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Auditing for a Better Oregon

January 2, 2007

Major General Raymond F. Rees, Adjutant General
Oregon Military Department
1776 Militia Way SE
Salem, Oregon 97309-5047

Dear General Rees:

The statewide single audit that included selected financial accounts at the Oregon Military Department for the year ended June 30, 2006, 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 Military Department will continue on a periodic basis.

The following Oregon Military Department account was audited to determine its fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

SFMA Account	Description	Audit Amount
0852	Buildings and Building Improvements	$137,676,995

Based on our audit, we identified no reportable conditions. However, we identified the following two issues of lesser significance that we wanted to communicate to agency management so that they can be appropriately resolved:

Issue: Accounting for Construction in Progress

The Oregon Accounting Manual and generally accepted accounting principles indicate that Construction in Progress should only include costs that will later be transferred into other capital asset accounts. In addition, all expenditures posted to Construction in Progress accounts should be supported by appropriate documentation that is readily available for examination.

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For the period we audited, the department's accounting staff posted all project costs to Construction in Progress as they were approved by project managers. However, accounting staff did not determine whether all those costs qualified for capitalization until they performed a more detailed review at the end of the project. For one project that terminated during fiscal year 2006, over $26,000 was reclassified back into the Services and Supplies account from Construction in Progress. Because this was a multi-year project, the misclassifications affected four previous fiscal years. The total amount of these errors was not material, representing only 0.39 percent of the total project.

We also noted that documentation was not available to explain the methodology or justification for allocating some Construction in Progress expenditures between multiple capital asset accounts, thus, it was unclear whether these allocations were appropriate. The amounts we questioned were immaterial, but totaled approximately $56,000.

We recommend that department management adopt and implement formal procedures to ensure only appropriate project costs are recorded in the Construction in Progress account. Those procedures should ensure that documentation is retained to fully explain all capitalized amounts.

Issue: Capitalizing building costs and recording partial-year depreciation

Generally accepted accounting principles require organizations to depreciate assets over their estimated useful lives. They further indicate that capitalization should occur when projects are complete or assets are ready for their intended use.

The department's procedure for capitalizing building costs did not fully conform to the above principles regarding when buildings were to be capitalized and when depreciation would be recognized. Department procedure was to capitalize building costs after final payments were made to contractors, and depreciation would not be recognized for partial years of service. The effect of this policy was that the Buildings and Building Improvements account did not always include the cost of all assets in service. For example, the Baker City Readiness Center was substantially completed and occupied by April 2005, but final payment was not made until October 2005. As a result, the fiscal year 2005 Buildings and Building Improvements account did not include the center's cost of approximately $6.7 million, and its related depreciation was not recognized for the first 15 months the asset was actually in service. That depreciation would have totaled approximately $168,000.

We recommend that department management revise its procedures for capitalizing and depreciating buildings to conform with generally accepted accounting principles and adjust accumulated depreciation to correct the error noted above.

Because the above issues are of lesser significance, they do not require a Corrective Action Plan. However, we will follow up on the Oregon Military Department's progress in addressing these issues during the next fiscal year audit. Should you have any questions, please contact Mark Winter or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Neal E. Weatherspoon, CPA, CISA, CISSP
Audit Manager

NEW:bk
enclosure
cc: Colonel Mike Caldwell, Deputy Director State Affairs
Karl Jorgensen, Director, Financial Administration Division
Debbie Stratman, Assistant Comptroller
Bryce Dohrman, Controller
Lindsay Ball, Director, Department of Administrative Services