \$309 million to the County State-Aid Highway Fund, and \$90 million to the Municipal State-Aid Street Fund. Once a year, the department, through a commissioner's order, allocates the amounts received in the county and municipal funds to the counties and municipalities. Minn. Stat. Chapter 162 governs the state aid system and establishes the allocation formula. Counties and municipalities submit project plans for approval. MnDOT grants the funds to the counties and municipalities after projects are authorized. Most funds are granted at the beginning of an approved project with a final percentage of the estimated costs withheld until completion and final certification of the project. Fund balances in the County State-Aid Highway Fund and the Municipal State-Aid Street Fund are carried forward to subsequent fiscal years until projects are authorized, grant funds are advanced, and the final distribution is made for completed projects.

The department also is responsible for making state grant payments from the Transportation Fund to counties and municipalities for bridge construction. Cities and counties apply for the grants and are reimbursed based on supporting documentation once projects are completed. Fiscal year 1997 grants for bridge construction totaled \$15 million.

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Audit Objectives and Methodology

Our audit objectives were to:

- Determine whether the department properly processed and recorded state aid and grant payments; and
- Determine whether the department complied with material finance-related legal provisions.

We conducted interviews with key personnel to gain an understanding of the department's procedures for processing and recording state aid and grant expenditures. We also gained an understanding of the procedures for allocating funds to the two state aid funds and further to the counties and municipalities who receive the state aid allocations. On a sample basis, we tested the state aid and state grant expenditures. We also reviewed the distributions from the Highway User Tax Distribution for compliance with the state constitution and statutes.

Conclusions

We determined that the department properly recorded state aid expenditures in the County State-Aid Highway Fund and the Municipal State-Aid Street Fund. The department also properly recorded grant payments in the Transportation Fund. We also determined that the department appropriately transferred funds from the Highway User Tax Distribution Fund to the Trunk Highway Fund, the County State-Aid Highway Fund, and the Municipal State-Aid Street Fund as required by the Minnesota Constitution and Minnesota Statutes.

Chapter 3. Federal Programs

Chapter Conclusions

The Department of Transportation properly recorded financial activities in the state's accounting system for the Highway Planning and Construction Program (CFDA 20.205) and the Airport Improvement Program (CFDA 20.106). We noted the following reportable conditions involving internal control over compliance related to the Highway Planning and Construction Program:

1) The department did not enter the correct record date for certain expenditures for federal/county road and bridge projects. 2) The department did not complete supplemental agreements for some construction projects prior to starting the additional work. 3) The department did not properly monitor compliance with the Davis-Bacon Act nor with specification for product material testing.

During fiscal year 1997, MnDOT participated in the Highway Planning and Construction Program (CFDA 20.205). The Highway Planning and Construction Program has the objectives of (1) assisting states in constructing and rehabilitating the national highway system, including interstate highways and buildings or improving other federal-aid roads and streets; (2) providing aid for repairing the system, roads, and streets following disasters; (3) fostering safe highway design; and (4) replacing or rehabilitating unsafe bridges. The federal government provides funds to state highway agencies to pay for a defined portion of the planning, research, and construction costs of approved projects. State highway agencies can also make funds available to local public agencies. Total federal expenditures for the Highway Planning and Construction Program for fiscal year 1997 were \$311 million. Fiscal year 1997 state expenditures for the program totaled \$80 million.

MnDOT is also responsible for collecting and administering the federal share of jointly funded projects. The federal government provides various percentages of participation for approved projects related to highway construction, federal/county road and bridge projects, and right of way acquisitions. Federally approved projects are eligible for reimbursement under the Highway Planning and Construction Program (CFDA 20.205). MnDOT uses the state's accounting system (MAPS) to generate a weekly billing to the federal government for reimbursement of eligible costs on federally approved projects. The federal government wire transfers its share of the project costs to MnDOT.

MnDOT also administered the Airport Improvement Program (CFDA 20.106). The objectives of the program include assisting sponsors, owners, or operators of public use airports in the development of a nationwide system of airports to meet the needs of civil aeronautics. Local governments submit proposals for federal assistance to the Department of Transportation for review and approval. MnDOT is responsible for administering the program for the state. Federal expenditures for fiscal year 1997 totaled \$37 million and state expenditures totaled \$974,000.

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Audit Objectives and Methodology

Our audit objectives were to:

- Consider internal control over compliance with requirements that could have a direct and material effect on the federal programs; and
- Determine whether the department recorded financial activities properly in MAPS.

We and the MnDOT internal auditors conducted interviews with key personnel to gain an understanding of the department's procedures for processing and recording activities for the Highway Planning and Construction Program and the Airport Improvement Program. We, along with the MnDOT internal auditors, tested financial activities related to these programs.

