
Secretary of State

State of Oregon
OREGON STATE LIBRARY
Special Review



Audits Division

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Auditing for a Better Oregon

The Honorable John Kitzhaber
Governor of Oregon
State Capitol
Salem, Oregon 97310

Jim Scheppke, State Librarian
Oregon State Library
State Library Building
Salem, Oregon 97310

This report encompasses a review of selected activities at the Oregon State Library (library) for the period July 1, 1995, through December 31, 1996. The objectives of the audit were to determine whether controls were in place to safeguard assets and whether selected transactions complied with pertinent laws, rules, and regulations.

The results of our review found that certain internal controls need improvement. Documentation supporting assessment amounts and federal reports needs improvement. A working capital fund should be established for programs funded by the library's assessment process. The library also needs to improve fixed asset inventory procedures. We reviewed the status of prior audit recommendations and found that some were not implemented.

We conducted the audit in accordance with generally accepted government auditing standards. In this regard, we inquired of agency personnel, reviewed policies and procedures, tested relevant reports, and evaluated management controls as required to accomplish the objectives of our audit.

Our audit was limited to the specific matters described above, and was based on tests and procedures we considered necessary in the circumstances.

OREGON AUDITS DIVISION

John N. Lattimer
Director

Fieldwork Completion Date:
June 14, 1997

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SUMMARY

The Oregon State Library (library), authorized under *Oregon Revised Statutes* Chapter 357, has a seven-member board of trustees appointed by the Governor. The board of trustees is responsible for appointing the State Librarian, the agency's chief administrative officer. The mission of the library is to provide quality information services to Oregon state government, provide reading materials to blind and print-disabled Oregonians, and provide leadership, grants and other assistance to improve local library service for all Oregonians.

During the 1993-95 biennium, the legislature shifted the library's principal funding source from the General Fund to Other Funds. Other Fund revenue is derived from assessments to state agencies, donations, and miscellaneous receipts. The library also receives federal funds from the Library Services and Construction Act. These funds assist local libraries in capital development, improvement of services, and resource sharing projects.

We reviewed the internal controls at the library and tested transactions for the period July 1, 1995, to December 31, 1996. The transactions were tested to evaluate the effectiveness of internal controls and compliance with laws and regulations. We tested receipts and revenues, payroll, travel and other expenditures, fixed asset records, and federal expenditure reporting. We also followed up on previous audit findings.

The results of our review found that internal controls for processing cash receipts and authorizing certain expenditures could be improved. Documentation needs to be improved for determining assessment amounts and reporting federal expenditures. The programs that are funded by the assessment to state agencies need to establish a working capital fund. The library also needs to comply with fixed asset inventory procedures required by the *Oregon Accounting Manual*. We also found that some of the recommendations from the previous audit had not been completely or properly implemented.

The library's response, which is included in this report, concurred with the findings and described improvements being implemented.

INTRODUCTION

ORGANIZATION AND FUNCTIONS

The Oregon State Library (library), authorized under *Oregon Revised Statutes* Chapter 357, has a seven-member board of trustees appointed by the Governor. The board of trustees is responsible for appointing the State Librarian, the agency's chief administrative officer. The current State Librarian is Jim Scheppke.

The mission of the library is to provide quality information services to Oregon state government, provide reading materials to blind and print-disabled Oregonians, and provide leadership, grants and other assistance to improve local library service for all Oregonians.

The library is organized into five program units. They are Administration, Library Development Services, Talking Book and Braille Services, Information Services, and Support Services.

The Administration program unit sets policies and manages the personnel and finance functions.

The Library Development Services program unit administers state and federal grants to local public libraries.

The Talking Book and Braille Services program unit supplies reading materials to Oregonians who are blind or have other disabilities that prevent them from reading conventional printed materials.

The Information Services program unit provides state government with information from various published resources. It also provides the public with access to state government publications, Oregon history and genealogy publications and research, census information, and grant information.

The Support Services program unit is responsible for acquiring, cataloging, inventorying and preparing for circulation all library materials, including books, periodicals, and state and federal government publications.

It also provides user support and maintenance for WORKsmart, the library on-line information system for state government.

FINANCIAL ACTIVITIES

During the 1993-95 biennium, the legislature shifted the library's principal funding source from the General Fund to Other Funds. Other Fund revenue is derived from assessments to state agencies, donations, and miscellaneous receipts. The library receives federal funds from the Library Services and Construction Act. These funds assist local libraries in capital development, improvement of services, and resource-sharing projects.

