

**Office of the Secretary of State**

Kate Brown  
Secretary of State

Barry Pack  
Deputy Secretary of State



**Audits Division**

Gary Blackmer  
Director

255 Capitol Street NE, Suite 500  
Salem, OR 97310

(503) 986-2255

**fax** (503) 378-6767

February 16, 2010

Louise Solliday, Director  
Department of State Lands  
775 Summer Street NE, Suite 100  
Salem, Oregon 97301-1279

Dear Ms. Solliday:

We have completed audit work of selected financial accounts at the Department of State Lands (department) for the year ended June 30, 2009.

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, 2009, 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 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
<u>Special Revenue Fund – Common School Fund (GAAP fund 1113)</u>		
0810	Income from Investments	(26,637,100)
0830	Net Increase (Decrease) in FV of Investments	71,738,290
0929	Investments-Noncurrent	23,477,596
2340	Gain/Loss on Sale of Investments	154,798,990
0240/0245	Investments – Designated	724,636,168
0350	Securities Lending Cash Collateral	58,644,810
0503	Accounts Receivable – Other Unbilled	78,054,878
1551	Deposit Liability – Without DF Support	(338,060,463)
1600	Obligations Under Security Lending	(58,644,810)
1854	Transfers Out to Dept of Education	40,637,985
<u>Special Revenue Fund – Environmental Management Fund (GAAP fund 1107)</u>		
0070	Cash on Deposit with Treasurer	3,521,472

Our consideration of internal control was for the limited purpose described above 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:

**Inadequate System Of Internal Controls Over Investment Transactions**

The Oregon Constitution dedicated revenues from the sale and management of some state-owned rangelands, forest lands, waterways and other types of lands to the Common School Fund, with earnings distributed to Oregon’s public schools. The Common School Fund is managed by the State Land Board, with the Department of State Lands (department) serving as the administrative agency of the fund. The State Treasurer and the Oregon Investment Council manage the investments of the Common School Fund and the department accounts for the investments. The fair value of the Common School Fund portfolio as of June 30, 2009, was \$748 million.

We reviewed the department’s processes and controls in place over investments. We found that the department was not properly recording all of its monthly investment activity. Specifically, the department was only recording monthly activity for one of its thirteen investment funds and some of that recorded activity was not properly accounted for as a purchase, sale, investment income, or a gain/loss on the sale of investments. Upon inquiry, fiscal staff and management were unaware that they were not reporting all of their investment activity and were not aware of the investment activity reports they were receiving from the Office of the State Treasurer.

With assistance from the Department of Administrative Services controller's division, the department prepared year-end closing entries related to its investments and accurately reported investments at fiscal year-end. However, we found that investment-related activity associated with investment income, unrealized gains and losses for investments and investment expenses were not always properly classified in the state's accounting system.

Without an adequate system of internal control in place, management does not have assurance that transactions are accurately, completely, and properly recorded in the accounting system in accordance with generally accepted accounting principles.

**We recommend** department management obtain an understanding of their investment portfolio and the financial reporting standards and implement controls to ensure that their investments and investment-related transactions are accurately, completely, and properly recorded in the accounting system.

In addition to the significant deficiency identified above, we identified another matter that management should consider for improving internal controls. This matter does not require a written response. We will follow up on the department's progress in addressing this matter during the next fiscal year audit.

#### **Lack of Reconciliation Between Unclaimed Property System to Accounting System**

Under Oregon's Unclaimed Property Act, the department holds in trust abandoned funds such as bank accounts, lost securities, uncashed checks and estates of people who die without wills and without known heirs. These assets are reported in the Common School Fund and the interest earned on these assets is distributed to schools. The department uses the Unclaimed Property System (UPS) to record the receipt and disbursement of unclaimed property. The UPS is a subsidiary system of the state's accounting system and provides the underlying detailed information for the department's financial records.

In prior audits, we found the department had not performed reconciliations between balances in the UPS and the accounting system. Although the department has made improvements including designing and implementing a reconciliation process, the current year audit found the reconciliation process had not been performed since September 2008. Department management was unaware the quarterly reconciliation was not being conducted. While the department has continued a process to identify "unmatched" transactions and records between UPS and the accounting system, we found no procedures in place to ensure that the necessary corrections were being made. As of 2009 fiscal year-end, a difference of \$2,050,811 existed between the two systems.

An effective internal control system includes performing regular reconciliations between accounting records and underlying detail records. By not performing reconciliations, the department may not be able to timely identify and correct errors or potential misappropriation of unclaimed property.

**We recommend** department management ensure the reconciliation between the two systems is timely performed and that reconciling differences are addressed.

The significant deficiency, along with your response, will be included in our Statewide Single Audit Report For the Fiscal Year Ended June 30, 2009. 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 only be accomplished 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 24, 2010. 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, the State Land Board, and others within the organization and is not intended to be and should not be used by anyone other than the specified parties.

We would like to express our appreciation to your staff for their assistance and cooperation during the conduct of the audit. Should you have any questions, please contact Jamie Ralls or me at (503) 986-2255.

Sincerely,  
OREGON AUDITS DIVISION

Kelly L. Olson CPA  
Audit Manager

KLO:sms

cc: Cyndi Wickham, Assistant Director, Finance and Administration Division  
Vena McCoy, Internal Auditor  
Pamela Konstantopoulos, Fiscal Services Manager  
Scott Harra, Director, Department of Administrative Services  
Ted Kulongoski, Governor of Oregon, Oregon State Land Board