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Auditing for a Better Oregon

January 31, 2005

Max Williams, Director
Oregon Department of Corrections
2575 Center Street NE
Salem, Oregon 97301-4667

Dear Mr. Williams:

The statewide single audit that included selected financial accounts at the Department of Corrections for the year ended June 30, 2003, has been completed.

This statewide single audit work is not a comprehensive audit of your agency. Instead, this audit permits us to give an opinion on the statewide financial statements contained in the State of Oregon's Comprehensive Annual Financial Report and to report on internal control and the state's compliance with laws and regulations. Regular audits of the Department of Corrections will continue on a periodic basis.

The following Department of Corrections accounts and transactions were audited to determine their fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

SFMA Account	Description	Audit Amount
General Fund		
Compt. Object 3111	Regular Employees	$142,403,682
Compt. Object 3210	PERS Contribution	$24,744,877
Compt. Object 3221	Social Security Taxes	$12,106,912
Compt. Object 3263	Medical, Dental, Life Insurance	$19,838,872
Compt. Object 3264	Medical, Dental, life Insurance-Agency Subsidy	$6,982,571
Compt. Object 6300	Distribution to Counties	$87,452,189
Government Wide Reporting Fund		
Compt. Object 1279	COP Payable – Current	$20,920,000
Compt. Object 1704	COP Payable – Noncurrent	$560,900,531

Management Letter No. 291-2004-01-01

Based on our audit, we identified four reportable conditions needing corrective action. Our findings and recommendations are presented in the enclosed Audit Findings and Recommendations Summary accompanying this letter.

The reportable conditions, along with your responses, will be included in our statewide audit report. Including your responses with responses from other state agencies satisfies the federal requirement that management prepare a Corrective Action Plan (CAP) covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the response to each reportable finding includes the information specified by the federal requirement, and only if the responses are received in time to be included in the audit report. The following information is required for each response:

1. Your agreement or disagreement with the finding. If you do not agree with an 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 names of the contact persons responsible for corrective action.

For the reportable conditions, please respond by January 30, 2004.

Should you have any questions, feel free to contact Shandi Frederickson or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Neal Weatherspoon, CPA
Audit Administrator

NW:bk
cc: Sue Acuff, Business and Finance Administrator
Denise Teixeira, Internal Audit Administrator
Ellie Sjoholm, Controller
Gary Weeks, Director, Department of Administrative Services

Audit Findings and Recommendations Summary
Department of Corrections Statewide Audit
State Fiscal Year 2003

REPORTABLE CONDITIONS

Classification of Expenditures

To satisfy Generally Accepted Accounting Principles (GAAP), financial transactions must be complete, accurate, valid and consistently allocated to the appropriate accounts. Department of Corrections (department) management is required to establish and maintain internal controls to safeguard assets and ensure that financial information is appropriately recorded in the state's centralized accounting systems. The accuracy and adequacy of financial information is necessary to ensure accountability over assets and compliance with funding requirements. In addition, good financial information is necessary to support effective and efficient operations.

The department maintains its own financial accounting system. This system automatically provides summary level accounting information into the Department of Administrative Services' Statewide Financial Management Application (SFMA) for statewide financial reporting purposes. To ensure consistency in financial reporting, the State Controller's office has established a uniform chart of accounts for SFMA describing financial information to be reported in each account. State agencies providing data into SFMA are required to follow the chart of accounts.

During our audit, we selected a sample of expenditures to determine whether they were classified into the appropriate accounts. Of the sample that we tested, the majority were not classified consistently with the state's chart of accounts. For example, we identified a $300,000 sewer surcharge that was improperly posted to the "Professional Services over $75,000" account rather than in the "Fuels and Utilities" account. In addition, several "Medical Services" expenditures were inappropriately classified as "Professional Services over $75,000". Furthermore, because of errors in recording interfund reimbursements, the "Agency Program Related Services" account was misstated by approximately $5.7 million, resulting in a negative expenditure balance.

The department's chart of accounts for its internal accounting system did not provide sufficient description to ensure consistent classification of expenditures or to ensure that expenditures would be ultimately posted to the appropriate SFMA accounts. In addition, procedures for reviewing and approving expenditures prior to input were not sufficient to effectively prevent account classification and posting errors before they occurred. Furthermore, the department has not developed or implemented controls designed to detect posting errors so that they may be corrected in a timely manner.

We recommend that the department develop a more descriptive chart of accounts for its internal accounting system. The chart of accounts should provide clear guidance to accounting staff regarding which accounts should be used to ensure that their balances are recorded into appropriate SFMA accounts. We also recommend that department management design and implement controls to ensure more effective transaction error prevention and detection.

Expenditure Decision Authority

Agency directors having delegated commitment and expenditure authority are responsible for approving the use of state resources for their agencies. The *Oregon Accounting Manual* sets accountability standards for agency heads who have such authority. The manual indicates that agency heads may delegate, in writing, the authority to approve expenditures to their subordinates to facilitate operations. It also requires agency heads to maintain written documentation of the expenditure approval authority they have delegated to specific individuals. Employees authorizing expenditures must ensure that expenditures constitute an appropriate use of State funds. Expenditure approvals should be evidenced by the approving officer's signature.

