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Secretary of State AUDIT REPORT

Department of Human Services Mental Health and Addiction Services Program: Capital and Non-Capital Assets

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

Summary

PURPOSE
This audit was conducted to determine whether the Department of Human Services, Mental Health and Addiction Services Program (department) has adequate controls in place over capital and non-capital assets and complied with applicable state policy.

RESULTS IN BRIEF
We found that the department did not have a detailed list of capital assets and had not conducted annual inventories at the Eastern Oregon Psychiatric and Training Centers. We also found that the department includes an amount in its Institutional Revenue Service fund that may not represent actual assets, and has not accurately and consistently calculated depreciation for some assets.

We also identified other issues of lesser significance that did not warrant reporting in the audit report. These issues were conveyed to the department in Management Letter No. 309-2003-08-01.

RECOMMENDATIONS
We recommend that the department develop a detailed capital asset property ledger and conduct annual physical inventories. We also recommend that the department review the correctness of the amounts included in the Institutional Revenue Service fund and ensure that deprecation of assets is accurately and consistently calculated.

AGENCY'S RESPONSE
The Department of Human Services generally agrees with the recommendations.

Introduction

As of June 30, 2002, the Department of Human Services, Mental Health and Addiction Services Program (department) reported capital assets with an original acquisition value of more than $62 million.

The majority of the department's capital assets (e.g., buildings, equipment and vehicles) are located at the Oregon State Hospital and the Eastern Oregon Psychiatric and Training Centers. Assets with a purchase price of $5,000 or more and a useful life greater than one year should be recorded in the applicable funds in the department's financial system.

Audit Results

Controls Over Assets Need To Be Established at the Eastern Oregon Psychiatric and Training Centers

At the time of this audit, the Eastern Oregon Psychiatric and Training Centers (centers) were unable to provide detailed property records. In addition, there had not been a physical inventory of capital assets in more than four years.

In order to ensure that assets are properly accounted for and classified in accounting records, state policy requires assets with an acquisition value greater than $5,000 and a useful life longer than one year to be capitalized, tagged with a State of Oregon identification tag and property control number, listed on the capital asset property ledger, and physically inventoried at least annually.[1] State policy also requires that these assets be depreciated throughout their useful life.

According to department management, there was a misunderstanding with the department and the centers had insufficient staff resources available to prepare detailed property listings and conduct annual inventories.

Because a detailed property listing was unavailable, the department recorded the same depreciation entries for fiscal year 2002 that it recorded in fiscal year 2001 instead of calculating depreciation based on the current value of the assets.

We recommend that the Eastern Oregon Psychiatric and Training Centers:

- Develop a detailed capital asset property ledger and reconcile it to the general ledger.
- Conduct a physical inventory to identify all capital assets and conduct annual physical inventories hereafter.
- Adjust the capital asset and accumulated depreciation accounts to reflect correct asset values and accumulated depreciation.

Agency's Response:

We agree. We are in the process of developing a capital asset property ledger through the inventory process. Once completed, we will reconcile these amounts to the general ledger. In addition, physical

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[1] *Oregon Accounting Manual* Policy and Procedure Numbers 15 60 10, 10 50 00 and 15 60 20.

inventories will be conducted on an annual basis and reasonable depreciation expense estimates will be reported in this year's Statewide Financial Report.

Capital Asset Balances in the Institutional Revenue Service Fund May Not Represent Actual Assets

The department's newly acquired assets are directly reported in the accounting records of the facility to which they are assigned. Previously when assets were purchased, they were reported in the department's Institutional Revenue Service (service) fund until they were transferred to the facility where they were used. Even after the department stopped using the service fund to record the initial purchase of capital assets, balances continued to be reported in the service fund.

The department has stated that the remaining capital asset balances reported in the service fund do not represent actual assets and they intend to remove the capital asset and accumulated depreciation balances in the service fund.

We recommend that the department examine the amounts in the service fund to ensure they are properly accounted for and make any necessary adjustments to remove inappropriate amounts.

Agency's Response:

We agree. We are in the process of removing inappropriate amounts and ensuring amounts in the service fund are accounted for properly. We anticipate completion by August 31, 2003.

Depreciation is Misstated For Some Capital Assets

We found that the department incorrectly calculated depreciation for some of its buildings, building improvements, land improvements and utility systems; as a result, the department misstated its asset and depreciation amounts in its financial records. Specifically, we noted that the department:

- Calculated depreciation expense using a shorter useful life than intended for most buildings. The department has established a useful life of 110 years for buildings. Therefore, a building acquired in 1951 should have been depreciated for 110 years or until 2061. In our sample, however, a building acquired in 1951 was given a useful life ending date of 2011 and was, therefore, set up to depreciate for only 60 years.

  By using a shorter useful life, depreciation expense and accumulated depreciation are overstated for a given year.

- Calculated depreciation expense for building improvements using incorrect useful lives. These improvements should have been depreciated starting from the time the improvement was completed. However, the department depreciated these improvements from the original acquisition date of the asset which, in some cases, was several years before the building improvement was completed. As a result, depreciation expense and accumulated depreciation were misstated for a given year.

We recommend that the department recalculate depreciation for buildings and related improvements, land improvements and utility systems at the department using the correct useful lives of the assets and adjust the financial records accordingly.

Agency's Response:

We agree. We are in the process of recalculating depreciation for the assets identified. We hope to have this completed by August 31, 2003.

Depreciation Methodologies are Inconsistent

During fiscal year 2002, the department used inconsistent methods for calculating depreciation. Depreciation for real property and infrastructure was calculated using a half-year method. Under this method, a half of a year of depreciation expense is recognized for both the year the asset is purchased and the year the asset is disposed.

The department determined depreciation for equipment, motor vehicles and data processing assets using a ratio method. Under the ratio method, depreciation is determined based on the month in which the asset was acquired.

State accounting policy requires that agencies adopt a consistent policy for partial year depreciation. Both methods of determining partial year depreciation are acceptable. However, to meet the state policy for partial year depreciation, the department should use a consistent method for all types of assets.

We recommend that partial year depreciation for all capital assets be determined using a consistent methodology.

Agency's Response:

We agree. Effective immediately, depreciation will begin the month the asset is put into use.

Objectives, Scope and Methodology

The objectives of the audit were to determine if the Department of Human Services, Mental Health and Addiction Services Program (department) controls over capital and non-capital assets were adequate and determine if the department was compliant with applicable state policy.

To accomplish our audit objective, we:

- Interviewed department personnel;
- Reviewed relevant state rules;
- Reviewed current department policies and procedures in relation to our audit;
- Reviewed source documentation and accounting records for asset purchases and dispositions; and
- Conducted physical inventories of a randomly selected sample of assets.

Fieldwork was conducted March through June 2003. We performed 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.

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

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