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Auditing for a Better Oregon

January 21, 2005

Bruce A. Warner, Director
Oregon Department of Transportation
355 Capital St. NE, Rm. 135
Salem, Oregon 97301-3871

Dear Mr. Warner:

The statewide single audit that included selected financial accounts at the Oregon Department of Transportation for the year ended June 30, 2004, has been completed.

This statewide single audit work is not a comprehensive audit of your agency. Instead, this audit permits us to give an opinion on the statewide financial statements contained in the State of Oregon's *Comprehensive Annual Financial Report* and to report on internal control and the state's compliance with laws and regulations. Regular audits of the Oregon Department of Transportation will continue on a periodic basis.

The following Oregon Department of Transportation accounts and transactions were audited to determine their fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

SFMA Account	Description	Audit Amount
Special Revenue Fund — Public Transportation Fund (1111)		
0065	Unreconciled Deposit	$36,558,968
0070	Cash on Deposit with Treasurer	376,928,638
0122	Motor Fuels Tax Revenue	406,023,758
0123	Weight Mile Tax Revenue	225,490,881
0126	Vehicle Registration Tax Revenue	165,269,751
0300	Federal Revenue	359,028,577
1215	Accounts Payable	74,713,896
1404	Transfer to Cities	109,176,221
1405	Transfer to Counties	170,317,584
3111	Regular Employees	178,374,662
4975	Agency Related Program Services	456,446,873

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Government-Wide Reporting Fund (8500)

0815	Equipment and Machinery	195,571,686
0840	State Highways	10,811,446,133
0842	Tunnels and Bridges	2,727,329,859
0850	Land	1,454,449,905
0852	Buildings and Building Improvements	128,169,152
0856	Land Improvements	48,477,686

SFMA Account	Description	Audit Amount
0880	Accumulated Depreciation – State Highways	5,898,720,601
0881	Accumulated Depreciation – Tunnels and Bridges	934,876,067
4975	Agency Program Related Services	357,820,227
7476	Depreciation Expense	596,645,325

Based on our audit, we identified one reportable condition and two other conditions needing corrective action. Our findings and recommendations are presented in the enclosed Audit Findings and Recommendations Summary accompanying this letter.

The reportable condition, along with your responses, will be included in our statewide audit report. Including your response with responses from other state agencies satisfies the federal requirement that management prepare a Corrective Action Plan (CAP) covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the response to the reportable finding includes the information specified by the federal requirement, and only if the response is received in time to be included in the audit report. The following information is required for the response:

1. Your agreement or disagreement with the finding. If you do not agree with the audit finding or believe corrective action is not required, include in your response an explanation and specific reasons for your position.

2. The corrective action planned.

3. The anticipated completion date.

4. The name(s) of the contact person(s) responsible for corrective action.

The other conditions are issues of lesser significance that we wanted to communicate to agency management. These conditions do not require a Corrective Action Plan. We will follow up on the department's progress in addressing these issues during the next fiscal year audit.

For the reportable condition, please respond January 31, 2005. Should you have any questions, feel free to contact Raul Valdivia or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Kelly L. Olson, CPA
Audit Manager

cc: Mike Marsh, Deputy Director, Central Services Division
Dennis Strachota, Chief Financial Officer, Financial Services Branch
Drummond Kahn, Internal Audit Services Chief
Laurie Warner, Acting Director, Department of Administrative Services

Audit Findings and Recommendations Summary
Oregon Department of Transportation Audit
State Fiscal Year 2004

REPORTABLE CONDITION

Improve Infrastructure Valuation

The Oregon Department of Transportation (ODOT) needs to document its methodology for valuing highways and bridges, reevaluate which project codes should be capitalized, ensure projects are actually complete, ensure historical cost associated with capitalized projects is appropriately removed, and reevaluate its methodology based on estimated prospective valuation to ensure book value is appropriately reported.

Bridges and Highway Methodology

ODOT has not documented a detailed methodology of the process it used to derive the costs to be removed from the value of highways and bridges. The process to calculate infrastructure costs is complex and difficult to remember and recreate. This situation was evident during our audit when we asked ODOT personnel for a particular piece of data and they determined the original number was incorrect.

We recommend ODOT document a detailed methodology for both bridges and highways and maintain original data and spreadsheets used to derive costs of highways and bridges. The detailed methodology should identify the data fields, the specific computer systems they were obtained from, how they were calculated, and any limitations applied.