The department keeps an electronic file of the expenditure authority delegated to specific individuals. This file specifies the authorization limits given to each approver including assigned cost centers and transaction threshold amounts. We selected a sample of 87 expenditures to determine whether they were appropriately approved prior to payment. Of the transactions tested:

- 15 were appropriately approved
- 18 either had no evidence of an approval or were approved by an individual with insufficient authority
- 50 approvals were signed by individuals who were not included in the department's authority listing.
- 4 lacked documentation to determine whether they were properly approved.

Ensuring that purchases are appropriately approved prior to payment is an important aspect of internal control. Inadequate approval processes significantly increase the risk that invalid, inappropriate, erroneous or fraudulent invoices may be paid. The above exceptions occurred because the department did not have sufficient procedures to ensure that formal delegation of expenditure authority was appropriately documented, validated, monitored and enforced.

We recommend that the department develop and implement policies and procedures to ensure that a more accurate and complete record of formal delegation of expenditure authority is maintained. In addition, department management should reevaluate the delegated authority it has given to subordinates to ensure that it is justified and adequate. Furthermore, department management should ensure that these controls are periodically monitored to promote or validate compliance.

Payroll

The department processes payroll expenditures through the Oregon State Payroll Application hosted by the Department of Administrative Services (DAS). Specific internal control requirements and procedures for processing payroll expenditures are outlined in the *Oregon Accounting Manual*. These internal controls are designed to ensure that important payroll functions are appropriately separated and that payroll expenditures are authorized, complete and accurate prior to payment. They also are designed to lessen the risk that errors or fraudulent transactions will be introduced into the system and go undetected.

The department has not fully complied with *Oregon Accounting Manual* requirements for providing sufficient internal controls over payroll transactions. Specific areas needing attention include the following:

- Individuals who have the ability to enter transactions into the automated payroll system sometimes distribute payroll checks and stubs.
- Payroll unit employees were responsible for reviewing gross pay adjustment reports.
- Gross pay adjustment reports were not retained for the complete audit cycle.
- Monthly payroll reconciliations between the statewide accounting system, the agency's internal accounting system, and the Oregon State Payroll Application were not always performed in a timely manner.
- The agency was unable to provide authorization forms for all voluntary deductions from employee pay.

In addition to the above compliance issues, we noted the following other internal control weakness regarding payroll:

- The department did not have formal procedures to ensure that payroll data files were completely and successfully transferred to the agency's internal accounting system and the statewide accounting system.
- The payroll expenditure accrual entry did not have supporting documentation.
- Employees did not sign approximately 25 percent of payroll timesheets.

We recommend that the department fully comply with internal controls over payroll as outlined in the *Oregon Accounting Manual*. Specifically, department management should ensure that important payroll functions are appropriately separated; gross pay adjustment reports are timely reviewed by managers outside of the payroll unit and are retained as required; reconciliations are performed timely; and authorization forms for voluntary payroll deductions are completed and retained. We also recommend that the department develop and implement formal procedures to ensure payroll data is completely and successfully transferred to internal and external accounting systems. In addition, department management should ensure supporting documentation is available for all payroll transactions and employees sign timesheets as required.

<u>Segregation of Duties and Logical Access to Accounting Systems</u>

The department maintains its own automated financial accounting system that provides summary level account information into the state's centralized accounting system. Thus, department management is responsible to ensure that access to the system is limited based on an individual's demonstrated need to view, add, change or delete data. Appropriate logical access controls for financial accounting systems supports and enforces segregation of duties by limiting the resources that any one individual has the ability to view, alter or control.

To ensure appropriate segregation of duties, persons having the ability to alter users' logical access should not have the ability to enter transactions into those systems. In addition, financial system users should not be assigned duties, nor provided logical access to systems, that may compromise segregation of duties principles. Furthermore, individuals independent of the security function should periodically confirm and validate the access granted to users to ensure that assess privileges are valid, authorized and reasonable.

Department management has assigned various financial system users responsibilities that should be performed by others to provide appropriate segregation of duties. For example, the accounting manager and one fiscal analyst have extensive access to the system including the ability to establish or modify users' access, enter contracts, modify contract dollar limits, input payments, and approve and release payments. Furthermore, the accounting staff has the ability to perform functions contrary to good separation of duties practices. We also noted that the fiscal analyst, mentioned above, was responsible for monitoring and validating the logical access provided to system users, thus, that function was not being performed independently.

Although various managers authorize access to the financial system, few individuals at the department understand how the financial system's security works or which access privileges would violate segregation of duties principles if combined. In addition, the department has not sufficiently developed nor documented policies and procedures to ensure that responsibilities are appropriately separated and access granted to achieve appropriate separation of important accounting and security functions.

We recommend that department management develop, document and implement policies and procedures to ensure accounting responsibilities are appropriately segregated. Specifically, management should ensure adequate separation of authorization for the execution of transactions, recording of transactions, custody of assets, and periodic reconciliation of existing assets to recorded amounts. In addition, management should ensure that individuals performing financial system security functions do not have conflicting accounting duties or responsibilities for monitoring and validating logical access, to ensure those functions are independently performed.

We also recommend that the department review and adjust logical access to its financial system on a case-by-case basis to ensure that users' access is based on a demonstrated need to view, add, change or delete data.