Office of the Secretary of State

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January 21, 2015

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

Dear Mr. Garrett:

We have completed audit work of selected financial accounts at your department for the year ended June 30, 2014. 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, 2014, 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, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control that we consider to be a significant deficiency.

Significant Deficiency

Strengthen Cash Handling Procedures for Fuels Taxes

In fiscal year 2014, the department collected over $493 million in revenue from fuels taxes. These taxes are applied to the purchase of gasoline, aircraft fuels, ethanol blends, and other use fuels, and are generally collected and remitted to the department by retailers and distributors. While the department collects the majority of this revenue through wire transfers and electronic payments, during state fiscal year 2014, approximately $7.2 million was collected in the form of checks.

During our audit, we reviewed the department's procedures for processing fuels tax receipts. We noted some procedures that were contrary to the Oregon Accounting Manual's guidance for handling cash receipts. For example, the Oregon Accounting Manual recommends that two individuals open the mail, and responsibilities for preparing deposits and recording receipts be separated to help ensure that no one individual has control of cash transactions from beginning to end. We found that generally only one employee opened the mail, prepared the deposit, and recorded the transactions. By not separating these responsibilities, the department increases the risk that funds may be recorded incorrectly or go missing.

We recommend department management review and revise the existing cash handling procedures for fuels taxes to ensure receipts continue to be correctly recorded and to strengthen safeguards over the receipts.

Other Issues

During the course of our audit, we became aware of the matters below that are considered opportunities for strengthening internal controls. These matters do not require a written response from management.

Motor Fuels Documentation

As discussed above, motor fuels taxes are a significant source of revenue for the department. During our audit, we reviewed the procedures and documentation the department uses to ensure that motor fuels taxes are properly accounted for and recorded. When performing our testing, we noted two instances in which the documentation supporting the internal controls was not maintained. Specifically, a daily reconciliation of deposits to the accounting system was not retained, and evidence of communications between the motor fuels tax auditors and a fuels tax vendor was not available.

We recommend department management ensure that adequate supporting documentation is maintained to verify the internal controls are functioning as designed and as intended.

Train Set Depreciation

For the past five state fiscal years, the department made payments totaling approximately $41 million to purchase two train sets to operate commercial passenger lines in Oregon. Although Oregon retains ownership of the trains, Amtrak operates the trains and uses them to augment existing train schedules. The train sets, acquired in June 2013, were placed into service in November and December 2013.

Accounting standards require depreciation of capital assets, which is the systematic and rational allocation of the cost of a capital asset over its estimated useful life, to begin once the asset is placed into operation. Although the department placed the train sets into operation during fiscal year 2014, staff did not calculate and record depreciation for the train sets for that period. As a result, approximately $2.4 million of depreciation expense was not recorded in the financial statements. Department staff indicated the purchase of train sets is an infrequent occurrence and the event of placing the train sets into operation was not fully communicated to accounting staff.

We recommend department management ensure that infrequently purchased capital assets are depreciated over their useful lives and the depreciation amounts are properly recorded in the accounting system.

Ensure Managerial Review and Approval Occurs for all Cost Allocations

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, employees make entries to the accounting system to allocate the overall cost of the truck to the various projects for which it is used. Department policy requires that these allocations to various cost centers be reviewed and approved by an appropriate level of management.

During our testing, we identified 2 of 63 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 an asset 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 funded with federal funds. Managerial reviews of federal allocations are important to help ensure correct costs are being charged to federal grants.

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

The above significant deficiency, along with your response for the finding, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2014. Please prepare a response to the 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 6, 2015.

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

VDB:gmh

cc: Clyde Saiki, Deputy Director
Tracy Wroblewski, Chief Financial Officer
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Gregg Dal Ponte, Motor Carrier Division Administrator
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