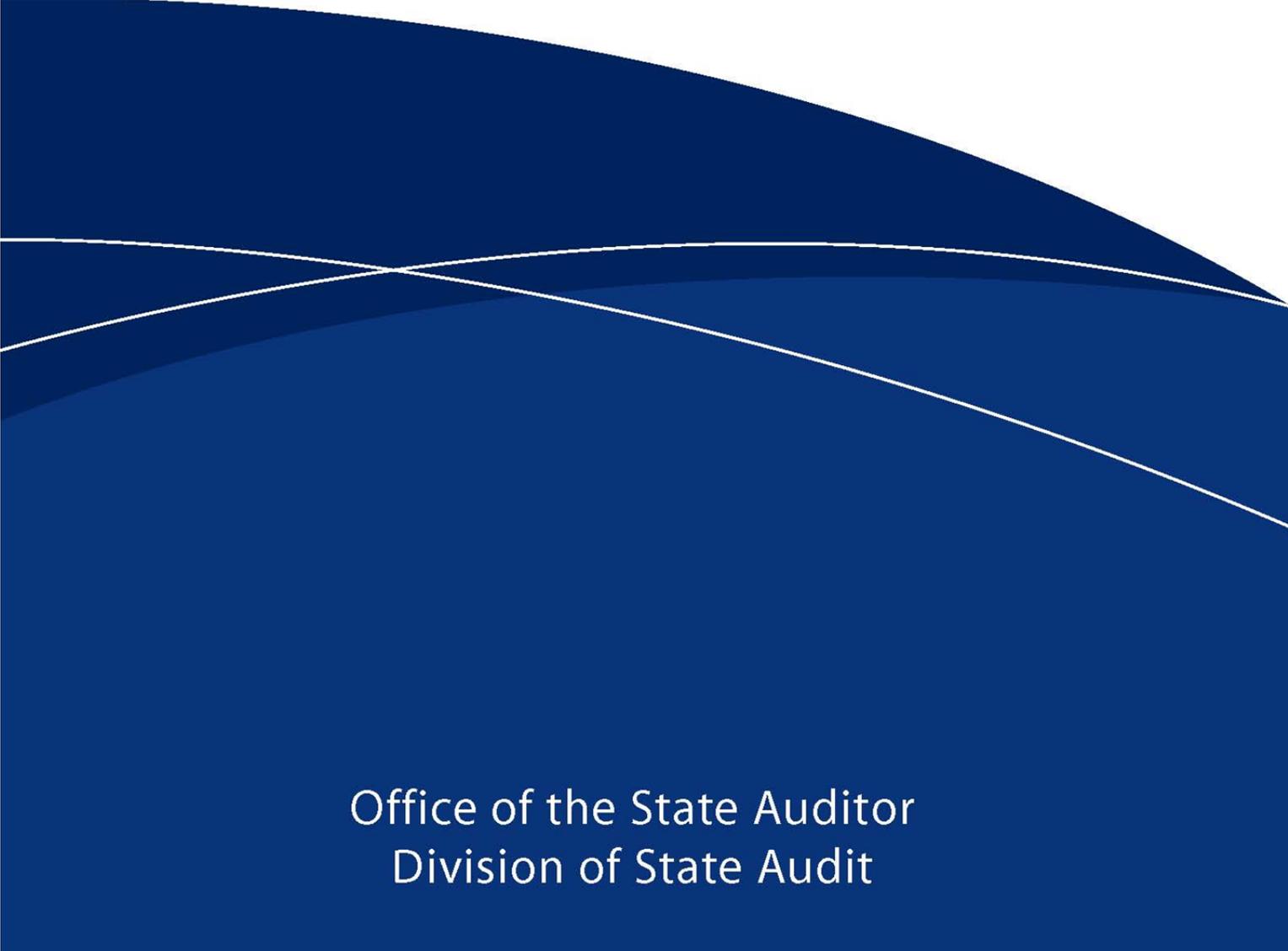


Department of Transportation
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2011

ROBERT R. PETERSON
STATE AUDITOR



Office of the State Auditor
Division of State Audit

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Transmittal Letter

January 11, 2012

The Honorable Jack Dalrymple, Governor
Members of the North Dakota Legislative Assembly
Mr. Francis Ziegler, Director

