Office of the Secretary of State

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March 15, 2010

Matthew Garrett, Director
Oregon Department of Transportation
355 Capitol St. NE, Rm. 135
Salem, Oregon 97301-3871

Dear Mr. Garrett:

We have completed audit work of selected financial accounts at Oregon Department of Transportation (department) for the year ended June 30, 2009.

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 accounts at the department as of and for the year ended June 30, 2009, 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 accounts at the department and determined their fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

SFMA Account	Description	Audit Amount
Government-Wide Reporting Fund (8500)		
0815	Equipment and Machinery	$ 239,223,449
0840	State Highways	11,007,060,050
0842	Tunnels and Bridges	2,804,155,717
0850	Land	1,534,740,832
0852	Buildings and Building Improvements	142,954,244
0861	Construction in Progress	2,229,971,806
0869	Accum. Depreciation – Equipment & Machinery	140,028,806
0875	Accum. Depr-Buildings & Bldg Improvement	74,681,015
0880	Accum. Depreciation – State Highways	7,825,200,959
0881	Accum. Depreciation – Tunnels and Bridges	1,082,594,171
1230	Interest Payable – Current	32,695,843
1276	Bonds Payable – Current	58,729,438
1714	Bonds Payable – Noncurrent	2,174,826,576
7476	Depreciation Expense	634,734,216
Special Revenue Fund- Public Transportation Fund (1111)		
0065	Unreconciled Deposit	$ 37,148,354
0070	Cash on Deposit with Treasurer	778,486,780
0240	Investments – Designated	120,662,740
0245	Investment Valuation Acct – Designated	(1,582,022)
1215	Accounts Payable	119,447,442
0122	Motor Fuels Tax	399,413,471
0123	Weight Mile Tax	210,354,008
0126	Vehicle Registration Taxes	185,201,983
0300	Federal Revenue	440,633,302
1401	Transfer Out to Other Fund	1,500,424,084
1405	Transfer to Counties	144,994,585
1503	Revenue Bonds	728,485,000
3111	Regular Employees	219,390,677
3210	Public Employees Retirement Contribution	28,737,525
3212	Pension Bond Assessment	13,562,354
3221	Social Security Taxes	18,291,228
3263	Medical, Dental, Life Insurance	56,427,295
4500	Professional Services Non-IT	149,194,212
4975	Agency Related Program Services	592,673,576

Our consideration of internal control was for the limited purpose described above and would not necessarily identify all deficiencies in internal control. As discussed below, we identified deficiencies in internal control that we consider to be material weaknesses.

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.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiencies constitute material weaknesses.

Infrastructure Reporting

The department has had a material weakness surrounding its infrastructure accounting and reporting processes since fiscal year 2004. Since that time, the department has taken action to correct some issues; however, the following issues remained unresolved during fiscal year 2009:

- The department's methodology for recording infrastructure transactions does not include a step to identify accumulated costs for completed projects that are to be capitalized. As a result, not all project costs were captured and properly recorded in the State Highways and Tunnels and Bridges accounts for fiscal year 2009. At fiscal year end, the department uses an automated tool to compile the infrastructure project costs for current year transactions. The costs are then identified as ongoing or completed. Costs for ongoing projects are added to the Construction in Progress account, and costs for completed projects are added to the State Highways and Tunnel and Bridges accounts as appropriate. Accumulated costs for the completed projects, however, are not identified and included in the department's adjustments to the accounts. As a result, the ending balances of the infrastructure accounts were understated. This condition was exacerbated by coding errors and double counting errors that were not detected by the department's review process, but were identified through auditing procedures.

- The department's method of depreciating the state's highways is resulting in a rapidly depreciating asset. We first reported this issue in fiscal year 2004 when the department's accounting records indicated that state highways were 55 percent depreciated. As of the end of fiscal year 2009, the accounting records indicated that 71 percent of the state highways were depreciated. At the current rate of depreciation, we estimate the highways would be almost fully depreciated by 2016. A number of factors affect the depreciation rate. For example, asset balances and accumulated depreciation need to be adjusted for additions and disposals as appropriate, and asset useful lives need to be reevaluated over time. Over the years, the department has made adjustments to its infrastructure accounts that resulted in incremental improvements; however, it has not dedicated sufficient resources to determine a cause or a resolution for this persistent condition. Inaccurate and incomplete accounting of infrastructure additions and disposals could cause the state's government-wide financial statements in the Comprehensive Annual Financial Report to be materially misstated.

- Communication needs to improve between divisions of the department that play a role in infrastructure financial issues. For example, the Highway Program Office maintains a database of infrastructure projects that the department's accounting unit accesses as part of the process for gathering costs on completed and ongoing infrastructure projects. During fiscal year 2009, employee absenteeism in the Highway Program Office prevented some projects from being updated in the system as completed. As a result, the department's accounting unit did not record all completed project costs, which caused some infrastructure accounts to be understated. Had communications occurred between the divisions, the missing data might have been identified in a timely manner. As it was, the missing information was identified through auditing procedures.

The quality of the state's Comprehensive Annual Financial Report depends on the accuracy and completeness of recorded accounting transactions. Because the department records its infrastructure transactions as year-end adjustments, it is essential that these adjustments be accurate and complete.

We recommend department management reassess its methodology for compiling infrastructure accounting information for year-end reporting and modify its methodology as needed to ensure infrastructure accounts are accurately and completely reported. Furthermore, the department needs to improve the effectiveness of its review process for the infrastructure accounts.

We recommend department management make it a priority to dedicate resources from all divisions involved in infrastructure reporting (e.g., Highway Program Office, Bridge Development Unit, Office of Maintenance and Operations, and Information Systems) to develop a solution for the rapidly depreciating assets.

We recommend department management identify internal divisions that play a role in infrastructure financial issues and establish communication channels with them to improve and enhance its infrastructure accounting and reporting processes.

Prior Audit Finding

In the prior fiscal year, we reported a significant deficiency to you in a letter dated February 5, 2009. This finding can also be found in the Statewide Single Audit Report for the fiscal year ended June 30, 2008; see Secretary of State Audit Report number 2009-07, finding number 08-15. During fiscal year 2009, the department made progress in correcting this finding. This finding will be reported in the Statewide Single Audit Report for the fiscal year ended June 30, 2009, with a status of partial corrective action taken.

The material weaknesses, along with your responses, will be included in our Statewide Single Audit Report For the Fiscal Year Ended June 30, 2009. Including your responses satisfies the federal requirement that management prepare a Corrective Action Plan covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the responses to the material weaknesses include the information specified by the federal requirement, and only if the responses are received in time to be included in the audit report. The following information is required for the responses:

1) Your agreement or disagreement with the findings. If you do not agree with an 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 12, 2010.

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

We appreciate your staff's assistance and cooperation during this audit. Should you have any questions, please contact Nicole Real or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

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

VDB:sms
cc: Clyde Saiki, Deputy Director, Central Services
Les Brodie, Chief Financial Officer
Marlene Hartinger, Chief Auditor
Gail Achterman, Chair, Oregon Transportation Commission
Scott Harra, Director, Department of Administrative Services