

Office of the Secretary of State

Kate Brown
Secretary of State

Barry Pack
Deputy Secretary of State



Audits Division

Gary Blackmer
Director

255 Capitol St. NE, Suite 500
Salem, OR 97310

(503) 986-2255
fax (503) 378-6767

February 23, 2010

The Honorable Ben Westlund, State Treasurer
Oregon State Treasury
350 Winter Street NE, Suite 100
Salem, Oregon 97301

Dear Mr. Westlund:

We have completed audit work of internal controls over financial reporting at the Oregon State Treasury (Treasury) for the year ended June 30, 2009.

This audit work was not a comprehensive audit of the Treasury. 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 planned and performed our audit at the Treasury as of and for the year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America. Our audit included evaluating the design of controls relevant to an audit of the financial statements of state agencies that rely upon the Treasury for financial information and to determine whether those controls were implemented as of June 30, 2009. Our audit was not designed to express an opinion on the effectiveness of Treasury's internal control. Accordingly, we do not express an opinion on the effectiveness of Treasury's internal control.

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. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements 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:

Strengthen Internal Controls Over Investment Valuations

The Oregon State Treasury's (Treasury) management is responsible for establishing and maintaining internal controls designed to provide reasonable assurance that investment balances reported to agencies are valued in accordance with generally accepted accounting principles. We found Treasury could improve the design of its controls over investment related to the following:

- During the audit period, Treasury did not have a specific control activity in place to ensure Treasury's investment custodian independently valued public equity and fixed income positions. Their custodian was relying on the price provided to them by Treasury's external investment managers for some positions rather than performing independent valuations. As a result, no independent reviews of the external fund managers' prices were being performed. After this issue was identified, Treasury began working with the investment custodian to decrease the number of positions not being independently priced. Based on a review of market price sources reported by the investment custodian as of June 30, 2009, 37 percent of the value of the fixed income and 8 percent of the value of the public equity positions were not independently valued but were based on prices provided by the external investment managers.
- As a result of a prior audit finding related to Treasury's controls over alternative investment valuations, Treasury implemented a process to review partnership valuations for financial reporting purposes. However, Treasury did not clearly identify and document specific criteria or situations that would require Treasury to further review and evaluate if there could be an impact to the alternative investments valuation. For example, although Treasury documented which partnership had a qualified independent audit opinion, they did not document their determination that the qualification had no impact on the valuation. Further, they had not developed criteria to support their determination

An effective internal control system includes adequate procedures that ensure investments are accurately and properly valued. By not performing sufficient control procedures, the Treasury may not be able to timely identify and correct investment valuation errors.

We recommend Treasury management continue to strengthen internal controls over the valuation of investments by ensuring an independent valuation is performed on all positions and developing specific criteria for evaluating reported fair values to ensure that valuations are reasonable.

Prior Audit Finding

In the prior fiscal year, we reported a material weakness to you related to Treasury's inaccurate financial reporting of investment balances. This finding can be found in the Statewide Single Audit Report for the Fiscal Year Ended June 30, 2008: see report number 2009-07, finding

number 08-01. We followed up on the corrective status of this finding during the fiscal year 2009 audit. Treasury has made progress in correcting this finding. This finding will be reported in the Statewide Single Audit Report for the Fiscal Year Ended June 30, 2009, with a status of partial corrective action taken.

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 Wednesday, February 24, 2010.

This communication is intended solely for the information and use of management, others within the Oregon State Treasury, and the Oregon Investment Council, 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 Byron Williams or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Kelly L. Olson, CPA
Audit Manager

KLO:sms

cc: Darren Bond, Deputy State Treasurer
Ron Schmitz, Chief Investment Officer
Andrea Belz, Chief Audit Executive
Members of the Oregon Investment Council
Geoff Guilfooy, Oregon State Treasury Audit Committee
Scott Harra, Director, Department of Administrative Services