Office of the Secretary of State

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February 24, 2010

Laurie Warner, Director
Oregon Employment Department
875 Union St. NE
Salem, Oregon 97311

Dear Ms. Warner:

We have completed audit work of selected financial accounts at the Oregon Employment Department (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
GAAP Fund 4015 – Unemployment Compensation Fund		
0077	Cash in Bank	$1,462,816,536
0300	Federal Revenues	(468,258,971)
0410	Taxes Receivable - Current	166,633,537
0420	Taxes Receivable – Noncurrent	6,932,529
0151	Employment Tax	(616,747,825)
0800	Interest on Investments	(89,804,415)
6800	Distribution to Individuals	1,874,980,286

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 and another deficiency that we consider to be a material weakness.

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.

Controls Over Initiating and Recording Transactions Should Be Improved

The Oregon Accounting Manual states that each agency is ultimately responsible for establishing, maintaining and improving the agency's internal controls. Internal controls must be adequate to provide reasonable assurance that management's goals and objectives are being accomplished effectively and efficiently and that transactions are accurate, properly recorded, and executed in accordance with management's authorizations.

The department did not have adequate controls in place to ensure that federal draws were appropriately calculated, recorded, and supported and that year-end accruals were accurate. Specifically, we noted the following:

- The department made calculation errors in five of 20 federal draws reviewed, resulting in miscalculations totaling $366,024 and a net underdraw of $110,346. Another draw contained calculation errors but we were unable to determine the correct draw amount because the department changed their methodology during the year and was not able to provide the supporting documentation. The department draws federal funds for benefit programs after the benefits are paid to individuals. The department performs complex calculations based on actual benefit amounts paid to determine the draw amounts. During fiscal year 2009, one person was responsible for calculating and performing the draws without any management review.

- Based on review of actual draws, the department understated fiscal year 2009 federal revenue by $14 million. At year-end, the department prepared an accrual to record federal revenue earned but not received. The department was not able to clearly indicate how they determined their accrual nor do they have an accrual methodology documented. Further, the federal revenue accruals were performed by one staff person without any management review.
- The department incorrectly calculated a year-end adjustment, which resulted in understatements to taxes receivable and employment tax revenues of $1.9 million.

We recommend department management implement a review process to ensure that transactions are appropriate and adequately supported.

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 believe that the following deficiency constitutes a material weakness:

Improve Controls Over Transactions and Reconcile to Accounting Records

An effective system of internal control includes adequate procedures that ensure transactions are accurately, completely, and properly recorded in the accounting system in accordance with generally accepted accounting principles**.** An effective system also includes adequate controls to ensure that financial information in the accounting system reconciles to supporting documentation. Further, the Oregon Accounting Manual states that departments should regularly perform bank reconciliations of cash recorded in agency records to bank statements. Cash reconciliations are an important control that provides assurance that account balances are accurate.

During our audit, an audit adjustment was made to the financial statements to correct a $106 million understatement of unemployment benefit expenditures and a $106 million overstatement of cash. The department's Oregon Benefit Information System creates unemployment benefit claims, tracks benefit amounts to be paid to claimants, withholds federal and state taxes, and collects on overpayments of benefits. On a daily basis, the benefit expenditure data from the benefit system is manually entered into spreadsheets, which the department maintains and uses to prepare the entry to record the expenditures in the state's accounting system. After the initial entry is recorded in the accounting system, the department makes additional accounting system entries to transfer the expenditures between funds for budgetary purposes. During this process, the department made an error, which resulted in the understatement of expenditures and overstatement of cash. The department does not have a process in place to ensure that these entries are made accurately in the accounting system.

The department's cash reconciliations also did not identify the cash error as the department reconciles cash balances between bank statements and the department's internal spreadsheets, but does not reconcile these balances to the cash balance in its accounting records. Furthermore, we identified additional cash reconciling errors totaling $9.4 million between the department's spreadsheets and its accounting records for its cash suspense account. We also identified an $11.8 million difference between the department's accounting records and its spreadsheets for its United States Treasury unemployment insurance trust fund cash account at June 30, 2009.

Monthly reconciliations of the cash accounts to the accounting records would have identified the errors in the cash accounts and other reconciling items that may have occurred. By not performing sufficient control procedures, the department was not able to timely identify and correct these significant accounting errors.

We recommend department management implement a control over the process of transferring expenditures for budgetary purposes, and perform reconciliations of its spreadsheets to its accounting system to ensure amounts are accurately, completely, and properly recorded in the accounting system.

Prior Year Findings

In the prior fiscal year, we reported two significant deficiency findings to you related to cash reconciliations not being performed timely and controls over year-end closing activities could be improved. These findings can be found in the Statewide Single Audit Report for the Fiscal Year Ended June 30, 2008; see report number 2009-07, finding numbers 08-6 and 08-7. We followed up on the corrective status of these findings during the current audit. We found that the department did make progress in correcting these findings, but is still in the process of resolving. These findings 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 and material weakness, along with your responses, will be included in our Statewide Single Audit Report for the Fiscal Year Ended June 30, 2009. 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 only be accomplished if the responses to the significant deficiency and material weakness include 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.
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 date agreed upon.

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

We appreciate your staff's assistance and cooperation during this audit. Should you have any questions, please contact Raul Valdivia or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Kelly L. Olson, CPA
Audit Manager

KLO:sms
cc: George Dunford, Chief Financial Officer
Corry Chain, Assistant Chief Financial Officer
John McGinn, Accounting Manager
Robert McQuillan, Internal Auditor
Scott Hara, Director, Department of Administrative Services