

Office of the Secretary of State
Bill Bradbury
Secretary of State

Jean Straight
Deputy Secretary of State



Audits Division
Charles A. Hibner, CPA
Director

255 Capitol Street NE, Suite 500
Salem, OR 97310
(503) 986-2255
fax (503) 378-6767

March 23, 2007

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

Dear Mr. Williams:

The statewide single audit that included selected financial accounts at the Department of Corrections (department) for the year ended June 30, 2006, 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 will continue on a periodic basis.

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

<u>SFMA Account</u>	<u>Description</u>	<u>Audit Amount</u>
<u>General Fund</u>		
3111	Regular Employees	\$159,459,217
3210	Public Employees Retirement Contribution	25,560,209
3221	Social Security Taxes	13,746,471
3263	Medical, Dental, Life Insurance	33,754,890
3264	Med, Dental, Life Insurance-Agency Subsidy	7,517,987
3212	Pension Bond Assessment	11,183,859
6300	Distribution to Counties	87,993,108
4600	State Government Service Charges	16,436,029
4901	Medical Services	16,017,211
<u>Community Protection Fund</u>		
3111	Regular Employees	\$2,443,616
3210	Public Employees Retirement Contribution	426,991
3221	Social Security Taxes	238,340
3263	Medical, Dental, Life Insurance	511,665
3264	Med, Dental, Life Ins-Agency Subsidy	109,833
4505	Professional Services Non-IT>\$75K	1,675,166
<u>Government-Wide Fund</u>		

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0852	Buildings and Building Improvements	\$558,121,111
1506	Certificates of Participation	150,900,000

Based on our audit, we did not identify any reportable conditions related to the accounts audited. However, we identified conditions of lesser significance that we wanted to communicate to department management. Our findings and recommendations are presented in the enclosed Audit Findings and Recommendations Summary accompanying this letter. During the next fiscal year audit, we will follow up on the department's progress in addressing these conditions.

Should you have any questions, please contact Michelle Rock or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

V. Dale Bond, CPA, CISA, CFE
Audit Manager

VDB:brk

cc: Tami Dohrman, Fiscal Services Administrator
Cheryl Harper, Payroll Administrator
Jamie Breyman, Internal Audit Administrator
Lindsay Ball, Director, Department of Administrative Services

Audit Findings and Recommendations Summary

Department of Corrections Statewide Audit

State Fiscal Year 2006

Payroll

The department processes payroll expenditures through the Oregon State Payroll Application hosted by the Department of Administrative Services. 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 had not fully complied with *Oregon Accounting Manual* requirements for providing sufficient internal control over payroll transactions. Specifically, individuals who have the ability to enter transactions into the automated payroll system also receive and distribute payroll checks and stubs. In addition, for the 2006 fiscal year, gross pay adjustment reports were not being reviewed timely, that is, before the release of pay, and one review was not completed.

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 and gross pay adjustment reports are reviewed timely.

Documents Required for Community Correction Programs

Oregon Revised Statutes require ongoing partnerships between the state and counties and financing for statewide community correction programs on a continuing basis. To obtain funding, counties must enter into an intergovernmental agreement with the department and submit a local community corrections plan consisting of specific elements such as program descriptions, budget allocation, performance objectives and methods of evaluating each correctional service to be provided by the county. In addition, each county must submit to the department a copy of the county's annual financial statements and that portion of the county's audit that addresses the community corrections program.

The department had not ensured that all required documents were received before releasing payments to counties. For example, during the 2006 fiscal year, the department released approximately \$8.9 million to five counties before intergovernmental agreements were signed and community corrections plans were received. In addition, we noted that the department had not obtained audited financial statements for 11 of 21 counties included in our review.

We recommend department management ensure that intergovernmental agreements are signed prior to distributing funds to counties and all required documents are obtained from the counties as required by *Oregon Revised Statutes*.

Expenditure Accruals

The state's governmental funds are reported using the modified accrual basis of accounting. Therefore, expenditures are recognized when the related liability is incurred regardless of the

timing of the related cash flows. The quality of the state's Comprehensive Annual Financial Report depends on the accuracy and completeness of year end closing activities. For agencies, this means financial statement accruals are recorded in month 13, the last period of each fiscal year. We found the department did not completely record accruals for four of its governmental fund accounts: Distributions to Counties; Professional Services; State Government Service Charges; and Medical Services. We identified approximately \$63,000 that should have been recorded as accruals in those accounts.

We recommend department management ensure that accruals are recorded for all of its accounts as appropriate at fiscal year end.

AFAMIS to SFMA Reconciliations

The department uses the Automated Financial Accounting and Manufacturing Inventory System (AFAMIS) as its main financial computer application to capture individual transaction level detail. AFAMIS is a subsidiary accounting system to the Statewide Financial Management Application (SFMA) and provides the underlying detailed information for the department's financial data in SFMA. To ensure the financial information is complete and accurate in SFMA, agencies are to reconcile their subsidiary accounting systems to SFMA as required by policies outlined in the *Oregon Accounting Manual*.

During the audit, we found that the department had not reconciled the AFAMIS system with SFMA. Upon our request, department personnel reconciled the selected financial accounts included in our review; however, the Medical Services account had an unreconciled difference of approximately \$648,000 that remained unresolved at the end of our audit.

We recommend department management perform regular reconciliations between AFAMIS and SFMA in compliance with the *Oregon Accounting Manual* to ensure all financial data in SFMA are complete and accurate. In addition, we recommend department personnel research the difference in the Medical Services account and make corrections to AFAMIS or SFMA, as appropriate.