The library generated revenue from the following sources for the period July 1, 1995, to December 31, 1996. The table below compares recorded revenues to estimated revenues for the biennium.

Revenue Category	Recorded Revenues as of December 31, 1996	Estimated Revenues for 1995-97 Biennium	Percent of Biennial Estimate Collected
Other Sales	\$ 98,162	\$ 17,735	553%
Interest	12,435	11,144	112%
Donations	58,073	50,426	115%
Assessments	2,822,191	4,004,666	70%
Federal Funds	1,765,086	3,418,311	52%
Total	\$ 4,755,947	\$ 7,502,282	63%

The 1995-97 biennium expenditure budget approved by the legislature for the library is:

Fund Type	Budgeted Expenditures
General Fund	\$ 2,166,426
Other Funds	4,088,098
Federal Funds	3,418,311
Total	\$ 9,672,835

Listed below are the expenditures for the period, July 1, 1995, to December 31, 1996, summarized from the library's accounting records, compared to the amounts budgeted for the biennium.

Expenditures by Program Unit	Recorded Expenditures as of December 31, 1996	Budgeted Expenditures for 1995-97 Biennium	Percent of Biennial Budget Expended
Administration	\$ 545,624	\$ 772,479	71%
Library Development	2,811,437	4,374,620	64%
Talking Book & Braille	725,212	1,001,287	72%
Support Services	1,181,953	1,775,702	67%
Information Services	1,344,198	1,748,747	77%
Total	\$ 6,608,424	\$9,672,835	68%

Note: 75% of the biennium was completed as of December 31, 1996.

SCOPE AND METHODOLOGY

We reviewed the internal controls at the Oregon State Library (library) and tested transactions for the period July 1, 1995, to December 31, 1996. The transactions were tested to evaluate the effectiveness of internal controls and compliance with laws and regulations. We tested receipts and revenues, payroll, travel and other expenditures, fixed asset records, and federal expenditure reporting. We also followed up on previous audit findings.

In our receipts and revenues testing, we reviewed procedures for depositing receipts and tested the methodology used in developing the assessment plan and the collection of assessment amounts.

For payroll, we tested whether the actual funding of positions agreed to those budgeted and whether proper payroll rates were being used. We also tested final payments to separated employees to determine whether payments were properly authorized and calculated. We reviewed the procedures for recording compensatory time and tested other leave accrual records to determine if the records were accurately maintained. We also reviewed payroll exception reports to determine if items were properly authorized and appropriately cleared.

For travel and other expenditures, we selected a sample of transactions to trace to supporting documentation. We verified that the amount paid was accurate, that it was properly classified and recorded, and that it complied with applicable agreements and regulations.

For fixed assets, we reviewed the inventory procedures and tested the subsidiary records to determine their accuracy.

For federal funds, we reviewed the allocation of grant awards to determine if they were properly authorized and fairly allocated. We tested expenditures to verify they were for allowable services. We also verified that matching and level of effort requirements were met and that expenditures were properly reported in the annual report.

We followed up on our audit report for the period April 1, 1991 to February 28, 1994, to determine whether the recommendations were properly implemented.

We conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Our audit was limited to the areas specified in this section of the report.

AUDIT RESULTS

REPORT ON INTERNAL CONTROL

The management of the Oregon State Library (library) is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control. The objectives of internal control are to provide management with reasonable assurance regarding the reliability of financial reporting, the effectiveness and efficiency of operations, and compliance with laws and regulations. Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit, we obtained an understanding of internal control. With respect to internal control, we obtained an understanding of the design of relevant controls and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures and not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions under the standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control system that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data.

A material weakness is a reportable condition in which the design or operation of one or more of the specific control activities does not reduce to a relatively low level the risk that errors or irregularities may occur and not be detected

within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. Reportable conditions are reported in the Findings and Recommendations section of the report.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Compliance with laws and regulations applicable to the library is the responsibility of management. As part of our audit, we performed tests of the library's compliance with certain provisions of laws and regulations relating to selected transactions. However, the objective of our audit was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed one instance of noncompliance that is required to be reported herein under *Government Auditing Standards*. The instance of noncompliance is reported in the Findings and Recommendations section of the report.

FINDINGS AND RECOMMENDATIONS

INTERNAL CONTROL OVER CASH RECEIPTS

The current system of internal control over cash receipts does not establish control over negotiable items as they are received. It also does not provide for timely deposit of cash receipts or adequate separation of duties for depositing and recording receipts.

