
Department of Transportation

Statewide Audit – Selected Programs Fiscal Year Ended June 30, 1998

March 1999

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

99-14

SUMMARY

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Department of Transportation

Selected Programs Statewide Audit Fiscal Year 1998

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Agency Background

The Department of Transportation (MnDOT) is responsible for providing a balanced transportation system in Minnesota. The system includes aeronautics, highways, motor carriers, ports, public transit, railroads, and pipelines. The department's activities are funded primarily from Trunk Highway Fund appropriations, federal grants, and bond proceeds. Department expenditures for fiscal year 1998 totaled approximately \$1.4 billion. Mr. James N. Denn was the commissioner of the department during our audit scope. In January 1999, the Governor appointed Mr. Elwyn Tinklenberg as the new commissioner.

Selected Audit Areas and Conclusions

Our audit scope was limited to those activities material to the State of Minnesota's general purpose financial statements for the year ended June 30, 1998, and to the Single Audit objectives. Our primary audit objective was to render an opinion on the State of Minnesota's financial statements. Our scope within the Department of Transportation 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 qualified our report dated December 1, 1998, on the State of Minnesota's general purpose financial statements because insufficient audit evidence exists to support the State of Minnesota's disclosures with respect to the year 2000. Auditing the state's year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that the Department of Transportation is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Department of Transportation does business will be year 2000 ready.

For the areas audited, the Department of Transportation's financial activities were fairly presented in the general purpose financial statements of the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1998. We, along with the MnDOT Internal Audit Section, noted the following reportable conditions involving internal control over compliance related to the Highway Planning, Research, and Construction Program and the Airport Improvement Program. The department did not complete supplemental agreements for some construction projects prior to starting the additional work. The department did not properly monitor compliance with the Davis-Bacon Act or with specifications for product material testing.

The Department of Transportation agrees with our report conclusions. The department is working with the various divisions to resolve the audit 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
Carl Otto, CPA	Auditor-in-Charge
Fubara Dapper, CPA	Senior Auditor
Charlie Klein	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following officials of the Department of Transportation at an exit conference held on February 18, 1999:

Ed Cohoon	Deputy Commissioner
Barbara Sundquist	Director, Finance and Administration Division
Ronald Gipp	Audit Director
Larry Kienitz	Internal Audit Manager
Richard Swanson	Director of Financial Management
Bonnie Kollmann	Director of Financial Operations
Dennis Herzog	Financial Reporting Supervisor

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

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Elwyn Tinklenberg, Commissioner
Department of Transportation

We have performed certain audit procedures at the Department of Transportation (MnDOT) as part of our audit of the financial statements of the State of Minnesota as of and for the year ended June 30, 1998. We also have audited certain federal financial assistance programs administered by the MnDOT as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 1998. We emphasize that this has not been a comprehensive audit of the Department of Transportation.

Table 1-1 identifies the financial activities within MnDOT that were material to the state's financial statements. We performed certain audit procedures on these MnDOT programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 1998, were free of material misstatement.

Table 1-1
Expenditures Material to the State's Financial Statements
Fiscal Year 1998
(in thousands)

<u>Fund</u>	<u>Area</u>	<u>Amount</u>
Trunk Highway	Capital Outlay	\$430,674
County State-Aid Highway	Grants to Counties	\$281,389
Municipal State-Aid Street	Grants to Municipalities	\$108,813
Transportation Fund	Bridge Construction Grants	\$10,195
Federal Fund	Federal/County Road and Bridge Grants	\$89,468
	Airport Improvement Grants	\$17,622

Source: State of Minnesota Comprehensive Annual Financial Report and Minnesota Accounting and Procurement System (MAPS) for fiscal year 1998.

MnDOT is responsible for the construction and maintenance of the state's highway system. Capital outlays are for highway construction, maintenance, and for right of way land purchases

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on the state's trunk highway system. The federal government provides various participation percentages 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 is responsible for making state aid payments to counties and municipalities for road construction and maintenance through the County State-Aid Highway and the Municipal State-Aid Street Funds. The Departments of Revenue and Public Safety deposit fuel tax receipts and motor vehicle registration tax receipts into the Highway User Tax Distribution Fund. Funds are then transferred from Highway User Tax Distribution Fund to the Trunk Highway Fund, the County State-Aid Highway Fund, and the Municipal State-Aid Street Fund, as well as to several smaller state accounts. Distributions from the Highway User Tax Distribution Fund to MnDOT are identified in Table 1-2.

