

Report No. 2007-30

December 19, 2007



State of Oregon

Applying Agreed-Upon Procedures:
**Department of Human Services
Safe Drinking Water Revolving
Loan Fund**

Charles A. Hibner, Director, Audits Division

Bill Bradbury, Secretary of State

Secretary of State Report

Office of the Secretary of State
Bill Bradbury
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**INDEPENDENT ACCOUNTANT'S REPORT
ON APPLYING AGREED-UPON PROCEDURES**

To the Director and Management of the Department of Human Services:

As required by the U.S. Environmental Protection Agency (EPA), the State of Oregon submits financial statements for the Safe Drinking Water Revolving Loan Fund, which includes amounts for the Oregon Economic and Community Development Department (OECDD), Department of Human Services (department) and the Department of Environmental Quality (DEQ). The department was responsible for its financial statements and for preparing DEQ's financial statements. The OECDD prepares their own financial statements and provides them to the department for inclusion in the financial statements.

We performed the procedures, as described below, which were agreed to by department management. The procedures were solely to provide the department assurance that the department's set-aside funds, reported as part of the Safe Drinking Water Revolving Loan Fund financial statements for the year ended June 30, 2006, were reported in accordance with generally accepted accounting principles as submitted to the U.S. Environmental Protection Agency. Department management is responsible for preparing the financial statements and any required supplementary information, maintaining adequate accounting records, and selecting and applying appropriate accounting standards. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and generally accepted government auditing standards. The sufficiency of these procedures is solely the responsibility of the parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below.

The procedures performed and associated findings are discussed below. A more detailed description of the findings and other matters identified during the review are included in Attachment A.

1. We determined whether the balance sheet and operating statement were mathematically accurate and prepared in a format required by Generally Accepted Accounting Principles (GAAP). We found no exceptions as a result of this procedure.
2. We determined whether the statement of cash flows was mathematically accurate and prepared in the format required by GAAP. We found that the statement was mathematically correct, however, it was not in the format required by GAAP.
3. We agreed account balances on the balance sheet and operating statement to the department's accounting system to verify that reported amounts were adequately supported in accordance with GAAP. We found that several accounts did not agree to the accounting system and were not adequately supported in accordance with GAAP. We identified

additional misstatements in grant income and operating expenses, which also impacted accounts receivable and accounts payable. We also identified transactions that should have been recorded as prior period adjustments.

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the financial statements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. This report is intended solely for the information and use of the department and is not intended to be and should not be used by anyone other than the specified parties.

OREGON AUDITS DIVISION

A handwritten signature in black ink, appearing to read "Bill Bradbury". The signature is written in a cursive, flowing style with a long, sweeping tail on the final letter.

Bill Bradbury
Secretary of State

September 21, 2007

Attachment A
Agreed-Upon Procedures
Department of Human Services
Safe Drinking Water Revolving Loan Fund

Balance Sheet and Operating Statement Accounts
Not in Accordance with GAAP

We reviewed the Department of Human Services' (department) set-aside funds balance sheet and operating statement, excluding note disclosures, for mathematical accuracy and to ensure their preparation was in accordance with generally accepted accounting principles (GAAP). Although the balance sheet and operating statement were mathematically accurate and in acceptable formats, the accounts included on these statements did not always agree to the accounting system, and were not always in accordance with GAAP. As described below, we identified misstatements that were a result of account balances not agreeing to the state's accounting system. We also identified other revenue and expense misstatements.

Misstatements Resulting From Account Balances Not Agreeing to Accounting System

State policy requires that account balances reported in agency financial statements be derived from and agree to balances in the state's accounting system. The department prepared the department's balance sheet using accounting system trial balance control reports by grant phase. For the operating statement, the department ran a query of the state's accounting system datamart to obtain the detail of the revenue and expenses. However, the department did not include the revenue and expenditure accrual control accounts in the query and did not agree it to the control reports that were being used. As a result, the balances reported to the U.S. Environmental Protection Agency for the department's set aside funds did not always agree to the state's accounting system. In comparing the balances on the financial statements to the accounting records, we found the following:

- Cash was understated by \$257,638 as the department did not include all transactions related to one grant phase, which also caused the net asset balance to be overstated by the same amount;
- Grant income was overstated by \$166,145 as the department did not include the accounting system's financial statement accrual revenue control account;
- Operating expense accounts were overstated by a total of \$145,350 as the department did not include the accounting system's financial statement accrual expense control account;
- An operating expense account was overstated by a total of \$368,916 as the department reclassified a transfer out as an expense, which also caused the transfers out to be understated by the same amount;
- Beginning net assets was overstated by \$599,979 as the balance should have been zero per the state's accounting system; and
- The "Closing Adjustment" line item reported on the financial statements is not an account in the accounting system, but was created by the department to balance the financial statements.

