Office of the Secretary of State

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February 24, 2010

Marvin Brown, State Forester
Oregon Department of Forestry
2600 State Street
Salem, Oregon 97301

Dear Mr. Brown:

We have completed audit work of selected financial accounts at the Oregon Department of Forestry (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 1107, Special Revenue Fund – Environmental Management		
0065	Unreconciled Deposit	1,963,146
0070	Cash on Deposit with Treasurer	14,169,166
0703	State Forest Lands	73,412,500
1401	Transfer Out to Other Funds	3,886,315
1405	Transfer to Counties	42,484,338
1810	Transfer Out to Department of State Lands	13,569,087
3111	Regular Employees	25,608,161
3210	Public Employees Retirement Contribution	3,947,606
3212	Pension Bond Assessment	1,786,813
3221	Social Security Taxes	2,627,974
3263	Medical, Dental, Life Insurance	8,819,067
4xxx	Various Services and Supplies Expenditures	46,155,180

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 deficiencies in internal control that we consider to be significant deficiencies.

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.

Financial Reporting Risk Assessment Process Needs Strengthening

Risk assessment is part of an interrelated internal control framework. Management's responsibility is to identify financial reporting objectives and the risks related to achieving those objectives, including risks associated with system generated financial information. Once risks are identified, management should consider their significance, the likelihood of their occurrence, and ensure mitigation of key risks through implemented control activities. Department management's current practice is an informal process that identifies risks while reviewing and updating department policies. Management stated that they also address risks as concerns come to their attention. Their process does not begin with identification of financial reporting objectives and risks related to those objectives.

Without a formal process for identifying risks, there is a greater chance that key financial reporting risks could be overlooked. During our audit, we noted weaknesses in the purchase order system access controls and weaknesses in internal controls over services and supplies expenditures that might have been identified with a more comprehensive risk assessment process.

We recommend department management implement a comprehensive risk assessment for financial reporting objectives within its internal control framework. The risk assessment process should begin with identifying financial reporting objectives, and include risks related to those objectives. Management should assess the significance of the risks, the likelihood of occurrence of the risks, and implement control activities to address the key identified risks.

Weaknesses in Access Controls for Purchase Order System

The department processes services and supplies expenditures through its purchase order (PO) system. Access to the PO system is granted after an employee requests access and receives approval from his or her supervisor. User access should be in line with department needs and employee job requirements. According to department policy, the Application and Data Owner is responsible for: granting and tracking employee access to the computer application; maintaining a listing of employees and level of access; and, completing a periodic review of all access levels.

We noted the following weaknesses in the access controls over the PO system:

- The appointed Application and Data Owner for the PO system was unaware of the appointment. The prior Application and Data Owner had relinquished responsibility for granting employee access to the PO system.
- Access requests and approvals are not consistently documented in a centralized location.
- A listing of employees' access and their access levels is not maintained for the PO system. Additionally, the department could not readily produce a listing of employees with PO system access showing employees' levels of approved access.
- There are no periodic reviews of PO system user access.
- Eight employees who were noted as having the ability to initiate a purchase order in the PO system also have delegated signature authority to approve expenditures, thereby creating a weakness in segregation of duties controls over expenditures.
- PO system access is not terminated when an employee separates from the department. Department management informed us this weakness was mitigated by controls over the department's network access; employees that separate from the department should have their network access terminated, which would result in PO system access being effectively prevented. However, we found this mitigating control was not reliable. Four of seven employees with PO system access that separated from the department during fiscal year 2009 did not have their network access terminated timely. Termination of network access for these four employees ranged from 3 to 72 days past their termination dates. For one of the seven employees, network access was terminated, but the date access was terminated is unknown. The department's network directory does not log a date when a separated employee's access to the network is terminated and the department does not have an

alternative method of consistently documenting when an employee's access to the network is terminated.

These access control weaknesses increase the risk of unauthorized or unintentional use or modification of the PO system, which could result in inappropriate expenditures. Although expenditures require an approval signature by a delegated authority and are reviewed centrally in Fiscal Services, these controls do not completely mitigate the risks of inappropriate expenditures occurring and going undetected, as the department is highly decentralized with more than 150 employees with delegated signature authority.

We recommend department management ensure that access controls over the PO system are implemented and functioning. Controls should include the following:

- User access requests and appropriate approvals, from both the employee's supervisor and the Application and Data Owner, should be consistently required and documented prior to access being granted.
- An updated listing of employees with access to the system and their level of access should be maintained.
- Periodic reviews of user access for the PO system should occur to ensure appropriate PO system access levels are maintained.
- Segregation of duties controls should exist between the initiation of a purchase order and the expenditure approval.
- Access to the PO system, whether directly or through network access, should be terminated timely upon an employee's separation from the department.