We are pleased to submit this audit of the Department of Transportation for the biennium ended June 30, 2011. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Allison Bader. Lindsey Ressler, Angela Klubberud, and Richard Fuher, CPA, were the staff auditors. Fred Ehrhardt, CPA, was the audit supervisor and Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Director Ziegler and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota State Highway Commission was created in 1913. North Dakota Century Code (NDCC) Title 24 changed the North Dakota State Highway Commission to the North Dakota Department of Transportation (DOT) in 1989. The DOT is responsible for the construction, maintenance, protection, and control of the highways comprising the state highway system. The DOT is charged with spending state highway funds as to the following priority: 1) maintenance of the state highway system; and 2) construction and reconstruction in an amount necessary to ensure federal aid available to the state. Funds not expended under (1) or (2) may be spent for construction, improvement, or maintenance of the state highways (NDCC 24-02-37). In addition to the state highway system, NDCC 39-01-01.1 describes the general responsibilities of the Drivers License and Traffic Safety Division and the Motor Vehicle Division. The DOT, with the approval of the Public Service Commission, has the authority to qualify the state for rail service assistance under the Railroad Revitalization and Regulatory Reform Act of 1977 (NDCC 49-17.1-02). In addition, the Governor has designated the director of the DOT to act on his behalf to administer the National Highway Safety Act of 1966. The director of the DOT also serves as a liaison to the State Aeronautics Board.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's response are noted below.

Responses to LAFRC Audit Questions

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Department of Transportation in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Other than our findings addressing the "inadequate vehicle and fuel usage controls" (page 14), "improper reconciliation of motor vehicle clearing account" (page 15), and "lack of segregation of duties for vehicle registration and titling checks" (page 16), we determined internal control was adequate.

4. *Were there any indications of lack of efficiency in financial operations and management of the agency?*

Other than our work addressing "increase usage of the purchase card" (page 20), there were no indications of lack of efficiency in financial operations and management of the Department of Transportation.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

Except "improper reconciliation of motor vehicle clearing account" as shown on page 15, the Department of Transportation has implemented all recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 23 of this report, along with management's response.

LAFRC Audit Communications

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Department of Transportation's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

11. *Identify any serious difficulties encountered in performing the audit.*

None.

12. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

13. Identify any management consultations with other accountants about auditing and accounting matters.

None.

14. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.

ConnectND Finance, Human Resource Management System (HRMS) Vehicle Registration and Titling System, Drivers License Master File, Construction Automated Records System, Fleet Focus, Motor Carrier Online System, and Preliminary Automated Construction Electronic Records (PACER) are high-risk information technology systems critical to the Department of Transportation.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Department of Transportation for the biennium ended June 30, 2011 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Department of Transportation's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Department of Transportation and are they in compliance with these laws?
3. Are there areas of the Department of Transportation's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Department of Transportation is for the biennium ended June 30, 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Department of Transportation has its central office on the Capitol grounds and eight district offices. District office financial activity is processed through the central office and included in the scope of this audit. Inventory observations were also performed at district 6 and district 8.

- Central Office
- District 1 - Bismarck, ND
- District 2 - Valley City, ND
- District 3 - Devils Lake, ND
- District 4 - Minot, ND
- District 5 - Dickinson, ND
- District 6 - Grand Forks, ND
- District 7 - Williston, ND
- District 8 - Fargo, ND

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.

- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Department of Transportation's processes and procedures.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Discussion and Analysis

The accompanying financial statements have been prepared to present the Department of Transportation's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2011, operations of the Department of Transportation were primarily supported by appropriations from federal and special revenue funds. In addition, a general fund appropriation of \$4.6 million was received to defray the cost of highway projects in the Devils Lake area.

Financial Summary

The Department of Transportation's capital assets include land, buildings, equipment, infrastructure assets, and construction in progress, all of which are valued at historical cost. All capital assets with an original cost of \$5,000 or more per unit (\$100,000 or more for infrastructure) and an estimated useful life in excess of one year are capitalized. The Department of Transportation's total capital assets before deducting accumulated depreciation for biennium ended June 30, 2011 were approximately \$3.2 billion. The largest category of capital assets is infrastructure. Major infrastructure assets include statewide public systems such as freeways, freeway lighting systems, freeway drainage systems, freeway signs, bridges, bridge lighting systems, etc. Infrastructure for biennium ended June 30, 2011 was approximately \$3 billion.

Revenues consisted primarily of federal revenues as well as taxes, licenses, permits, fees, political subdivision receipts, and fleet services billings. These types of revenues make up 99% of all of the Department of Transportation's revenue. Total revenue for fiscal year ended June 30, 2011 was \$764,941,489, compared to \$696,965,435 for fiscal year ended June 30, 2010.