Cash receipts received in the mail are not controlled by the mailroom. Mail is distributed to the program units unopened if it can be determined which unit is to receive it. Each unit opens its own mail and takes any cash receipts to the Business Office, without establishing any formal control over the funds collected.

There are no formal procedures specifying when program units must take receipts to the Business Office or when deposits are to be taken to the bank. Tests of a program unit's informal records indicated that it took up to 15 days from the date of receipt to the date of deposit. Tests of formal cash receipts records in the Business Office indicate that it takes up to 13 days from the date cash receipts are formally controlled to the time they are deposited.

In the Business Office, one person is responsible for establishing control over the receipts, preparing the deposit, recording the transaction, depositing the funds, and verifying the transaction was properly recorded. After the receipts are brought to the Business Office, the accountant prepares a detail receipt form for each item to establish formal control over it. Then she prepares the deposit slip, lists the items on a spreadsheet to classify them and allocates the revenue to the correct program unit, and then records the items in the accounting system. The detail receipt forms are not sent to the remitters of the checks; they are for internal use only.

The process of preparing receipt forms at this point is a redundant procedure, because the same person also records the transaction in the accounting records. The control procedure is supposed to ensure that all receipts

are recorded, but when the same person performs those tasks it is a duplicative work effort.

The lack of adequate internal controls over cash exposes the library to risks that receipts may be lost or misused. Also, the lack of timely deposit causes the state and the library to lose interest income.

The *Oregon Accounting Manual* recommends certain control procedures for cash receipts. These include centralizing the receiving of cash as much as possible and establishing formal control over receipts immediately. Other recommended control procedures include that no one person should handle a cash transaction from beginning to end and deposits should be made intact on a daily basis or at least weekly.

We recommend that the procedures over processing cash receipts be formally documented. A listing of cash receipts should be made when the mail is opened and a copy of the listing should accompany the receipts to the Business Office. Procedures should require that receipts be taken to the Business Office each day after the final mail delivery. Bank deposits should be made by the next business day, whenever possible. The person who prepares deposits and records transactions should not also be responsible for verifying that transactions are properly recorded in the accounting records. In addition, we recommend that the preparation of receipt forms for internal use be eliminated.

AUTHORIZATION OF EXPENDITURES

Certain recurring transactions processed through the purchasing system can be entered into the accounting system and processed without being approved by anyone. Normally, transaction documentation is approved by program managers prior to entering the transaction into the accounting system. After the transaction is entered into the accounting system, the Business Manager releases the transaction for processing on-line.

When the library started using the state's new purchasing system, the Business Manager did not establish approval

paths for transactions within the purchasing system. As a result, these transactions are processed without supervisory review or authorization.

We recommend that library staff establish levels of approval within the purchasing system for transactions so that one employee cannot perform an entire transaction.

DOCUMENTATION FOR STATE AGENCY ASSESSMENT

The library assessment to other state agencies is based two-thirds on the number of full-time-equivalent employees that each agency has and one-third on usage of library services. The library uses five component units to allocate the usage portion of the assessment. The components are reference questions, circulation transactions, inter-library loan transactions, number of registered WORKsmart users and the number of Oregon document titles shipped. The library operations staff keeps a record of agency usage of each of these library services. The amount of time it takes to process a transaction is estimated and total use in minutes is calculated for each agency. The budgeted amount for the assessment is then allocated to each agency based on the percentage of estimated minute usage to the total number of minutes calculated.

Library management did not produce documentation supporting the five service components used in the assessment process or the number of minutes being used to calculate the time to provide each service. Without this documentation, it is difficult to determine if the assessment methodology results in a fair assessment. Library staff has not made documenting the assessment methodology a priority.

Furthermore, the Business Manager did not retain a copy of all supporting documentation used to prepare the usage assessed to each agency. The absence of such documentation makes it impossible to determine if agencies were assessed the correct amount.

The Business Manager made errors in computing agency assessments. In testing ten agencies' 1997-99 usage assessment, we noted seven agencies that were overcharged between \$156 and \$6,757. We also noted three agencies that were undercharged between \$110 and \$518 because incorrect numbers were used from the subsidiary records. The errors were not detected because there is not an independent review or crosscheck of the amounts calculated.