The U. S. Office of Management and Budget's Compliance Supplement discusses the programs' objectives. This supplement provides a listing of 14 types of compliance requirements for federal programs as follows: activities allowed or unallowed; allowable costs; cash management; Davis-Bacon Act; eligibility; equipment and real property management; matching level of effort; period of availability; procurement and suspension; program income; real property acquisition and relocation assistance; reporting; subrecipient monitoring; and special tests and provisions. We and the MnDOT internal auditors reviewed and tested controls over compliance with the requirements applicable to the Highway Planning and Construction Program and Airport Improvement Program.

Conclusions

The Department of Transportation properly recorded financial activities in the state's accounting system for the Highway Planning and Construction Program (CFDA 20.205) and the Airport Improvement Program (CFDA 20.106). We and the MnDOT Internal Audit Section noted the following reportable conditions involving internal control over compliance related to the Highway Planning and Construction Program. The department did not enter the correct record date for certain expenditures for federal/county road and bridge projects as discussed in Finding 1. The department did not complete supplemental agreements for some construction projects prior to starting the additional work as discussed in Finding 2. The department did not properly monitor compliance with the Davis-Bacon Act nor with specification for product material testing as discussed in Findings 3 and 4.

1. MnDOT did not enter the correct record date for expenditures paid from the federal/county road and bridge account.

The department did not enter the correct record date in the state's accounting system for construction vouchers paid from the federal/county road and bridge account. Only 5 of 39 transactions tested had the correct record date. The accounting clerk entered the current date as the record date when entering the payment transactions. The record date should identify the date that goods and services were received. The Department of Finance (DOF) uses the record date to determine accounts payable for financial reporting purposes. DOF summarizes all payments

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with a record date of June 30 or prior and reports them as accounts payable. Using an incorrect record date distorts the calculation.

Recommendation

- *MnDOT should enter the date that goods or services were received as the record date in the state's accounting system.*

2. MnDOT did not complete supplemental agreements prior to the start of additional construction work.

MnDOT Internal Audit Section found that the department did not complete written supplemental agreements between the project engineer and the contractor prior to the start of the work for two of fourteen projects audited. The total amount of work done prior to completion of the supplemental agreements was \$381,607. For one project, MnDOT did not complete seven of ten supplemental agreements prior to the start of work.

MnDOT's Contract Administration Procedures require a fully executed supplemental agreement for project changes prior to the start of work. Not having written agreements increases the risk of violations of Minn. Stat. Section 16A.15 (3), incurring obligations prior to encumbering funds. Written agreements also reduce the risk of contractor litigation regarding potential differences of opinion about contract modifications and the basis for payment.

Recommendation

- *MnDOT should complete supplemental agreements prior to the start of work.*

3. MnDOT did not properly monitor compliance with the Davis-Bacon Act.

MnDOT did not have a system in place to monitor compliance with Davis-Bacon minimum wage requirements. The Internal Audit Section found that the department did not: maintain a tracking system for the receipt of payroll documentation or the payment of minimum wages; ensure payroll wage classifications were listed in the project proposal wage decisions; perform required Fieldman's Checks; and post state and federal wage rates as required.

MnDOT did not have a monitoring system for the receipt of payroll documentation or the payment of minimum wages. Nine of the fourteen construction offices audited did not have a tracking system in place to determine payroll documentation required, submitted, and missing. No payroll documentation was available for review for one project. For another project, 69 of 80 required payrolls were not available for review. Project engineers complete a weekly form that lists contractors who worked during the week. Project engineers should use this form to determine which payroll documentation they should be receiving from the contractors. Payroll documentation is necessary to determine compliance with minimum wage requirements. Compliance is required for federal participation. These projects may be ineligible for federal funds if they are not in compliance.

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The department did not follow-up to ensure that wage classifications used on payroll was listed in the state and federal wage decisions. For one project, eight occupation codes used in the payroll documentation was not included in the project proposal state wage decision or in a separate wage decision. MnDOT Internal Audit Section could not determine minimum wage compliance for the employees classified in these occupation codes. Each project proposal includes both federal and state wage decisions that include occupational codes along with the minimum wage rates for those codes. When occupational codes are not in the wage decisions, the department cannot determine if the contractor paid minimum wages.

MnDOT project engineers did not document all required monthly field compliance reviews on labor provisions (Fieldman's Checks) for minimum wage compliance for 12 of 14 projects audited. Three of these projects had no Fieldman's Checks performed during fiscal year 1997. To perform Fieldman's Checks, the inspector at the site randomly asks employees of the contractor their name, wage classification code, and how much they are being paid. The inspector then compares the results to the wage decisions in the project proposal. MnDOT policies require Fieldman's Checks as a way to monitor compliance with the Davis-Bacon Act. In addition, MnDOT did not maintain poster boards with required state and/or federal wage rates for three of fourteen projects audited.