The largest source of revenue for the Department of Transportation is from federal revenues. Federal revenue increased approximately \$46 million during fiscal year 2011 compared to the prior fiscal year. In addition, federal revenue increased approximately \$220 million or 48% for the biennium ended June 30, 2011 as compared to the biennium ended June 30, 2009. Federal revenue is dependent on the projects the Department of Transportation is performing including the amount and timing of project reimbursement by the federal government. In addition, the Department of Transportation received \$176,082,671 in federal funding pursuant to the American Recovery and Reinvestment Act (ARRA) of 2009. The ARRA funding spending authority was approved as an emergency measure by the 61st Legislative Assembly pursuant to Senate Bill 2012 section 2 with the majority of funding received on a reimbursement basis during the biennium ended June 30, 2011.

The second largest source of revenue for the Department of Transportation is from taxes. Tax revenue for fiscal year 2011 was approximately \$249 million compared to approximately \$229 million for fiscal year 2010. Tax revenue consists primarily of motor fuel tax, special fuels tax, and motor vehicle excise tax. Fuels tax revenues are directly dependent on the taxes collected and deposited into the highway tax distribution fund each month. Motor vehicle excise tax will vary, based on the number of motor vehicles sold.

Licenses, permits, and fees increased from fiscal year 2010 to 2011 by approximately \$4.8 million. Revenues mainly consist of motor vehicle license and registration fees which are dependent upon vehicle and dealer registrations.

Revenue from political subdivisions (cities and counties) decreased approximately \$13 million during fiscal year 2011 compared to the prior fiscal year. The amount of revenue received from political subdivisions is dependent on the projects the Department of Transportation is performing, including the cost and timing of the projects as well as available federal participation in the projects.

Fleet services revenue increased approximately \$9 million during fiscal year 2011 compared to the prior fiscal year. This is a result of an increase in the number of fleet vehicles and additional fuel costs due to higher prices and higher usage of fleet vehicles during spring flooding and snow events of the audited period.

Other revenues included sales of capital assets, insurance recoveries, highway damage claims and program income, interest earnings, miscellaneous revenues, and transfers from other state funds. These revenues remained fairly constant for the Department of Transportation, increasing slightly.

Total expenditures for the Department of Transportation were \$622,411,539 for the fiscal year ended June 30, 2011 as compared to \$547,379,228 for the prior fiscal year. In addition, total expenditures for the biennium ended June 30, 2011 increased approximately \$278 million or 31% as compared to the biennium ended June 30, 2010. The increase in total expenditures for the audited period reflects primarily increases in expenditures for highway contractor payments, road maintenance, grants, professional services, and travel. These expenditure categories primarily reflect the number, size, and timing of highway projects of the Department of Transportation. All other expenditures remained fairly constant.

Analysis of Significant Changes in Operations

The American Recovery and Reinvestment (ARRA) of 2009 was passed by Congress and signed into law by the President on February 17, 2009. The North Dakota Department of Transportation received \$176,082,671 in ARRA funding for transportation infrastructure projects in North Dakota. ARRA spending authority was approved as an emergency measure by the 61st Legislative Assembly pursuant to Senate Bill 2012 section 2 for the biennium ending June 30, 2011.

The Department of Transportation received borrowing authority for \$120 million, or so much of the sum as may be necessary, from the Bank of North Dakota to provide funding for emergency relief projects on the state highway system. This authority was approved as an emergency measure by House Bill 1012, section 4 of the 62nd Legislative Assembly.

The Department of Transportation received significant special fund appropriations for the 2011-2013 biennium deemed emergency measures by House Bill 1012, section 14. Appropriation of \$142 million was approved to rehabilitate or reconstruct county and township paved and unpaved roads to support oil and gas production and distribution in North Dakota. Funding of \$228.6 million was approved for extraordinary state highway maintenance.

Increased traffic due to North Dakota's rapidly expanding oil industry has created significant impacts to roadways in the oil development areas. Roads are deteriorating faster than

expected. The transportation industry is also facing increased costs for road and bridge construction and maintenance due to increased costs of oil-based products and the impact of construction inflation. The Department of Transportation is working with the Upper Great Plains Transportation Institute which is studying local transportation needs in oil producing counties.

Analysis of Significant Variances - Budgeted and Actual Expenditures

The unexpended balances in the operating expense, capital improvement, and grant appropriation lines were primarily attributable to uncertainty surrounding the level of federal funds the department would receive during the biennium. At the time the 2009-2011 biennium budget was prepared, the current federal transportation program was slated to expire on September 30, 2009 and a new program had not yet been passed (as of January, 2012 a new program has yet to be passed through Congress). As a result, the level of federal funding that was budgeted was based on a best estimate of what may occur over the course of the biennium. The level of federal funding that was estimated did not materialize. Therefore, considerable appropriation authority remained unspent as North Dakota did not receive the federal revenue or the federal authorization to proceed with a higher level of projects. Approximately \$13.8 million of unexpended state funded appropriation from the capital improvement appropriation line has been carried over to the 2011-2013 biennium in accordance with NDCC 54-44.1-11. These unspent funds will be spent on state-funded highway repair projects and state fleet vehicles during the 2011-2013 biennium.

