Secretary of State

AUDIT REPORT

Bill Bradbury, Secretary of State
Cathy Pollino, Director, Audits Division

Report No. 2003-30 • August 14, 2003

Oregon Department of Aviation: Expenditure Audit Fiscal Year 2002

Summary

PURPOSE

The purpose of our audit was to comply with Oregon Revised Statute 835.065, which requires the Audits Division to perform an audit of all necessary expenses of the Oregon Department of Aviation (department).

RESULTS IN BRIEF

We tested controls over accounting system access, travel expenditures, state cell phone use, payroll, contracting procedures and contract expenditures. We found that most of the department's controls tested were in place, and the department was in compliance with applicable laws and requirements. We identified opportunities, however, to improve controls over cash handling, infrastructure valuation, and facilities maintenance contracting.

RECOMMENDATIONS

We recommend that the department:

- Strengthen existing controls over cash processing.
- Review the valuations of infrastructure assets to ensure they are accurate and complete.
- Develop policies and procedures for the valuation of infrastructure assets to ensure they are consistent with the requirements of governmental accounting and financial reporting standards.
- Establish a formal intergovernmental agreement with the Oregon Department of Transportation (ODOT) for facilities maintenance services.

AGENCY'S RESPONSE

The Oregon Department of Aviation generally agrees with the recommendations.

Introduction

The Oregon Department of Aviation (department) began operations as a separate state agency in 2000 as a result of Oregon Revised Statute (ORS) 835.100. Previously, the department was a division of the Oregon Department of Transportation (ODOT). Currently, the department is organized into five program areas, which provide oversight, inspections, development and implementation of a broad range of programs and services dedicated to ensuring safety, efficiency, and effectiveness within Oregon's aviation community.

The department's goals include developing aviation as an integral part of Oregon's transportation network, creating and implementing strategies to protect and improve Oregon's aviation system, encouraging aviation-related economic development, supporting aviation safety and education, and increasing commercial air service and general aviation in Oregon.

The department's activities are primarily funded by state aviation fuel taxes, aircraft registrations, leases and agreements on state-owned airports, and airport licensing fees.

Audit Results

The purpose of our audit was to comply with Oregon Revised Statute 835.065, which requires the Audits Division to perform an audit of all necessary expenses of the Oregon Department of Aviation (department).

To accomplish this purpose, we tested various expenditures incurred by the agency for the year ended June 30, 2002, and the controls related to those expenditures. During our audit, we found that the department's controls over accounting system access, travel expenditures, state cell phones, and payroll were in place and in compliance with applicable state rules and requirements. We also found that the department appropriately followed state contracting policies. In addition, contract expenditures complied with the related contract terms or federal grant requirements.

We also identified opportunities to improve controls that will help the department ensure that assets are correctly accounted for and properly safeguarded, and ensure that department policies and procedures are in compliance with state rules.

Cash Handling Controls

The department collects fees such as pilot licenses and aircraft registrations. During our audit, we noted that the department could improve its controls over cash handling.

We found that the department did not properly segregate cash handling duties as prescribed by the *Oregon Accounting Manual* (OAM). The OAM requires, to the extent possible, that agencies separate cash handling from record keeping duties, and that one person should not be allowed to process one transaction from beginning to end.

Specifically, we found that only one employee opened the mail, which may include cash payments. In addition, the department did not create a receipt log to ensure that all payments received were properly recorded. After the mail was opened, payments and license documentation were then forwarded to a second employee for processing. This second employee recorded all payments, including those received over the counter from walk-in customers, in the computer licensing system; distributed pilot licenses and aircraft registration certificates to customers; and prepared the deposit.

The department had not developed compensating controls, such as reconciling pilot licenses and aircraft registrations issued to cash receipts or training other employees to process cash.

Further, we found that the department did not deposit cash receipts in a timely manner. State law requires that cash receipts be deposited within one business day. Of the seven transactions tested, five (71 percent) were not deposited within one business day; two were not deposited for five business days.

We recommend that the department strengthen controls over cash handling. Specifically, we recommend that department management:

- Require two employees to open the mail when payments are received. In addition, create a receipt log of all payments received and have an employee who does not have cash handling duties reconcile this log to the actual deposits.
- Separate cash processing duties from record keeping duties to the extent allowed by current staffing levels to ensure that one employee cannot process a transaction from beginning to end.
- Require an employee who does not have cash handling duties to perform regular reconciliations of payments received and deposited to pilot licenses and aircraft registrations sold.
- Train additional employees on cash processing procedures.
- Ensure that cash receipts are deposited daily or file an exemption request as described in ORS 293.265.

Agency's Response:

In general, segregating cash processing and record keeping duties will be very difficult for us to accomplish with such a small staff. The entire agency consists of sixteen employees including management and field employees. Even so, we have recognized a need for tighter cash handling controls and found your recommendations helpful. I do agree with all of your recommendations in this area. We have already requested assistance from the Treasury Department in implementing better cash handling procedures. To date, they have reviewed our current procedures and given us a list of recommendations. We will continue to meet with them to develop workable procedures. We are also considering contracting out some the functions, such as opening the mail. We will file for an exemption to the requirement to make deposits within one day of receiving the payment. This filing will be made by September 1, 2003. We intend to have workable, updated cash controls implemented by January 1, 2004.