The Davis-Bacon Act provides for the payment of prevailing wage rates to laborers and mechanics employed by contractors and subcontractors on federal and federally assisted construction contracts exceeding \$2,000. Under the act, the secretary of labor determines local area wage rates for each of the construction trades and defines areas to which these rates apply. Certain fringe benefits are also mandated. Contractors performing work under a grant with Davis-Bacon Act requirements must certify that they will comply with the act's requirements. Sanctions for post-certification violations include suspension of payment, advance, or guarantee of grant funds, forced restitution of wages that should have been paid, and blacklisting of offending contractors.

MnDOT needs to improve monitoring of compliance with the Davis-Bacon Act by doing the following:

- The state aid engineer and the state construction engineer should work with the director of financial operations section to determine the appropriate status of federal participation for the five projects missing payroll documentation until compliance with the Davis-Bacon Act minimum wage requirements is attained. The engineers should also provide training to project personnel regarding Davis-Bacon requirements.
- The Labor Compliance Unit should investigate payroll documentation for these five projects to determine compliance with the minimum wage requirements.
- District engineers/metro division engineers should ensure that project engineers monitor the receipt of payroll documentation, perform Fieldman's Checks, and post required wage rates at the project site.

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Recommendations

- *MnDOT needs to work with various units to ensure compliance with the Davis-Bacon Act.*
- *MnDOT should work with the U.S. Department of Transportation to determine if repayments are due for federal participation.*

4. MnDOT did not adequately monitor compliance with specifications for product material testing.

MnDOT did not adequately monitor compliance with specifications for product material testing. MnDOT Internal Audit Section found that the quality and quantity requirements for material testing were not met for nine of the fourteen projects reviewed. MnDOT internal auditors identified significant concerns over four of these projects relating to a lack of documentation of tests. For one project, about half of the required tests were not documented as taken. MnDOT internal audit did not express an opinion regarding compliance with material testing requirements for this project. Without documentation that required tests were performed, and without the results of those tests, project engineers cannot determine if the materials meet specifications. Any necessary adjustments during the production of materials may not be made and the performance of the materials may be questionable.

Materials testing helps provide assurance that contract bid items, such as concrete and bituminous pavement, perform as designed. Each project has a Schedule of Materials Control that lists the quantity of tests for each bid item that must be performed. The quality of tests refers to the specifications that the materials must meet when being tested. The project proposal outlines the required specifications. Compliance with the specifications for product material testing ensures that a sufficient number of tests are performed for each bid item and that the quality of materials used is adequate to ensure product performance. OMB Circular A-133 Compliance Requirements state that state highway agencies or local public agencies must have a sampling and testing plan for projects on the National Highway System to ensure that materials and workmanship generally conform to approved plans and specifications.

Recommendation

- *MnDOT needs to work with project engineers to ensure compliance with material testing requirements. Project engineers need to document all material testing.*

Status of Prior Audit Issues

As of January 5, 1998

Most Recent Audit

January 28, 1997, Legislative Audit Report 97-6 focused on selected state and federal programs as part of the Statewide Financial and Federal Compliance Audit. The audit covered the Highway Planning and Construction Program (CFDA 20.205), the Airport Improvement Program (CFDA 20.106), County State-Aid Highway Fund grants, Municipal State-Aid Street Fund grants, and bridge construction. We found that the department's financial activities for programs included in the audit scope were fairly presented in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. The department complied with the federal requirements for the Highway Planning and Construction Program and the Airport Improvement Program. There were no written findings as a result of the audit.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University, and quasi-state organizations, such as the metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.



Minnesota Department of Transportation

Transportation Building
395 John Ireland Boulevard
Saint Paul, Minnesota 55155-1899

February 20, 1998

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to review and comment on the findings and recommendations addressed in the draft of your audit of the Minnesota Department of Transportation for the fiscal year ending June 30, 1997. This draft report accurately reflects the material that your staff discussed with us at the exit conference on February 12, 1998.

The fiscal year 1997 audit, through Mn/DOT Audit Report No. 98-800-44, identified several findings and recommendations. Mn/DOT concurs with the recommendations and has taken steps internally to implement actions designed to resolve the findings. Detailed responses to each of the recommendations are included as part of the official record for Audit Report No. 98-800-44.

Thank you again for the excellent work performed by your staff. They have been very helpful, as always.

Sincerely,

A handwritten signature in black ink, appearing to read 'James N. Denn', written over a horizontal line.

James N. Denn
Commissioner