The unexpended appropriation for the County and Township Road Program represents a portion of the funds passed by the 2011 Legislature and anticipated to be spent in the final months of the 2009-2011 biennium on local roadways in oil impact areas. Due to the wet weather conditions, the related projects could not be started until the 2011-2013 biennium. Accordingly, these funds were not spent in 2009-2011, but will be spent in 2011-2013.

The unexpended appropriation for Federal Stimulus Funds represents projects that were not completed in the 2009-2011 biennium. These unspent funds were appropriated by the 2011 Legislature and will be spent in the 2011-2013 biennium.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$ 363,981,926	\$ 317,724,722
Taxes	249,338,020	228,760,312
License, Permits, and Fees	93,936,776	89,109,217
Political Subdivisions	19,352,086	31,962,424
Fleet Services	31,644,705	22,947,400
Sale of Capital Assets	2,438,072	2,463,389
Insurance Recoveries	1,274,731	1,017,965
Highway Damage Claims and Income	829,119	940,354
Interest Earnings	644,798	766,235
Other Revenues	1,156,871	656,922
Transfers In	344,385	616,495
Total Revenues and Other Sources	<u>\$ 764,941,489</u>	<u>\$ 696,965,435</u>
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$ 78,253,121	\$ 73,079,683
Highway Contractor Payments	374,755,516	338,959,452
Road Maintenance	49,815,758	30,588,272
Grants	30,366,650	24,856,060
Highway Maintenance Equipment	13,645,158	24,424,511
Land and Buildings	3,533,800	1,580,404
Bond Principal and Interest	531,864	1,013,882
Major Operating Expenditures:		
Professional Services	25,117,871	17,083,611
Travel	20,040,810	12,068,039
Repairs and Other Equipment	9,752,539	7,623,714
Data Processing and Contract Services	4,557,191	4,467,720
Supplies	2,406,895	2,595,252
Utilities	2,323,954	2,166,778
Postage	947,376	815,509
Insurance	678,599	727,078
Other Operating Expenses	4,350,136	4,333,338
Transfers Out	1,334,301	995,925
Total Expenditures and Other Uses	<u>\$ 622,411,539</u>	<u>\$ 547,379,228</u>

Statement of Appropriations

For The Biennium Ended June 30, 2011

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 147,373,254	\$ 6,000,000	\$ 153,373,254	\$ 149,304,729	\$ 4,068,525
Operating Expenses	188,805,014	53,667,500	242,472,514	191,215,234	51,257,280
Capital Improvements	661,988,548	28,913,100	690,901,648	60,9625,421	81,276,227
Construction Carryover		11,244,166	11,244,166	10,723,931	520,235
Grants	69,766,101	15,500,000	85,266,101	52,493,382	32,772,719
County and Township Road Program		10,000,000	10,000,000		10,000,000
Federal Stimulus Funds - 2009	176,082,671	10,562,423	186,645,094	156,617,116	30,027,978
General Fund Transfer	4,600,000		4,600,000	4,600,000	
Totals	<u>\$1,248,615,588</u>	<u>\$ 135,887,189</u>	<u>\$1,384,502,777</u>	<u>\$1,174,579,813</u>	<u>\$209,922,964</u>
Expenditures by Source:					
General Fund	\$ 4,600,000		\$ 4,600,000	\$ 4,600,000	
Other Funds	1,244,015,588	\$ 135,887,189	1,379,902,777	1,169,979,813	\$209,922,964
Totals	<u>\$1,248,615,588</u>	<u>\$ 135,887,189</u>	<u>\$1,384,502,777</u>	<u>\$1,174,579,813</u>	<u>\$209,922,964</u>

Appropriation Adjustments:

Increase in the Salaries and Benefits line item (\$3,000,000) for market equity increases for classified state employees. These appropriated funds were approved by the 61st Legislative Assembly pursuant to Senate Bill 1015.

Increases in the Salaries and Benefits line item (\$3,000,000), Operating line item (\$10,000,000), Capital Improvements line item (\$64,250,000), and Grants line item (\$4,500,000) were approved by the Emergency Commission for additional spending authority to accept federal funds from the Federal Highway Administration Federal Emergency Relief fund (\$75,500,000) and state matching funds (\$6,250,000) from the State Highway fund for roadway projects in the Devils Lake Basin.