In addition to the significant deficiencies identified above, we identified the following other matters that warrant management's attention.

Controls over Services and Supplies Expenditures Could be Strengthened

State policy places responsibility on employees who authorize expenditures to use "good judgment" in spending public funds. Expenditures should further the business of the state and are to be a responsible and appropriate use of public funds. During our testing of services and supplies expenditures, we noted the following instances where the department could strengthen its controls over expenditures:

Training Conference: The department held a two and one-half day conference in March and April of 2009 at a hotel in Eugene, Oregon. The department anticipated the event to cost approximately $35,000. We noted the following areas where better use of public funds might have been attained:

- The department's request for proposal (RFP) specified meal gratuities should not exceed 18 percent and did not address non-food gratuities. The vendor selected imposed a 22 percent service charge on all food, room equipment, and room rentals, which was disclosed in the vendor's proposal. Part of the contracting process involves negotiating contract terms; however, there was no evidence indicating why the department accepted a higher rate or whether management tried to negotiate the RFP gratuity rate.

- A recognition dinner, with a total cost to the department of approximately $3,600, including approximately $3,400 for 128 dinners and approximately $200 for room equipment, was held at the end of the first conference day. Department communication regarding the training conference noted meals are provided as part of the conference agenda to discourage participants from leaving the facility so that presentations and training sessions can resume promptly and benefit the greatest number of people. However, there was no business conducted during or following the recognition dinner. The department's recognition policy prohibits the use of state funds to cover costs associated with any employee recognition function.
- Eight retiree award plaques presented at the conference cost $75 each. State and department policies limit awards to $50 per individual per calendar year.

Annual Operators Dinner: The department, along with the Associated Oregon Loggers, cooperatively sponsored an Annual Operators Dinner and Meeting in April 2009. The department paid a total of $578, which included the facility rental fee and half the cost of the dinners for 97 attendees. Of the 97 attendees, only 15 were department employees. The remaining attendees included three department employees' spouses, forest operators, and forest operators' spouses. The agenda showed no business being conducted during the dinner. Although there was a training held the same day for the forest operators, the notice to the forest operators specified the training and dinner were two events held at separate locations. Providing dinner does not appear to further the business of the state; additionally, paying for spouses' dinners is an inappropriate use of state funds.

Segregation of Duties and Department Cell Phone Usage: A department employee who is assigned a cell phone also has approval authority over the cell phone invoice. Allowing an employee to approve his/her own expenditures causes a weakness in segregation of duties and increases the risk of inappropriate expenditures occurring. We reviewed the cell phone invoice for February 2009 and found that the personal use of two cell phones could be better managed. The activity on the invoice included numerous calls with the employees' personal residences while the employees were not on travel status. Calls also occurred over all weekends during the billing period and on several weekdays after 6:00 p.m. A Government Standards and Practices Commission Advisory Opinion states public agency cell phones are not for the convenience or personal use of employees. The Opinion allows for an occasional personal use of the cell phone if it's directly related to official duties, such as the employee is going to be late getting home due to a last minute schedule change. The Opinion also states that these calls should be of brief duration and should occur infrequently, such as two to three times monthly.

Other examples: Other instances where the department could have exercised better use of state funds include the purchasing of a less expensive refrigerator to meet department needs and not using department funds to purchase personal items such as a watch battery.

We recommend: management ensure all expenditures further the business of the department and provide for a responsible and appropriate use of public funds. Specifically, we recommend department management:

- Use contract negotiations, as necessary, to receive the best price for services and materials purchased.
- Abide by its policy to not use state funds for costs associated with any employee recognition function.
- Limit awards to not exceed $50 per individual in a calendar year.
- Discontinue expenditures that do not further the business of the department. Additionally, department management should seek reimbursement for employees' spouses dinners.
- Ensure all expenditures are reasonable and appropriately reviewed and approved.

The significant deficiencies, 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 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.
2) The corrective action planned.
3) The anticipated completion date.
4) The name(s) of the contact person(s) responsible for corrective action.

In addition to responding to the significant deficiencies, please include a response to the other matter identified above: Controls over Services and Supplies Expenditures Could be Strengthened. Although the other matter will not be reported in the Single Audit Report we will follow up on the department's progress in addressing all of these issues during the next fiscal year audit. Please respond by **March 12, 2010**.

This communication is intended solely for the information and use of management, others within the organization, and the Board of Forestry 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 Diane Farris or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Julianne Kennedy, CPA
Audit Manager

JK:sms
cc: Satish Upadhyay, Administrative Services Division Chief
Mark Hubbard, Business Services Director
David Clouse, Quality Assurance Program Director
John Blackwell, Chair, Board of Forestry
Scott Harra, Director, Department of Administrative Services