We recommend that the library document the methodology used to develop the usage component of the assessment and retain copies of all supporting documentation used in calculating agency assessments. We also recommend that a second employee perform an independent review of assessment calculations to assure their accuracy.

**ASSESSMENT FUNDED
PROGRAMS NEED
WORKING CAPITAL**

The State Library programs funded by the assessment to other state agencies do not receive enough revenue in the first six months of the biennium to pay operating costs. This also is a problem at other points in the biennium because the Department of Administrative Services does not transfer assessment amounts collected to the library on a routine basis. The State Library programs that are funded by the assessment incur about \$150,000 in expenditures per month.

In the 1995-97 biennium, the Department of Administrative Services transferred the first assessments collected in November 1995; the next transfers occurred in March 1996 and October 1996. These periodic transfers do not provide the State Library a regular cash flow to pay expenditures.

The library needs to have a positive cash balance in its Other Funds Account in order to process expenditure transactions on the new Statewide Financial Management System (SFMS). Other sources of funds are used to pay operating expenses until the Department of Administrative Services collects the assessment amounts from other agencies and transfers the funds to the library. During the

period when expenditures are temporarily transferred to the General Fund Appropriation, the library's budget status reports do not accurately show what budget balances exist. At December 31, 1996, with 25 percent of the biennium left, the Library had only 20 percent of its appropriation balance available for expenditure because it was temporarily subsidizing programs that were not supposed to be funded by the appropriation.

We recommend that the library staff work with its budget analysts to establish a working capital fund that can be used until the Department of Administrative Services can send out invoices for the assessments and collect the cash necessary to operate programs funded by the assessment. The library staff should work with the Department of Administrative Services to ensure that assessment invoices are issued in a timely manner and collections are transferred to the library on a routine basis. Another option would be to arrange for the Department of Administrative Services to advance a portion of the assessment until sufficient funds are collected.

RECONCILIATION OF FEDERAL REPORTS TO THE ACCOUNTING RECORDS

In previous audits, we found that expenditures presented in federal reports did not reconcile with amounts in the accounting records. During this audit we tested 10 federal projects reporting expenditures of \$495,157 for the 1996 federal fiscal year, which ended September 30, 1996. Total federal expenditures reported for this period were \$1,338,803. None of the reports tested agreed to the accounting records at September 30, 1996. We were able to identify amounts paid after September 30 on four projects and reconcile the amounts reported to the accounting records. On the other six projects, amounts reported for federal expenditures exceeded the amounts recorded on the accounting records by \$115,384. We were able to trace \$379,773 or 77 percent of the amounts reported to the accounting records.

The library staff uses informal records, which are not reconciled to the accounting records, and other information received through telephone calls to grantees to prepare

reports on the expenditure of federal funds. These manual records document when a grant is approved, when quarterly reports are received, when payments are approved, and amounts approved.

The formal accounting records were not used to prepare federal reports because it was easier for the program unit staff members who prepared the reports to use their own informal records and other information obtained from grantees.

We question the allowability of \$115,384 of expenditures for Title I of the Library Services and Construction Act, reported on the federal reports for the 1996 federal fiscal year, because we could not verify that they were appropriate transactions. In order to provide an accurate accounting of federal grant expenditures, the federal reports must be prepared from and supported by the accounting records. Further, adjustments to the reports must be adequately documented and explained.

We recommend that library staff prepare and retain a reconciliation of amounts on the library's accounting records to those presented on the federal reports. The Business Manager should retain a copy of all documentation supporting the amounts listed in the federal report.

FIXED ASSET INVENTORY

The library's fixed assets consist of an estimated value for the books and other published material and a subsidiary listing of equipment items. The general ledger shows the total value of fixed assets is \$6,928,967. The library had not conducted a physical inventory since 1988. The absence of a physical inventory has led to an inaccurate subsidiary ledger and general ledger. The subsidiary ledger contained many items under the \$5,000 threshold established for recording fixed assets, included items that had been disposed of, and did not include an item that had been purchased during the 1995-97 biennium.

We estimate that the fixed asset inventory on the general ledger is understated by about \$2 million because periodic physical inventories have not been performed and the

perpetual inventory records maintained. The *Oregon Accounting Manual* requires a physical inventory of the agency's property be taken at least biennially.

We recommend that library staff comply with the fixed asset inventory procedures required by the *Oregon Accounting Manual*. A physical inventory should be conducted, subsidiary records should be updated, and the general ledger should be corrected.