Increases in the Operating line item (\$250,000) and Capital Improvements line item (\$410,000) were approved by the Emergency Commission for additional spending authority to accept federal funds from the U.S. Department of Homeland Security to implement security enhancement in eight driver license testing sites for staff safety, customer privacy, security of sensitive data, and compliance with the Americans with Disabilities Act.

Increases in the Operating line item (\$7,500,000) and Grants line item (\$1,000,000) were authorized pursuant to Senate Bill 1012, section 9 of the 61st Legislative Assembly for highway projects and public transportation grants.

Increases in the Operating line item (\$35,917,500) and decreases in the Capital Improvements line item (\$35,917,500) for the construction and maintenance of highways authorized by Senate Bill 1012, section 9 of the 61st Legislative Assembly.

Increase in the Capital Improvements line item (\$170,600) for additional spending authority to accept federal funds from the U.S. Department of Homeland Security for upgrading the state radio network from analog to digital service by January 2013 for state agency and DOT vehicles. The adjustment was approved by the Emergency Commission.

Increase in the Federal Stimulus Funds - 2009 line item includes \$160,000 for additional spending authority to accept federal funds from the Federal Highway Administration Federal Land American Recovery and Reinvestment fund for a construction project of Forest Highway 5 in Slope County. The increase in the line item also includes \$14,130,000 for additional spending authority to accept federal funds from the U.S. Department of Transportation TIGER II Discretionary Grant Program to construct the North Central Regional Economic Growth Intermodal Port Connector Project in Minot. The adjustment was approved by the Emergency Commission. The Federal Stimulus Funds - 2009 line item also includes a decrease of \$3,727,577 for stimulus funds appropriated as an emergency measure by Senate Bill 2012, section 2 of the 61st Legislative Assembly and expended during the 2007-2009 biennium.

Increase in the Grants line item includes \$10,000,000 for additional spending authority to accept federal funds from the Federal Highway Administration Emergency Relief fund to reimburse cities and counties to repair damages caused by the 2010 high water events in the state. The adjustment was approved by the Emergency Commission.

The increase in the County and Township Road Program line item (\$10,000,000) was authorized and declared an emergency measure pursuant to House Bill 1012, section 10 of the 62nd Legislative Assembly for engineering and design costs incurred as of January 1, 2011.

The increase in the Construction Carryover line item of \$11,244,166 was authorized by section 54-44.1-11 of the North Dakota Century Code that allows for unexpended capital construction budgets to be carried forward to the next biennium. The adjustment was approved by the Carryover Committee.

Expenditures Without Appropriations Of Specific Amounts:

Highway Fund has a continuing appropriation authorized by NDCC 24-02-35.2 (\$176,030 of expenditures for this biennium).

Insurance recoveries have a continuing appropriation authorized by NDCC section 54-44.1-09.1 (\$681,885 of expenditures for this biennium).

Drivers License Trust Fund is authorized by NDCC 39-16-10 to account for cash received and to make payments and refunds to/from motor vehicle operators involved in accidents that have no automobile liability policy (\$25,300 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2011, we identified the following areas of the Department of Transportation's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the following information systems:
 - Vehicle Registration and Titling System (VRTS).
 - Drivers License Master File System.
 - Construction Automated Records System (CARS).
 - Fleet Focus System.
 - Motor Carrier Online System.
 - Preliminary Automated Construction Electronic Records (PACER).
- Controls surrounding vehicle and fuel usage operations of the Fleet Services Division.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate, noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of Department of Transportation in a management letter dated January 11, 2012.

Inadequate Vehicle and Fuel Usage Controls (Finding 11-1)

Condition:

The controls surrounding the vehicle and fuel usage at the Department of Transportation are inadequate. Specifically, we noted the following control weaknesses:

- Monitoring policies and procedures have not been documented to include:
 - Monitoring unnecessary use of retail fuel sites compared to district fueling sites;
 - Issuing and cancelling of fuel cards;
 - Guidelines for issuing, returning, and monitoring the use of permanently assigned fleet vehicles; and,
 - Frequency of reviews and documentation for exceptions to established guidelines for fleet vehicle replacement.
- Documentation of review procedures is not retained to identify review procedures performed, frequency of the review, conclusions, and further investigation of unusual results.
- Comparison of fuel usage to miles driven is not performed to detect unauthorized fuel usage.
- Individuals are not required to certify receipt and acknowledgement of significant policies in the state fleet services policy manual guidelines including notification of taxable commuting benefits and requirements for insurance of personally assigned garaged fleet vehicles.

