Office of the Secretary of State

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March 10, 2011

Laurie Warner, Director
Oregon Employment Department
875 Union Street 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, 2010.

This audit work was not a comprehensive audit of the department. We performed this audit work as part of our annual statewide financial audit. The objective of the statewide audit was to 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.

In planning and performing our audit of the selected financial accounts at the department as of and for the year ended June 30, 2010, 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 and determined 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		
0075	Cash on Deposit – Suspense Acct at Treasury	$ 2,538,691
0077	Cash in Bank	766,582,498
0300	Federal Revenues	1,627,414,332
0410	Taxes Receivable – Current	221,452,801
0420	Taxes Receivable – Noncurrent	5,995,791
0151	Employment Tax	773,453,853

6800	Distribution to Individuals	3,013,853,880

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. As discussed below, we identified a deficiency in internal control that we consider to be a material weakness and a deficiency that we consider to be significant deficiency.

Material Weakness

Controls Over the Federal Draw Process Could Be Improved

As part of the Unemployment Insurance program, the department makes benefit payments to eligible unemployed individuals. For benefit payments eligible for federal funding, the department submits requests to the federal government for reimbursement of these payments. The department's process for drawing federal funds for these benefit payments involves the use of a complex spreadsheet that contains several formulas. The formulas are modified periodically based on changes implemented by the federal government. During our audit, we noted that federal revenues were about $127 million less than federal expenditures for the fiscal year ended June 30, 2010. The department researched and determined that beginning in July 2008 an error in a formula caused the department to draw about $183 million less in federal funds than allowed. The department provided support to the federal government and was able to draw the federal funds in September 2010.

We recommend department management periodically review its federal draw process to ensure that federal funds are properly drawn.

Significant Deficiency

Established Controls Not Consistently Followed

The department makes daily entries into the state's accounting system to record all cash activity, including revenues from employment taxes. According to the Oregon Accounting Manual, department management is responsible for establishing, maintaining and improving the department's internal controls. The department has procedures in place to ensure the daily entries are accurate, complete and appropriate. These procedures include independent reviews, control totals and segregation of duties.

During our testing of employment tax revenue, we found the department did not consistently follow established control procedures over daily entries. Although we did not identify errors, consistent application of control procedures helps to minimize the risk for errors to occur and not be detected in a timely manner. Specifically, we found:

- The department either did not document or did not perform independent reviews for 16 of the 40 entries tested. For 9 of these entries, the review was not documented and we were not able to determine if the review had occurred. The remaining 7 entries were not independently reviewed; they were prepared and reviewed by the same individual.

- The department did not include control totals for 6 of the 40 entries reviewed. As a result, we were unable to determine if the department verified that daily entries were accurately entered into the state's accounting system.

We recommend department management ensure established control procedures are followed.

Other Matter

In addition, we identified the following other matter that is an opportunity to strengthen internal controls but is not considered to be a significant deficiency or a material weakness. This other matter does not require a written response from management.

Year End Accrual Methodologies Could Be Improved

To facilitate year end closing, agencies are encouraged to use accounting estimates if actual accrual amounts are not available on a timely basis. Using estimates is an acceptable accounting practice, provided the basis on which the estimates are made is fundamentally sound and sufficiently documented. The department develops several estimates related to unemployment benefits receivable, including an amount owed to the federal government and an estimate of the amount of receivables that will not be collected. The department's current methodology is complex and involves using various ratios. During our audit, we identified improvements that could be made to simplify the department's methodology. As part of the unemployment program, program staff track and report benefit receivables, collections and write-offs regularly to the federal government. By identifying and using other reports already available, the department could simplify its methodology and improve the estimates recorded in the accounting records.

We recommend the department review current methodologies used to develop unemployment benefit receivable accounting estimates and determine if other reports or historical data are available that could help simplify the department's methodologies and improve its receivable estimates.

Prior Year Finding(s)

In prior fiscal years, we reported significant deficiencies related to controls over initiating and recording transactions and cash reconciliations in letters dated February 24, 2010, and February 25, 2009. These findings can also be found in the Statewide Single Audit Reports ; see

Secretary of State audit report number 2010-19, finding number 09-04, and audit report number 2009-07, finding number 08-6, respectively. We followed up on these findings during the fiscal year 2010 audit. We found that the department made progress and is in the process of resolving these issues. These findings will be reported in the Statewide Single Audit Report for the fiscal year ended June 30, 2010, with a status of partially corrected.

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, 2010. 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 and material weakness 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 each 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 March 18, 2011.

This communication is intended solely for the information and use of management and others within the organization 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 Olson, CPA
Audit Manager

KLO:RV:nmj

cc: Bill Fink, Deputy Director
George Dunford, Chief Administrative Officer
Corry Chain, Accounting Manager
Bob McQuillan, Internal Auditor

Kris Kautz, Acting Director, Department of Administrative Services