Table 1-2
Highway User Tax Fund Distributions
Fiscal Year 1998
(in thousands)

<u>Fund</u>	<u>Amount</u>
Trunk Highway	\$626,000
County State-Aid Highway	\$319,000
Municipal State-Aid Street	\$93,000

Source: State of Minnesota Comprehensive Annual Financial Report and Minnesota Accounting and Procurement System (MAPS) for fiscal year 1998.

The MnDOT provides rail service improvement loans through the Minnesota Rail Service Assistance Act of 1976. This program allows the state and rail users to enter into contracts with railroads for rail line rehabilitation or other rail service improvements. Outstanding rail service improvement loans as of June 30, 1998, totaled \$18.5 million.

Table 1-3 identifies the State of Minnesota's major federal programs administered by the Department of Transportation. We performed certain audit procedures on these Department of Transportation programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its major federal programs. We worked in conjunction with the MnDOT Internal Audit Section to perform the Single Audit.

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Table 1-3
Major Federal Programs Administered by the Department of Transportation
Fiscal Year 1998
(in thousands)

<u>Program Name</u>	<u>Federal</u>	<u>State</u>	<u>Total</u>
Highway Planning and Construction – CFDA 20.205	\$300,355	\$91,664	\$392,019
Airport Improvement Program – CFDA 20.106	\$17,622	\$1,260	\$18,882

Source: Minnesota Accounting and Procurement System (MAPS) for fiscal year 1998.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

We qualified our report dated December 1, 1998, on the State of Minnesota's Comprehensive Annual Financial Report, because of uncertainties about the potentially adverse effect the year 2000 computer issue may have on state operations. Information technology experts believe that many computer applications in private businesses and government may fail as a result of data integrity problems and erroneous calculations beyond December 31, 1999. The state is currently addressing year 2000 issues related to its computer systems and other electronic equipment. During fiscal year 1996, the state established the Minnesota Year 2000 Project Office to develop and monitor the overall statewide effort for executive branch agencies. The project office is tracking over 1,300 mission-critical applications owned by state agencies. As of September 1998, the project office believed that 75 percent of the applications were compliant or had completed the necessary modifications. However, because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter.

Auditing the state's year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that the Department of Transportation is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Department of Transportation does business will be year 2000 ready.

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 1, 1998, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB *Circular A-133*.

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For the areas audited, the Department of Transportation's financial activities were fairly presented in the general purpose financial statements of the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1998. For the federal programs tested, the department complied, in all material respects, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 1998. However, as a result of the Federal Compliance Review performed by the MnDOT Internal Audit Section, the following weakness in internal control and noncompliance with program requirements were identified at the Department of Transportation.

1. The Department of Transportation did not comply with certain federal requirements for the Highway Planning Construction Program and the Airport Improvement Program

The Department of Transportation did not comply with certain regulations related to allowable costs, materials testing, supplemental agreements, and the Davis Bacon Act. The MnDOT Internal Audit Section issued a report to MnDOT management describing reportable conditions involving internal control over compliance related to the Highway Planning and Construction Program (CFDA 20.205) and the Airport Improvement Program (CFDA 20.106). The internal audit report has six findings and two observations citing concerns related to allowable costs, materials testing, supplemental agreements, and the Davis-Bacon wage requirements. These findings and observations are listed below, with their corresponding recommendations.

- Paint blasting residue was not properly controlled. The Office of Environmental Services developed a logbook monitoring system but it has not been implemented on all projects. MnDOT Internal Audit Section recommended that a logbook system for all projects involving paint blasting residue be implemented for the 1999 construction season.
- Concrete gradation requirements were not met on a bridge project. MnDOT Internal Audit Section recommended that a policy be implemented to ensure bituminous and concrete plant test results and decertification issues be communicated to project engineers, including city/county engineers, in a timely manner. MnDOT should contact the FHWA regarding plant decertifications and any impact on federal participation.
- Cost reimbursement plus fixed fee interim overhead rates were not adjusted to audited overhead rates on Aeronautics contracts. MnDOT Internal Audit Section recommended that the Office of Aeronautics communicate with applicable airport managers to ensure that interim overhead rates are adjusted to the audited overhead rate.
- Controls are needed to improve closure of materials certification audits performed by the Office of Materials and Road Research. MnDOT Internal Audit Section has five recommendations to improve the materials certification process and follow up on materials certification audit concerns.
- Approval of supplemental agreements needs to be completed prior to work being performed. MnDOT Internal Audit Section recommended that supplemental agreement work and payments follow established procedures. This is a prior audit finding.