Criteria:

The *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission identifies that appropriate policies, procedures, techniques, and mechanisms with respect to each activity be developed; management reviews of actual numbers versus targets be performed; and, internal control procedures, transactions, and other significant events be clearly documented.

Cause:

The Department of Transportation has not adequately evaluated policies and procedures for monitoring vehicle and fuel usage including taxable benefits and insurance requirements.

Effect or Potential Effect:

Improper use of vehicles and fuel could occur and go undetected; taxable benefits may not be properly claimed by individuals; and personal storage of fleet vehicles may not be properly covered by individual insurance policies.

Recommendation:

We recommend the Department of Transportation strengthen vehicle and fuel usage controls to:

- Develop documented monitoring policies and procedures.
- Retain documentation of review procedures performed.
- Perform comparison of fuel usage to miles driven to identify unauthorized fuel usage.
- Require certification of receipt and acknowledgement of significant policies in the state fleet services policy manual guidelines.

Department of Transportation Response:

NDDOT concurs with the finding. Policies and procedures will be developed and implemented as recommended.

Improper Reconciliation of Motor Vehicle Clearing Account (Finding 11-2)**Condition:**

The reconciliation of the motor vehicle clearing account is inadequate. On a monthly basis, monies are transferred to the State Treasurer and deposited as prescribed by law. The Department of Transportation has not adequately accounted for unallocated funds still pending in the motor vehicle clearing account after the monthly transfer to the State Treasurer.

Criteria:

North Dakota Century Code section 54-06-08 states “each officer shall report to the state treasurer monthly the amount of fees or profits received, verified by oath, and at the same time shall pay the amount of such fees or profits to the treasurer.”

Cause:

Prior recommendations for proper reconciliation procedures from the Department of Transportation’s biennium ended June 30, 2009 audit and the audit of the 2009 Comprehensive Annual Financial Report have not been implemented.

Effect or Potential Effect:

The motor vehicle clearing account represents significant activity for the Department of Transportation with approximately \$190 million transferred to the State Treasurer during fiscal year 2011. Without a proper reconciliation, there is an unacceptably high risk of errors or fraud in the management of the motor vehicle clearing account and monthly transfer to the State Treasurer.

Recommendation:

We recommend the Department of Transportation properly reconcile the motor vehicle clearing account.

Department of Transportation Response:

NDDOT agrees with the finding and recommendation. NDDOT is currently pursuing a method to successfully reconcile the clearing account and properly transfer all funds out of the account.

It should be noted that Motor Vehicle management and NDDOT internal audit staff have reviewed the collection and deposit activities for the Motor Vehicle Division and have determined that all revenues received are being deposited into the Motor Vehicle clearing account in the Bank of North Dakota.

All funds are properly deposited and accounted for in the clearing account; however, the problem lies in the fact that the funds are not all being distributed out of the clearing account and transferred to the ND State Treasurer's Office for subsequent distribution.

Reconciliation of the motor vehicle clearing account is a very complex undertaking. The primary system involved in the processing of the related transactions is the Vehicle Titling and Registration System (VRTS). This system is extremely complex and it is used to process a multitude of unique transactions that are allocated to many separate funds as directed by our legislature. The reconciliation problems that have been encountered likely stem from procedural and/or information technology issues as related to the VRTS system since the VRTS system was not designed to have a financial reconciliation function. Also, any problems with distribution may stem from the fact that the current VRTS system is incapable of handling the complex and multiple distributions required by law.

To successfully resolve this issue, NDDOT has assembled a large, multi-disciplinary task force. Currently, individuals with accounting, auditing, Motor Vehicle, and information technology expertise are actively pursuing a solution. Each unique category of transaction is being researched, mapped and traced through the VRTS system in a test environment. As discrepancies are revealed through this process, procedural and/or information technology solutions will be developed, implemented, and further tested to ensure that a satisfactory solution is put in place.

Lack of Segregation of Duties for Vehicle Registration and Titling Checks (Finding 11-3)**Condition:**

Checks issued from the Vehicle Registration and Titling System can be initiated and approved by the same individual. The same individual is also responsible for preparing the bank reconciliation of the motor vehicle clearing account. Approximately 24,000 checks totaling \$5.9 million were processed through the Vehicle Registration and Titling System during fiscal years 2010 and 2011.

Criteria:

The Internal Control Integrated Framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) states that proper segregation of duties is an integral requirement of internal control.

Cause:

The Department of Transportation did not properly segregate employee responsibilities.

Effect or Potential Effect:

Increased risk for misappropriation of money through improper processing of checks.

