

Office of the Secretary of State

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Audits Division

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February 7, 2008

Susan Castillo, Superintendent of Public Instruction
Oregon Department of Education
255 Capitol NE
Salem, Oregon 97310-0203

Dear Ms. Castillo:

We have completed the statewide single audit that included selected financial accounts at the Department of Education (department) for the year ended June 30, 2007.

This audit work was not a comprehensive audit of the department. Instead, the audit work performed allowed us, in part, to achieve the following objectives: (1) express an opinion on whether the financial statements contained in the State of Oregon's Comprehensive Annual Financial Report were fairly presented, in all material respects, in conformity with generally accepted accounting principles; (2) determine whether the state's internal controls provided reasonable assurance of proper accounting, financial reporting, and legal compliance of transactions; and (3) determine whether the state has complied with applicable legal requirements that may have a direct and material effect on the state's financial statements.

In planning and performing our audit of the selected financial accounts at the department as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the department's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements of the State of Oregon, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

We audited the following accounts and transactions at the department 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 (GAAP Fund 0001)</u>		
6200	Intraagency General Fund/Other Fund Transfer	\$2,480,332,834
<u>Special Revenue Fund: Educational Support Fund (GAAP Fund 1105)</u>		
6600	Distribution to Local School Districts	3,004,253,177
6725	Distribution to Non-Governments	139,640,976

Special Revenue Fund: Nutritional Support Fund (GAAP Fund 1109)

6600	Distribution to Local School Districts	99,159,502
6725	Distribution to Non-Governments	27,232,040

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control. As discussed below, we identified a deficiency in internal control that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiency to be a significant deficiency in internal control.

Inaccurate Expenditure Accruals

During the fiscal year 2006 closing process, the department reclassified outstanding encumbrances to accounts payable and concurrently accrued expenditures even though no goods or services were received at the time. The error was detected by the Department of Administrative Services (DAS) during the compilation of the statewide financial statements. DAS completed an analysis to make corrections for the statewide financial statements. DAS communicated with department management to verify the analysis and department management agreed with the corrections. The department, however, overlooked the fact that they had already made a portion of the accrual correction, resulting in a total misstatement of expenditures of approximately \$9.7 million. The department corrected this error prior to fiscal 2007 year end.

During the fiscal year 2007 closing process, the department's expenditure accrual process did not ensure complete reporting of all nutritional support expenditures incurred during the current reporting period. The process determined reported expenditures based on appropriation year instead of the fiscal year in which the expenditures were incurred. As a result, expenditures were understated by approximately \$557,000 at June 30, 2007.

Generally accepted accounting principles require expenditures be recognized when goods or services are received. In addition, state accounting policy guidelines indicate management is responsible to ensure fiscal year end closing procedures will result in reporting agency financial information in conformity with generally accepted accounting principles.

We recommend department management establish and implement controls to ensure expenditures are reported to the proper period in conformity with generally accepted accounting principles.

The significant deficiency, along with your response, will be included in our Statewide Single Audit Report For the Fiscal Year Ended June 30, 2007. Including your response satisfies the federal requirement that management prepare a Corrective Action Plan covering all reported audit findings. Satisfying the federal requirement in this manner, however, can be accomplished only if the response to the significant deficiency includes the information specified by the federal requirement, and only if the response is received in time to be included in the audit report. The following information is required for the response:

1. Your agreement or disagreement with the finding. If you do not agree with the 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 name(s) of the contact person(s) responsible for corrective action.

Please respond by February 13, 2007.

This communication is intended solely for the information and use of management, others within the organization, and the Board of Education and is not intended to be and should not be used by anyone other than the specified parties.

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

Sincerely,
OREGON AUDITS DIVISION

Julianne Kennedy, CPA
Audit Manager

JK:brk

cc: Susan MacGlashan, Assistant Superintendent, Office of Finance and Administration
John Hutzler, Chief Audit Executive
Tomas Flores, Director, Accounting Services
Jerry Berger, Chair, Board of Education
Kris Kautz, Interim Director, Department of Administrative Services