

Office of the Secretary of State

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Audits Division

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February 8, 2008

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

Dear General Rees:

We have completed the statewide single audit that included a selected financial account at Oregon Military Department (department) for the year ended June 30, 2007.

This audit work was not a comprehensive audit of the department. Instead, the audit work performed allowed us, in part, to achieve the following objectives: (1) express an opinion on whether the financial statements contained in the State of Oregon's Comprehensive Annual Financial Report were fairly presented, in all material respects, in conformity with generally accepted accounting principles; (2) determine whether the state's internal controls provided reasonable assurance of proper accounting, financial reporting, and legal compliance of transactions; and (3) determine whether the state has complied with applicable legal requirements that may have a direct and material effect on the state's financial statements.

In planning and performing our audit of the selected financial account at the department as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the department's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements of the State of Oregon, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

We audited the following account at the department to determine its fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

| <u>SFMA Account</u> | <u>Description</u> | <u>Audit Amount</u> |
|-----------------------------|-------------------------------------|---------------------|
| <u>Government-Wide Fund</u> | | |
| 0852 | Buildings and Building Improvements | \$137,784,838 |

Our consideration of internal control was for the limited purpose described in the preceding paragraphs and would not necessarily identify all deficiencies in internal control. As discussed

below, we identified a deficiency in internal control that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following matter to be a significant deficiency in internal control:

Classification of Building Costs

Generally accepted accounting principles and the *Oregon Accounting Manual* indicate that temporary capitalization of construction costs should be reclassified to a capital asset account when the project is complete.¹

The department's procedures for reclassifying capitalized construction costs did not fully conform to the above principles. The department's usual procedure was to reclassify capitalized construction costs after final payments were made to contractors. As a result, the capital asset account, Buildings and Building Improvements, was not always accurate. For example, during the fiscal year 2007 audit, we found that phase one of the Lane County Armed Forces Reserve Center was completed in January 2006, but department staff did not reclassify the related construction costs until June 2007. Therefore, the fiscal year 2006 Buildings and Building Improvements account was understated by approximately \$4.9 million. We also reported this condition to the department during the fiscal year 2006 audit.² There was no effect to this account during fiscal year 2007.

We recommend department management revise its procedures for reclassifying capitalized construction costs to conform with generally accepted accounting principles and the *Oregon Accounting Manual*.

The significant deficiency, along with your response, will be included in our Statewide Single Audit Report For the Fiscal Year Ended June 30, 2007. Including your response 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 significant deficiency 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 OAM 15.60.10.PR.106

² Oregon Audits Division Management Letter No. 248-2007-01-01

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.

Please respond by February 13, 2008.

This communication is intended solely for the information and use of management and others within the department and is not intended to be and should not be used by anyone other than the specified parties.

Should you have any questions, please contact Michelle Rock or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

V. Dale Bond, CPA, CISA, CFE
Audit Manager

VDB:brk

cc: Brigadier General Mike Caldwell, Deputy Director State Affairs
Karl Jorgenson, Director, Financial Administration Division
Bryce Dohrman, Controller
Kris Kautz, Interim Director, Department of Administrative Services