Recommendation:

We recommend the Department of Transportation properly segregate duties for initiation and approval of checks issued from the Vehicle Registration and Titling System. We also recommend the Department of Transportation ensure the bank reconciliation of the motor vehicle clearing account is performed by an independent individual.

Department of Transportation Response:

NDDOT agrees with the finding and recommendation. The Motor Vehicle staff duties have now been segregated in accordance with this recommendation.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2011, we identified and tested Department of Transportation's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Proper collection and deposit of fees:
 - Nonresident Commercial Drivers License Fee (NDCC 39-06.2-09.1(2)).
 - Driving Record Information Fee (NDCC 39-06.2-13.1).
 - Accident Report Fee (NDCC 39-08-1(5)).
 - Personalized Plate Fee (NDCC 39-04-10.3).
 - ND Gold Star Plate Fee (NDCC 39-04-10.14)
 - License Plate Fees (NDCC 39-04-18(2)).
 - Temporary Motor Vehicle Registration Fees (NDCC 39-04-18.2(2a-d)).
 - Motor Vehicle Registration Fees (NDCC 39-04-19(2a-c),(4)).
 - Dealer License Violation Fees (NDCC 39-18-01).
 - Trailer Registration Fees (NDCC 39-18-03.2).
 - Dealer Enforcement Violation Fees (NDCC 39-22-16).
 - Dealer ND Participation Fee (NDCC 39-22-20).
 - Snowmobile Safety Fee (NDCC 39-24-03.1).
 - Off-Highway Vehicle Title Tax Fee (NDCC 39-29-03(3)).
 - Unconventional Vehicle Registration Fee (NDCC 39-29.2-03(5)).
- Proper use of the following legally restricted funds:
 - Motor Vehicle fund for motor vehicle operations. (NDCC 24-02, NDCC 39-05-30).
 - Highway-Rail Grade Crossing Safety fund for funding grants for highway-rail grade crossing projects. (Senate Bill 2338, section 2 of the 2009 Legislative Session).
 - Dealer Enforcement fund for motor vehicle licensing. (NDCC 39-22).
 - State Infrastructure Bank for funding eligible projects as determined by agreement of the members of the multistate infrastructure bank. (NDCC 24-02-43).
 - Special Road fund for construction and maintenance of access roads and roads within recreational, tourist, and historical areas. (NDCC 24-02-37).
 - Public Transportation fund for distribution to public transportation providers to establish and maintain public transportation. (NDCC 39-04.2-04).
 - State Rail fund for the continuation of operations and maintenance of railroads within the state. (NDCC 49-17.1-02).
 - Drivers License Trust fund to account for amounts received from uninsured drivers. (NDCC 39-16-10).
 - Fleet Services fund to account for costs of operating and maintaining state owned vehicles (NDCC 24-02-03.5).
- Proper distribution of public transportation funds (NDCC 39-04.2-04).
- Proper purchasing of construction improvements (NDCC 24-02-17).
- Proper deposit of interest to the Highway fund and Special Road fund in accordance with NDCC 24-02-37(3).
- Proper surety bonds for contracted motor vehicle district managers handling significant amounts of cash (NDCC 26.1-21-08).

- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2009 North Dakota Session Laws chapters 40 and 573).
- Compliance with OMB's Purchasing Procedures Manual.
- Proper use of outside bank accounts, petty cash funds, and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards require auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that has occurred or is likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the Department of Transportation in a management letter dated January 11, 2012.

Operations

Our audit of the Department of Transportation identified the following area of potential improvement to operations, as expressed by our operational objective:

- Did the Department of Transportation utilize the P-card program so as to maximize the amount of applicable purchases made on the P-card versus making payment through the Accounts Payable module?

Increase Usage of the Purchase Card (Finding 11-4)

Condition:

The Department of Transportation is not utilizing the purchase card (P-card) to the extent possible. Based on an analysis of expenditures during fiscal year 2011, we noted that the Department of Transportation only made 69 payments for purchases less than \$2,500 using the P-card compared to more than 24,000 similar small purchase payments that could have been paid with a P-card. In addition, less than 1% of all applicable payments were paid using a P-card.

Criteria:

- *OMB Purchasing Card manual* – denotes some of the benefits of using the P-card to include: 1) reducing administrative costs for the state; 2) reducing the amount of paperwork; and 3) reducing the number of checks issued, among other benefits.
- *Government Finance Officers Association (GFOA) Recommended Best Practices* – use of purchasing cards improves the efficiency of purchasing procedures and reduces overall purchase processing costs.
- *National Association of Purchasing Professionals* – estimates that P-cards can save 55% to 90% off the cost of a payment transaction.
- *RPMG Research Corp.* – 2003 Purchasing Card Benchmarking Study demonstrated that P-cards reduce the procurement cycle by 74%.
- *RPMG Research Corp.* – 2005 Purchasing Card Benchmarking Study Highlighted the cost savings of using a P-card ranges from \$24 (normal purchase process) up to \$67 (making a purchase via a purchase order) per transaction.