FOLLOW-UP ON PRIOR AUDIT RECOMMENDATIONS

This section reports follow-up action taken by the Oregon State Library (library) management on the recommendations presented in the Audit Comments section of our audit released January 1995.

Prior Audit Recommendations	Disposition
Develop a checklist of administrative requirements for personal services contracts.	A checklist was developed, but it is incomplete and does not include all of the administrative requirements.
Prepare and retain a reconciliation of amounts presented on the federal reports to the library's accounting records.	See current audit comment on "Reconciliation of Federal Reports to the Accounting Records."
Allocate expenditures based on a cost-allocation plan prepared in accordance with Circular A-87.	The library has developed a method for allocating costs; however, the basis used for allocating costs has not been documented.
Document subrecipient cash draws and expenditures to ensure that excessive cash is not being drawn.	Resolved. The library has modified the request for payment form to include information on cash balances.

REPORT DISTRIBUTION

This report is a public record and is intended for the information of the Oregon State Library's management, the governor of the state of Oregon, the Oregon Legislative Assembly, and all other interested parties.

COMMENDATION

The courtesies and cooperation extended by the officials and employees of the Oregon State Library, during the course of our audit were very commendable and sincerely appreciated.

AUDIT TEAM

Dale Schneider, CPA
Jennifer Stinson

AGENCY'S RESPONSE TO THE AUDIT REPORT

October 14, 1997

John N. Lattimer, Director
Division of Audits
Office of the Secretary of State
255 Capitol St. NE, Suite 500
Salem, Oregon 97310

Dear Mr. Lattimer:

I have reviewed the draft audit report on the State Library for the period July 1, 1995, through December 31, 1996. My comments, including our planned actions to implement the recommendations follow. We plan to take all actions indicated below before the end of the year, with the exception that some aspects of the recommendation concerning working capital will need to be dealt with in early 1998, as we develop our proposed assessment for the 1999-2001 biennium.

Internal control over cash receipts:

We concur with the findings. We have changed the Talking Book and Braille Services cash receipts process to comply with the recommendation. We will review other program areas, and we plan to adopt an agency-wide policy and procedure consistent with the recommendation.

Authorization of expenditures:

We concur with the findings. The ADPICS approval path has been changed. The recurring payments are authorized by managers to be recurring unless authorization is withdrawn. We are reviewing signature authorization procedures.

Documentation for state agency assessments:

We concur with the findings. The internal systems for tracking agencies' usage of the library are being reviewed for accuracy and effectiveness to ensure that a fair assessment is levied each agency. The methodology of the service components tracked will be reviewed and documented. Our accountant will review the assessment calculations for accuracy.

Assessment funded programs need working capital:

We concur with the findings. The DAS Internal Support Division (ISD) concurs that assessment moneys collected were not routinely transferred to the State Library. We are working with the DAS, Budget and Management Division, and ISD to implement the recommended changes. ISD will continue to bill the State Library assessment to state agencies and record payments made. Assessment amounts collected will be transferred to the State Library account on a monthly basis. To provide working capital at the beginning of the biennium, ISD advanced the State Library \$150,000 in July, 1997. Routine payments will be made once assessments have been collected to cover the advance amount.

John A. Kitzhaber
Governor



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Reconciliation of federal reports to the accounting records:

We concur with the findings. We have identified the components of the questioned costs and are correcting the accounting records and/or we are amending the annual report to accurately account for the expenditures. We are reviewing our reporting procedures and are working with subrecipients to improve accuracy of the data source reports. We have modified our accounting structure to ensure that the administrative and program expenditures by the State Library are recorded by the intended federal fiscal year indicator.

Fixed asset inventory:

We concur with the findings. We have completed an inventory of our fixed assets, and are correcting the accounting records. We have reviewed our criteria/procedures for valuing the Library materials collection to provide timely postings to the general ledger.

Follow-up on prior audit recommendations:

- Checklist of administrative requirements for personal services contracts: Our checklist was reviewed and approved by Audits Division staff in 1994. The cover pages required by DAS address the additional requirements. We are reviewing the checklists for completeness.

We appreciate the work of the Audits Division, and we look forward to using these recommendations to improve the operations of the State Library.

Sincerely,



Jim Scheppke
State Librarian

- c: Jim McAdler, Statewide Accounting Manager, DAS
Coyne Smith, Internal Support Division Administrator, DAS
Dave Fajer, Budget Analyst, DAS