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- Controls need to be improved over compliance with the Davis-Bacon minimum wage requirements. MnDOT Internal Audit Section recommended that MnDOT engineers monitor and timely follow up on receipt of payroll documentation, inclusion of wage classes, and labeling of payrolls with wage class codes. The MnDOT Internal Audit Section also recommended the resolution of payroll concerns for certain state projects. This is a prior audit finding.

In addition to the above findings, MnDOT Internal Audit Section had the following observations:

- Use of 3309 weathering steel appears more cost effective than using 3310 steel. MnDOT Internal Audit Section recommended the development of a life cycle cost analysis considering the cost and performance comparisons between 3309 and 3310 steel. MnDOT should determine whether a revision to the policy regarding the painting of bridge steel is needed.
- Timely incentive payments to contractors would reinforce contractor performance. MnDOT Internal Audit Section recommended that incentive payments correlate with material placement.

Recommendation

- *The Department of Transportation should resolve these weaknesses in internal control and noncompliance and implement the recommendations in a timely manner.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Transportation. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 5, 1999.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen
Deputy Legislative Auditor

End of Fieldwork: January 22, 1999

Report Signed On: February 26, 1999

Status of Prior Audit Issues As of January 22, 1999

February 20, 1998, Legislative Audit Report 98-11 examined the MnDOT's activities and programs material to the State of Minnesota's Annual Financial Report and the Single Audit for the year ended June 30, 1997. The scope included 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 1997. The department complied with the federal requirements for the Highway Planning and Construction Program and the Airport Improvement Program. This report included four reportable conditions involving internal control over compliance related to the Highway Planning and Construction Program. The recommendation relating to one of the findings was implemented. Three other issues were repeated as findings this year.

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 of Minnesota, any 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 25, 1999

James Nobles, Legislative Auditor
First Floor - Centennial Office Building

Dear Mr. Nobles:

Thank you for your letter of February 11, 1999 and the attached report. We certainly appreciate all of the time and effort that went into your financial audit review for Fiscal Year 1998. Your report was qualified due to the fact that auditing the state's year 2000 compliance efforts was not an objective of this audit. Although this was a qualification and not a finding, I want to first address the Year 2000 issue and some of the actions we have taken in our department. Then I will briefly describe our intended follow-up regarding the internal audit findings discussed in your report.

The Year 2000 issue is very serious and Mn/DOT has taken several steps toward resolving potential problems. Mn/DOT appointed a Year 2000 Project Manager and divisional Year 2000 coordinators. An inventory and assessment of all Mn/DOT hardware, package software, custom applications, interfaces and systems with embedded chips or microprocessors has been completed. In order to focus on priority issues, this inventory has been separated into four categories: 1) mission critical, compliant; 2) mission critical, non-compliant; 3) non-mission critical, compliant; and 4) non-mission critical, non-compliant. Eighteen mission critical, non-compliant systems were identified and so far eleven of those have been modified, five are scheduled to be compliant by July, 1999 and the remaining two should be compliant by November, 1999.

In addition, we are in the process of identifying risk associated with systems which are interdependent on entities over which we have no control in order to develop risk abatement plans and contingency plans. Steps have been taken to ensure that new development and equipment purchases are Year 2000 compliant. Mn/DOT's internal audit function will be conducting audits to help identify any gaps in a timely manner.

Regarding Finding 1 "The Department of Transportation did not comply with certain federal requirements for the Highway Planning Construction Program and the Airport Improvement Program" (which is a summation of six findings contained in our internal audit's single audit report), our Division Directors were asked to respond to the various findings and recommendations. Our Deputy Commissioner reviews those responses and makes a determination whether any further action is required. All of the detailed responses are contained in Mn/DOT's Internal Audit Report No. 99-800-124 dated February 16, 1999.

Progress towards implementation of specific recommendations will be monitored. The contact person for information on that follow-up activity will be Dennis Herzog. He can be reached at 297-1481.

Sincerely,

A handwritten signature in dark ink, appearing to read "Elwyn Tinklenberg".

Elwyn Tinklenberg
Commissioner