Cause:

The Department of Transportation has not fully examined the cost savings of the P-card program to the state or the Department of Transportation.

Effect or Potential Effect:

Administrative efficiency could be increased and check processing costs eliminated by paying eligible expenditures with the P-card. In addition, at least \$125,750 of revenue would have been available to the state general fund through the P-card rebate program during fiscal year 2011.

Operational Improvement:

We recommend the Department of Transportation look for ways to increase their usage of the P-card as a form of payment. We further recommend, if necessary, the Department of Transportation meet with officials from the Office of Management and Budget to facilitate this process by developing procedures for purchase order transactions, raising P-card limits, identifying vendors for which P-card payments could be made, or changing the accounting on their P-cards so as to limit the need to re-allocate P-card expenditures.

Department of Transportation Response:

NDDOT will continue to explore ways to increase the usage of the P-card. When appropriate and operationally effective, NDDOT will attempt to use the P-card as the preferred payment method.

NDDOT has recently expanded the use of the P-card to our eight district shops. As a result, we expect to see a substantial increase in the number and dollar amount of P-card transactions for the department.

Prior Recommendations Not Implemented

Prior recommendations have been implemented with the exception of the following:

Inadequate Procedures Surrounding Revenue Collections (Finding 09-2)

Recommendation:

We recommend the Department of Transportation properly reconcile the motor vehicle clearing account to the report of amounts processed and pending each month.

Status:

Not implemented. See new recommendation on page 16.

Management Letter (Informal Recommendations)

January 11, 2012

Mr. Francis Ziegler, Director
Department of Transportation
608 E. Boulevard Avenue
Bismarck, ND 58505-0700

Dear Mr. Ziegler:

We have performed an audit of the Department of Transportation for the biennium ended June 30, 2011, and have issued a report thereon. As part of our audit, we gained an understanding of the Department of Transportation's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

LEGISLATIVE INTENT

Informal Recommendation 11-1: We recommend the North Dakota Department of Transportation develop policies and procedures to ensure the amounts of the surety bonds furnished by Motor Vehicle branch managers are sufficient.

Informal Recommendation 11-2: We recommend the Department of Transportation distributed public transportation funds in accordance with NDCC 39-04.2-04.

INTERNAL RISK ASSESSMENT

Informal Recommendation 11-3: We recommend the Department of Transportation continue the fraud risk assessment process to design and document the necessary control activities to ensure that each significant fraud exposure identified has been adequately mitigated.

INVENTORY

Informal Recommendation 11-4: We recommend the Department of Transportation follow the internal inventory adjustment policy to ensure inventory adjustments are proper. We also recommend the Department of Transportation properly evaluate inventory adjustments submitted by the districts to conclude that adjustments are proper, correct inadequate measuring techniques, or identify potential misappropriation of assets.

Informal Recommendation 11-5: We recommend the Department of Transportation develop proper safeguards and monitoring procedures for auxiliary fuel usage.

INFORMATION SYSTEMS

Informal Recommendation 11-6: We recommend the Department of Transportation review access privileges within Fleet Focus groups to ensure individuals are only provided access necessary to perform their job duties.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 11-7: We recommend the Drivers License and Motor Vehicle divisions of the Department of Transportation develop documented credit card refund policies that outline refund processes including supporting documentation, proper approvals, and reconciliation procedures.

REVENUE

Informal Recommendation 11-8: We recommend the Department of Transportation review and approve the monthly deposit of Motor Vehicle Division revenues to the State Treasurer's Office.

Informal Recommendation 11-9: We recommend the Department of Transportation assess interest and penalties as identified in the Department's 2011 International Fuel Tax Agreement Instruction Manual or develop proper policies and approval procedures for waivers.

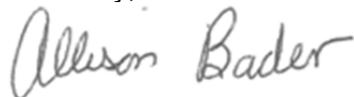
OPERATIONAL

Informal Recommendation 11-10: We recommend the Department of Transportation review methods to increase online quarterly submission of motor carrier quarterly filings to the Motor Carrier Online System to reduce or eliminate manual entry procedures.

Management of the Department of Transportation agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Allison J. Bader
Auditor in-charge

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www.nd.gov/auditor/

or by contacting the
Division of State Audit

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