

Office of the Secretary of State

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Audits Division

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February 9, 2009

Susan Castillo, Superintendent of Public Instruction
Department of Education
255 Capitol St. NE, Suite 200
Salem, OR 97310

Dear Ms. Castillo:

We have completed audit work of selected financial accounts at the Department of Education (department) for the year ended June 30, 2008.

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.

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.

SFMA Account	Description	Audit Amount Debit (Credit)
<u>GAAP Fund 0001-General Fund</u>		
6200	General Fund/Other Fund Transfer	\$2,765,092,810
<u>GAAP Fund 1105-Educational Support Fund</u>		
0300	Federal Revenue	(369,513,947)
1306	Transfers in from Department of Administrative Services	315,002,500
6725	Distributions to Non-Governments	153,535,293
<u>GAAP Fund 1109-Nutritional Support Fund</u>		
0300	Federal Revenue	(135,008,453)

In planning and performing our audit of the selected financial accounts at the department as of and for the year ended June 30, 2008, 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.

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. 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 deficiencies to be significant deficiencies in internal control:

Employee Fraud

Audit standards require that we communicate any instances of fraud on the part of senior management to those charged with governance. Between June 2007 and June 2008, the department's former accounting director misappropriated approximately \$925,000 in federal funds. In perpetrating the fraud, the former accounting director was able to use knowledge of the department's internal controls and accounting structure to override the existing internal controls of the department. Following a guilty plea in April 2008, the former accounting director was sentenced to two years in prison and is required to repay the department for the total amount of funds misappropriated.

Following the identification and investigation of the theft, department management reviewed and made changes to controls as determined appropriate.

We recommend department management minimize the opportunity for fraud to occur by maintaining internal controls that are adequate to ensure all accounting transactions are appropriately authorized, justified, documented and reviewed for accuracy. Additionally, we recommend that management provide training to department staff to identify symptoms of fraud and inform staff of how to respond when a potential fraud is identified.

Year End Accruals

Generally accepted accounting principles (GAAP) require that revenues be recognized when the underlying expenditures have occurred. The Oregon Accounting Manual (OAM) clarifies that revenues received within 90 days of fiscal year end for expenditures that occurred during the year should be recognized in the year in which the expenditures occurred.

Through our testing we found weaknesses in the department's process for accruing expenditures and the related revenue. The department did not accrue all expenditures and revenue known or

estimated through the 90 day period after June 30, 2008. As a result, expenditures and revenue for fiscal year 2008 were misstated by approximately \$19.2 million in the Educational Support Fund and \$1.8 million in the Nutritional Support Fund.

We recommend the department review and update their policies and procedures to ensure year end accruals are made in conformity with generally accepted accounting principles. The procedures should include steps to identify all expenditures and revenue known at the time of preparing the year-end closing adjustments and an estimate of the revenue likely to occur after year-end close and prior to the 90-day recognition period.

Prior Audit Finding

In the prior fiscal year, a significant deficiency similar to the preceding deficiency was reported to you in a letter dated February 7, 2008. That finding also was included in the Statewide Single Audit Report for the fiscal year ended June 30, 2007; see Secretary of State Audit Report number 2008-03, finding number 07-20. During the current fiscal year, the department made progress in correcting this finding. This finding will be reported in the Statewide Single Audit Report for the fiscal year ended June 30, 2008, with a status of partial corrective action taken.

In addition to the significant deficiencies identified above, we identified an other matter that warrants management's attention.

Lack of Timely Review

The department was assigned responsibility to complete the review of single audit reports in accordance with OMB Circular A-133 for 132 subrecipients who received federal funds from the State of Oregon. Specific responsibilities and requirements for the review of subrecipient audit reports are listed in the Oregon Accounting Manual. These responsibilities include reviewing the subrecipient audit reports within 90 days of either: (1) the receipt of the audit report or (2) notification of assignment as audit agency for the subrecipient.

We reviewed the department's monitoring for 10 subrecipient audit reports. We found that seven of the ten subrecipient reviews were performed after the 90-day requirement. Timely review of subrecipient audit reports helps to ensure issues of noncompliance or errors in the Schedule of Expenditures of Federal Awards are identified and addressed in a timely manner.

We recommend department management ensure that audit reviews are performed within either 90 days of receiving the audit report or the assignment date.

The significant deficiencies, along with your responses, will be included in our Statewide Single Audit Report for the Fiscal Year Ended June 30, 2008. Including your responses 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 each significant deficiency 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.

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- (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 20, 2009. The other matter does not require a written response. We will follow up on the department's progress in addressing these issues during the next fiscal year audit.

This communication is intended solely for the information and use of management, others within the department, 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 Geoff Hill or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Julianne Kennedy, CPA
Audit Manager

JK:brk

cc: Sue MacGlashan, Assistant Superintendent, Office of Finance and Administration
John Hutzler, Internal Auditor
Tomas Flores, Accounting Services Director
Duncan Wyse, Chair, Board of Education
Scott Harra, Director, Department of Administrative Services