Capitalization of Highway Costs

ODOT is not accounting for the highway system in accordance with governmental accounting standards. Under ODOT's current methodology, ODOT only removes the cost of the replaced roadway surface and its associated accumulated depreciation for projects classified under the code for "Reconstruction on Existing Route". However, ODOT capitalizes the costs of all projects whether they are classified as for reconstruction, resurfacing, etc. According to the Governmental Accounting Standards Board (GASB), if a project is considered maintenance—a recurring cost that does not extend the road's original useful life or expand its capacity—the cost of the project should be expensed. If the project increases the serviceability (e.g. increases load capacity) or extends the original useful life of the road, the project should be capitalized. If a project is capitalized, the cost of the replaced roadway surface and its associated accumulated depreciation should be removed.

We recommend ODOT financial Services and Highway Finance Office work together to reevaluate and document which project codes should be capitalized and which should be expensed. In addition, ODOT should account for the highway system in accordance with GASB.

ODOT determines when a project should be capitalized based on whether the project status is "complete." During our review of data, we found that a project is usually broken into the preliminary engineering phase or construction phase as each new phase begins. Given the two phases, it is possible for the engineering phase to be completed and be capitalized even though construction has not begun. According to GASB, projects should be capitalized after the construction phase. Thus, ODOT may be capitalizing projects too soon and may not be capitalizing the entire cost of the project. Once a project has been determined to be "complete" and is a "reconstruction" project as described above, ODOT will remove the historical cost and associated accumulated depreciation of the mileage associated with the project. During this fiscal year, we found that ODOT removed historical costs from some projects that were also removed in the prior fiscal year. As a result, the project was removed twice. We also found instances where, based on the data, the reconstruction project was complete but the historical cost related to the reconstructed mileage had not been removed.

We recommend ODOT review the projects identified as "complete" to ensure construction has actually been completed before the project is capitalized and ensure the associated historical cost for capitalized reconstruction projects is appropriately removed.

Book Value of Highway System

When ODOT began reporting the highway system in fiscal year 2002, they estimated the system only had a remaining useful life of approximately 10 years. ODOT monitors the condition of its pavement by conducting the pavement condition surveys on a biennial basis. The information obtained from the condition surveys provides ODOT with a measure of the current health of the state highway system. Based on the Pavement Condition Report, in 2001 81 percent of all highways were in fair-or-better condition and in 2003 84 percent of all highways were in fair-or-better condition. In fiscal year 2004, the reported cost of the highway system was $10.8 billion and accumulated depreciation was $5.9 billion. Thus, the accounting records report that ODOT's highway system is 55 percent depreciated. Based on ODOT's current methodology and data to date, it is estimated that by 2011 the highway system will be almost fully depreciated and have a book value of approximately $2 billion. According to GASB, if assets are significant and still in use, the asset should not be reported as fully depreciated and periodic reassessment of the estimated useful life may be appropriate. Given the information now available, we recommend that ODOT develop a workgroup to reevaluate the accumulated depreciation value now that actual data is being gathered to ensure the accumulated depreciation amount recorded in the accounting records is reasonable and develop a methodology for reassessing the useful life in future years.

OTHER CONDITIONS

Underpayment of Weight Mile Tax

The Motor Carrier Transportation Division did not verify the total miles declared on a summary attachment submitted with a motor carrier tax report. The summary of total miles was incorrect and was entered into ODOT's Motor Carrier system. The motor carrier also used an incorrect tax rate in the tax calculation. This resulted in a net underpayment of $6,345 of weight mile tax.

We recommend that management collect the $6,345 in underpaid tax from the carrier and ensure summary information is verified prior to entry into the system.

Transfers to Cities and Counties

According to Oregon Revised Statute 366.749, beginning in January 2004, ODOT was required to identify the amount of incremental revenue related to dealers and towing businesses removing registration tags from used cars they sold. The incremental revenue was to be distributed to cities and counties using the percentages outlined in the statute. Although ODOT has received all revenues associated with registration fees, it has not developed a method to identify the revenues attributed to removing the registration tags. Lacking this information, it has not correctly distributed these revenues according to statute.

We recommend that ODOT management develop a methodology to identify the revenues related to removing registration tags so revenues can be distributed in accordance with statute.