



Auditing for a Better Oregon

September 2, 2004

Randall Edwards, State Treasurer
Oregon State Treasury
350 Winter St. NE, Suite 100
Salem, Oregon 97301-3896

Dear Mr. Edwards:

We have completed our SAS 70 review of internal controls at Oregon State Treasury (Treasury) and our opinion audit of the Oregon Short Term Fund for the fiscal year ended June 30, 2004. During our audit, we did not identify any reportable conditions related to internal control or to noncompliance with applicable laws and regulations. Professional auditing standards define reportable conditions as matters relating to significant deficiencies in the design or operation of internal control over financial reporting that, in our judgment, could adversely affect your ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. We did identify the following issues that we determined were not reportable conditions, but did require management's attention. We previously met with department staff to discuss these issues.

Policies and Procedures

In our management letter dated August 21, 2003, we noted that "some implemented procedures... have not been updated in the written policy and procedure manuals." Although progress has been made toward documenting policies and procedures, we found that certain key areas are not adequately addressed in the control procedures documentation, and that the documented procedures do not always provide for adequate segregation of duties.

We noted the following areas where written controls are missing or inadequate.

The Finance Division's written policies and procedures do not:

- Include controls over access to the lockbox that contains the master keys and combinations to secured areas.
- Contain all control activities performed by the EFT coordinator or the local government services coordinator.

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The Investment Division's written policies and procedures do not:

- Include activities over Oregon Short Term Fund portfolio trading.
- Provide enough guidance in the maintaining of documentation that supports key review procedures.

The Oregon Accounting Manual (OAM) discusses the importance of documenting internal controls, specifically, "Documentation of internal control systems should appear in management directives, administrative policy, and accounting procedure manuals. Documentation of transactions and other significant events should be complete and accurate and should allow tracing the transaction or event from before it occurs, while it is in process, through its completion." "Supporting documentation for conclusions should be gathered and kept on file at least five years." (OAM 10.10.00 PR .111)

We recommend management continue to actively develop policies and procedures that address key internal controls in all areas. The procedures should be in sufficient detail to support appropriate segregation of duties and provide guidance on the specific duties to be performed to "assure the assertions made by management in the accounting records and reports are materially correct with respect to existence, completeness (including proper period), rights and obligations, valuation, and presentation." (OAM 10.10.00 PR .106 c)

Evidence of Review

In our management letter dated August 21, 2003, we recommended, "evidence of review of reports be retained to document compliance with Treasury's Policy and Procedures and internal control requirements." Although management has taken some steps to require the retention of these documents, we found during testing of internal controls that no documentation is retained to support the review of external managers for compliance with investment monitoring contracts.

In addition, we found that investment division staff did not provide the required quarterly reports to the Oregon Investment Council (OIC) concerning one external manager that was placed on the OIC Watchlist.

We recommend management ensure the retention of all evidence supporting the performance of the required review. We specifically recommend management determine the appropriate method for reviewing external managers and that proper documentation is maintained to support the performance of the reviews and the conclusions reached. We also recommend that management ensure the OIC is notified of external manager compliance as required by Oregon State Treasury and OIC policies.

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We will follow up on Treasury's progress in addressing these issues during our fiscal year 2005 audits. Should you have any questions, feel free to contact Julianne Kennedy or me at 503-986-2255.

Sincerely,
OREGON AUDITS DIVISION

Nancy L. Young, CPA, CISA, CFE
Audit Manager

NLY:bk

cc: Linda Haglund, Deputy State Treasurer
Curt Hartinger, Internal Audit Manager/IT Security Officer
Theresa McHugh, Acting Director, Department of Administrative Services