Other Expense and Revenue Misstatements

Based on our review of the department's set-aside funds operating expenses, we identified a total understatement of expenses of \$226,887. The misstatement is a result of the following:

- At year end, the department accrued expenses of \$144,410. These accruals are part of entries the department makes for year-end accruals for all federal programs. We performed a high level review of expenses incurred 90 days after year-end and compared those expenses to the accrual to determine if it was reasonable. We found that the expense accrual was overstated by \$117,982, which also caused an overstatement of accounts payable. As the prior fiscal year expense accrual affects the current year, we reviewed it and determined it was overstated by \$172,727, which resulted in a corresponding understatement to the current year expenses. The net effect of these accruals is an understatement in expenses of \$54,746 at June 30, 2006.
- In testing a sample of operating expenses, we identified two transactions that were corrections of prior fiscal year grant expenses. These transactions, which should have been recorded as prior period adjustments, resulted in an understatement of \$172,142 in current year expenses.

As a result of the department's revenue accrual methodology, the year-end set-aside funds revenue accrual is also impacted by misstatements in the current and prior fiscal year expense accruals and by incorrectly recording transactions in the wrong period. The net effect of these misstatements resulted in a \$226,887 understatement of revenue at June 30, 2006:

- The current year expense accrual misstatement of \$117,982 overstated revenue and overstated accounts receivable by the same amount.
- The prior year expense accrual misstatement of \$172,727 and the transactions incorrectly reducing expenses because they were recorded in the wrong period of \$172,142 understated current year revenue by \$344,869.

We recommend department management comply with generally accepted accounting principles and ensure that balances reported on the financial statements are adequately supported and agree to the state's accounting system; any differences should be readily explained. Also, department management should review the department's year-end accrual methodology and ensure it is reasonable for federal programs of all sizes and ensure transactions impacting prior fiscal years are recorded as prior period adjustments.

AGENCY'S RESPONSE:

The department agrees with this recommendation while noting we do comply with GAAP and reconcile statements. The department reconciles the drinking water loan fund and set-asides reporting statements to the state's accounting system with any differences explained in notes to the statements. The Department utilized system control reports for this purpose while the auditors used queries of the statewide financial management system. The department will continue to refine the year end accrual methodology and make appropriate adjustments to the methodology, so that accruals reflect better the year-end loan fund and set-aside financial position.

Cash Flow Statement Format Not in Accordance with GAAP

We reviewed the department's set-aside funds statement of cash flows to ensure it was mathematically accurate and consistent with the format required by GAAP. We did not verify the accuracy of line item amounts. Although the format used was mathematically accurate, the department did not prepare the cash flow statement using the format required by GAAP. The Government Accounting Standards Board (GASB) requires the cash flow statement be prepared using the direct method and include a reconciliation of operating cash flows and operating income. The direct method requires, at a minimum, delineation of the following sources and uses: receipts from customers, receipts from inter-fund services provided, receipts from other operating activities, payments to employees for services, payments to suppliers of goods and services, payments for interfund services used, and payment of other operating activities.

We recommend the department prepare the set-aside funds cash flow statement in accordance with GAAP.

AGENCY'S RESPONSE:

The department will implement the recommendation by using a standard cash flow statement format that is in accordance with GAAP.

Other Matters

Department of Environmental Quality Safe Drinking Water Revolving Loan Fund Statements

The Safe Drinking Water Revolving Loan Fund financial statements include amounts for the department, the Department of Environmental Quality (DEQ), and the Oregon Economic Community Development Department. The department was responsible for its financial statement amounts and for preparing DEQ's financial statements. During our review, we noted discrepancies between DEQ's financial statement amounts and amounts recorded in the state's accounting system. As we were not asked to review the DEQ portion of the financial statements, we conducted no further review of these discrepancies.

We recommend department management ensure the amounts reported in the financial statements for DEQ agree to the state's accounting system.

AGENCY'S RESPONSE:

The department is not responsible for the information reported by DEQ, but will notify DEQ of the recommendation.

Set-Aside Fund Management

The department did not adequately monitor its set-aside funds cash balance. The cash balance as of June 30, 2006, for the department's set-aside funds was a deficit of almost \$683,000. The fiscal year 2006 expenses, after above adjustments, were approximately \$1.3 million. These are federally reimbursed expenses. As the cash deficit was over 50 percent of the fiscal year's

total expenses, the deficit cash balance did not appear to be due to the timing of federal reimbursements. We inquired of department program and accounting staff to explain why there was such a large deficit cash balance. After research by department staff, the department determined they had incurred expenses within certain set-aside phases where no more funding was available. As a result, they had not been able to draw down federal cash to cover these expenses. Through research, the department determined funding was available in other phases to cover these expenses. According to the department, this situation occurred due to a lack of communication between accounting and program staff in years prior to fiscal year 2006.

We recommend department management ensure adequate cash monitoring processes are in place over the department's set-aside funds.

AGENCY'S RESPONSE:

The department will work with program staff to establish procedures to manage expenditures and cash by fiscal year within the federal budget period for the Drinking Water set-aside funds.

ABOUT THE SECRETARY OF STATE AUDITS DIVISION

The Oregon Constitution provides that the Secretary of State shall be, by virtue of his office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

Directory of Key Officials

Director	Charles A. Hibner, CPA
Deputy Director	William K. Garber, MPA, CGFM
Deputy Director	Mary E. Wenger, CPA

Team

Kelly L. Olson, CPA, Audit Manager
Nicole Rollins

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from:

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The courtesies and cooperation extended by officials and employees of the Department of Human Services were commendable and sincerely appreciated.

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