Infrastructure Valuation

We reviewed the department's process for determining the value of infrastructure assets and the associated depreciation expense. We reviewed the detailed costs of one judgmentally selected airport and found the department included land costs of $243,250 as infrastructure. In addition, we found a clerical error that undervalued the cost of the same project by $14,839. As a result, the net overstatement of infrastructure assets was $228,411, which resulted in an incorrect calculation of depreciation expense.

Current governmental accounting standards require that governments report infrastructure assets and, when applicable, depreciation expense for those assets. Infrastructure assets are long-lived capital assets that, normally, are stationary in nature and, normally, can be preserved for a significantly greater number of years than most capital assets. Airports, including runways, are considered infrastructure; land, however, is not infrastructure and is not depreciable.

Infrastructure assets should be depreciated in a consistent manner over the useful life of the asset, once the asset is placed into operation. We found that the department was incorrectly determining the date on which assets were placed into operation for financial reporting purposes. For example, the department began depreciating an infrastructure asset on the date the grant application was submitted to the federal government, before construction started. Since depreciation should begin when the asset is placed into operation, it is important that agency fiscal records accurately reflect when the assets become operational and available for use. Assigning incorrect operational dates may cause depreciation expense to be miscalculated in a fiscal year.

During our testing, we also found that the department had not developed policies and procedures to specify when construction projects should be classified as infrastructure assets, which are capitalized and depreciated, or maintenance expenses, which are expensed when incurred. Accordingly, in addition to misstating assets, there is an increased risk that depreciation expense may be misstated if construction projects are incorrectly classified.

We recommend that the department review its valuations of infrastructure assets to ensure that they are complete and accurate and, in particular, do not include costs for non-depreciable assets such as land.

We also recommend that the department develop policies and procedures relating to the valuation of infrastructure and apply them retroactively to the year ended June 30, 2002, as well as to future years. Specifically, the policies and procedures should be consistent with the requirements of governmental accounting and reporting standards and include:

- A determination as to when an asset is considered to be placed into operation for financial reporting purposes to begin depreciation.
- The distinction between infrastructure projects, which are capitalized and depreciated over the asset's useful life, and maintenance projects, which should be expensed when incurred.

Agency's Response:

We agree with the auditors' findings and recommendations. Original work done to value the agency's infrastructure assets was sloppy and inconsistent. We have developed an agency policy which defines capital construction and maintenance projects, consistent with federal guidelines. Then we re-valued all our infrastructure assets based on this policy. We have already completed this work and are confident that we now have accurate valuations of our facilities, have appropriately figured depreciation, and have a standardized procedure in place to update these figures as improvement projects are done. Additionally, we have set up a filing system that will make it easier for staff and auditors to review airport values and changes in the future. This work is completed.

Facilities Maintenance Contract

The department is responsible for performing maintenance at 28 airports throughout the state. Maintenance may include repaving runways, changing runway lights and landscape upkeep in and around the runways. During fiscal year 2002, the department paid the Oregon Department of Transportation (ODOT) $144,453 for facilities maintenance services. The department, however, did not have a formal contract with ODOT covering the services performed. In the absence of an intergovernmental agreement between state agencies, terms and provisions of services may not be adequately specified. Unnecessary services may be provided, resulting in added expenses, or services performed may not be in accordance with the department's expectations.

We recommend that the department establish a formal intergovernmental agreement with ODOT for provided facilities maintenance services.

Agency's Response:

We agree with the auditors' findings and recommendations in this area. When Aviation separated from Transportation in 2000 we did execute an intergovernmental agreement which covered the ongoing and special airport maintenance services which Transportation would perform. Unfortunately, because of the long-standing relationship between the two agencies and the familiarity between the two staffs, it was determined that a contractual relationship wasn't needed. This determination was incorrect. We are currently negotiating an agreement with Transportation and expect to have this completed by September 1, 2003.

Objectives, Scope and Methodology

The objective of our audit was to review the department's expenditures as required by ORS 835.065. Specifically, our objectives included determining if the department's expenditures for the year ended June 30, 2002:

- Were properly classified in the accounting system,
- Adhered to proscribed policies and applicable rules and guidelines, and
- Represented a reasonable and necessary expenditure of public funds.

We selected for review accounts that had significant expenditures as reported in the State Financial Management System (SFMA) as of June 30, 2002. Specifically, we tested expenditures for facilities maintenance, depreciation, contracts, and payroll.

In addition to the significant expenditures, we tested federal grant expenditures by reviewing selected grants that were in effect during fiscal year 2002 to ensure compliance with the grant agreement. We also tested controls over high-risk transactions such as cash handling procedures, SFMA access, state cell phone use, and travel expenditures.

Our work included inquiries of department personnel, examination of state and federal rules and guidelines, and a review of state policies and procedures and documents relating to our objective.

Fieldwork was conducted in April and May 2003. We conducted our audit in accordance with generally accepted government auditing standards.

This report, which is a public record, is intended to promote the best possible management of public resources. Copies may be obtained by mail at Oregon Audits Division, Public Service Building, Salem, Oregon 97310, by phone at 503-986-2255 and 800-336-8218 (hotline), or internet at Audits.Hotline@state.or.us and http://www.sos.state.or.us/audits/audithp.htm.

AUDIT ADMINISTRATOR: *Jason M. Stanley, CPA* • AUDIT STAFF*: Diane B. Farris, CPA • Geoff M. Hill, CPA • Jamie E. Breyman*

DEPUTY DIRECTOR: *Mary E. Wenger, CPA*

The courtesies and cooperation extended by the officials and staff of the Department of Aviation were commendable and much appreciated.

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