**Office of the Secretary of State**

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February 4, 2014

Matthew Garrett, Director
Oregon Department of Transportation
355 Capitol St. NE, MS11
Salem, Oregon 97301-3871

Dear Mr. Garrett:

We have completed audit work of selected financial accounts at your department for the year ended June 30, 2013. This audit work was not a comprehensive financial audit of the department, but was performed as part of our annual audit of the State of Oregon's financial statements. We audited accounts that we determined to be material to the State of Oregon's financial statements.

## Internal Control over Financial Reporting

In planning and performing our audit of the financial statements of the State of Oregon as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, we considered the department's internal control over financial reporting as a basis for designing auditing procedures that are appropriate in the circumstances 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.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, weaknesses and deficiencies may exist that have not been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

## Material Weakness

### Transporting Process for IRP Receipts Should Be Strengthened

The department's Motor Carrier Transportation Division (MCTD) is responsible for registering trucking companies (carriers) domiciled in Oregon. MCTD participates in the International Registration Plan (IRP), which is a reciprocity agreement among states of the United States, the District of Columbia, and provinces of Canada providing for payment of apportionable fees on the basis of total distance operated in all jurisdictions. Oregon carriers pay MCTD registration fees related to the jurisdictions the carriers will be traveling in. MCTD collects and remits the fees to the appropriate jurisdictions.

Of the $57 million IRP receipts collected by MCTD during fiscal year 2013, $33.5 million was received in check form. These receipts arrived at a local post office box, were collected by a manager on her way to work each morning, and delivered to MCTD headquarters for processing. The Oregon Accounting Manual specifies that controls and safeguards must be adequate to provide management with a reasonable degree of assurance that cash and cash related transactions will be properly accounted for and controlled. Because only one person collects and transports a large volume of receipt to MCTD, additional control procedures may be warranted, such as dual custody. Involving two people in a critical cash handling task encourages cash handlers to monitor each other, reduces the opportunity for robbery and theft, and if a loss does occur, cash handlers are protected from unwarranted suspicion.

**We recommend** department management implement controls to ensure IRP receipts are appropriately controlled when transported to MCTD.

## Significant Deficiencies

### Annual Fee Test Processes Could Be Improved

Member jurisdictions of the International Registration Plan (IRP) are required to participate in an annual fee test administered by IRP, Inc., the oversight body for the IRP. The test is to help ensure that registration fees are calculated correctly for all jurisdictions. IRP, Inc. creates test cases for each jurisdiction to run through their system. IRP, Inc. makes the results available for each jurisdiction to review for calculation errors. Each jurisdiction is responsible for contacting other jurisdictions to correct any errors noted.

We requested the department's policy for reviewing the annual fee test and found no formal policy existed. Additionally, we found the department had not maintained documentation showing the annual fee test had been reviewed for 2013. We reviewed the results of the 2013 annual fee test and noted six jurisdictions with calculation errors for Oregon registration fees. Although the department had contacted each of the jurisdictions to inform them of the errors, no further follow up was performed to ensure the errors were corrected. Uncorrected calculation errors may result in the department receiving incorrect registration fees from other jurisdictions.

**We recommend** department management implement policies and procedures to ensure reviews of annual fee tests are documented and error notifications to other jurisdictions are followed up on.

### Documentation of System Changes Should Be Maintained

The department's Transportation Application Development (TAD) division is responsible for implementing system changes for the Financial Services Branch of the department.

During fiscal year 2013, TAD made changes affecting two major departmental systems: the Fixed Asset System (FAS) and the Motor Fuels Tax System (MFTS). The department uses FAS for recording its fixed assets such as equipment and machinery, buildings, and land. The second system, MFTS, calculates taxes due from motor fuel sales. The Oregon Accounting Manual requires that adequate controls over system changes include maintaining appropriate documentation of the change, which should include testing methodologies and pre-implementation approvals. We requested testing and approvals documentation for the changes to the two systems. TAD was unable to provide this documentation because its current process for system changes does not require documentation of testing and approvals be maintained for smaller, less complex projects (those estimated to need fewer than 400 hours to complete). Without evidence that proper testing and approvals occurred, management has less assurance that system changes were made correctly and programming errors were detected, both of which help ensure proper financial reporting.

**We recommend** department management ensure TAD follow state policy and maintain adequate documentation of all system changes.

### Fixed Asset Controls Should Be Strengthened

The department is responsible for tracking and recording over $1.8 billion of fixed assets, including land, equipment, machinery, and buildings. Department management is responsible for establishing and maintaining internal controls to provide reasonable assurance that transactions related to fixed assets are accurately and properly recorded. The department has established controls over the fixed asset accounts, including performing reconciliations and providing managerial reviews of accounting transactions. However, we noted several areas where controls could be strengthened.

We reviewed ODOT's land, equipment and machinery, and buildings account balances for June 30, 2013 and found the following:

- An entry to remove the value of land from the accounting system due to a land sale was not correctly calculated, resulting in an overstatement of $2.8 million.
- Transactions to record proceeds from land sales were not recorded in the proper account, resulting in an overstatement of $487,400.
- The annual reconciliation between ODOT's Fixed Asset System and the accounting system was not completed and reviewed timely, resulting in several undetected errors at the close of the fiscal year.

**We recommend** department management strengthen its reconciliation process and review of fixed asset transactions to ensure appropriate and accurate financial reporting.

### Managerial Reviews of Cost Allocations Should Be Improved

The department frequently purchases goods and services that may be used for multiple programs or projects. For example, the department may purchase a truck that will be used for multiple construction projects over the life of the asset. As part of the cost accounting for the department's operations, staff make entries to the accounting system to allocate the overall cost of that truck to the various projects for which it is used. Department policy requires that these allocations to various cost centers be reviewed by an appropriate level of management.

During our testing, we identified four of 41 sample items in which there was not evidence of management review and approval of the allocations. While the department's procedures and internal controls provide assurance that the initial cost to acquire the assets was appropriate, without evidence of managerial review of allocations of costs, management has less assurance that the final disposition of those costs is appropriate. In addition, many of the department's construction projects are partially funded with federal funds. Failure to perform reviews of allocations increases the potential for incorrect costs being charged to the federal grants, which may lead to noncompliance with federal program requirements and limitations.

**We recommend** department management ensure that proper review and approval of cost allocations occurs.

**Federal Revenue Accruals Should Be Complete**

During fiscal year 2013, the department implemented an indirect cost plan. The plan allows the department to draw federal funds for indirect costs relating to construction projects under the Highway Planning and Construction program. Under this agreement, the department is allowed to draw an additional 9.5% of the reimbursable costs to pay for indirect costs.

In preparing the year end accruals, the department did not record an accrual for the additional federal revenues relating to the indirect cost plan. As a result, the federal revenues and accounts receivable were both understated by approximately $1.4 million. Accounting standards require that the department recognize the federal revenue in the accounting period in which it is eligible to be drawn from the federal government.

**We recommend** department management revise the existing policies and procedures for year end accruals for federal revenues to include an accrual for the eligible indirect cost reimbursements.

The above significant deficiencies and material weakness, along with your response for each finding, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2013. Please prepare a response to each finding and include the following information as part of your corrective action plan:

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 21, 2014.

The purpose of this letter is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the department's internal control. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control. Accordingly, this letter is not suitable for any other purpose.

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

Sincerely,
OREGON AUDITS DIVISION

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

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