Office of the Secretary of State

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February 7, 2012

Michael Jordan, Director
Department of Administrative Services
155 Cottage St NE U20
Salem, OR 97301

Dear Mr. Jordan:

We have completed audit work of selected financial accounts at the Department of Administrative Services (department) for the year ended June 30, 2011.

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, 2011, 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 0001 - General Fund		
0065	Unreconciled Deposit	$ (643,445,472)
0070	Cash on Deposit with Treasurer	629,779,142
1853	Transfer Out to Oregon University System	358,925,007

GAAP Fund 0054 – General Fund

1854	Transfer Out to Department of Education	$ 283,746,694

GAAP Fund 1105 - Education Support Fund

0300	Federal Revenue	$ 277,982,240

GAAP Fund 1108 – Health and Social Services Fund

0065	Unreconciled Deposit	$ 2,439,867
0070	Cash on Deposit with Treasurer	258,531,046

GAAP Fund 5001 – Central Services Fund

0407	Other Charges for Services	$ 811,467,691
	Buildings and Building Improvements, Net of Accumulated Depreciation	211,370,150

GAAP Fund 8500 – Government-Wide Reporting

0967	Net Pension Asset	$ 1,678,700,000
1276	Bonds Payable, Current	108,492,580
1714	Bonds Payable, Noncurrent	2,274,954,632

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 significant deficiency.

Significant Deficiency

Method for Replacing Building Components Should be Improved

When agency management replaces a component of a building, such as a carpet or a roof, it should use one of three methods to avoid duplicating the component in its accounting records. If management originally recorded the component separately from the building, the component should have a value of zero when it is replaced, due to depreciation, and the new asset would take its place. However, if management recorded the original component as an integral part of the building, the subsequent replacement of that component should be treated as a repair and expensed in the current period. Lastly, rather than treat the replacement as a repair management may choose to replace the component by estimating its cost and disposing of the un-depreciated balance of the component. (Oregon Accounting Manual 15.60.20.117) Under each of these methods, the accounting records are adjusted so that the value of the component is not included twice.

During our audit, we found that in 2011 the department replaced HVAC units, carpeting, elevators and other such items previously capitalized as components of state owned buildings, and added them to the department's asset listing. The department did not use any of the approved methods discussed above to ensure the components were not duplicated in the accounting records. Department management disclosed that this practice for buildings that are capitalized as a single asset has been in place since at least 1999. Since the beginning of 2011, management has started recording the individual components separately with the intention of removing them from the accounting records as they are replaced. Not removing the original component when it is replaced could overstate the buildings account as well as associated depreciation accounts in the accounting records.

We recommend department management determine how much of the current Buildings and Building Improvements account and its related depreciation continues to be in the accounting records for assets that are no longer in use, and appropriately adjust those accounts to reflect the correct balances. We also recommend that going forward, department management use one of the approved methods in the Oregon Accounting Manual when replacing building components.

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.

Controls Over Asset Classification Need Improvement

There are several classifications under the general description of Buildings, Property and Equipment according to the Oregon Accounting Manual. Two of these classifications are "Buildings and Building Improvements" and "Land Improvements". In our review of Buildings and Building Improvements, we found improvements such as lighting, irrigation systems, and fountains that should have been classified as land improvements.

We recommend department management ensure assets that meet the definition of land improvements are classified as land improvements in the fixed asset system.

The significant deficiency, along with your response, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2011. 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 each response:

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.

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

Please respond by February 17, 2012.

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 would like to express our appreciation to Jim Russell, Mini Fernandez, Bret West and all the department staff for their assistance and cooperation during the audit. Should you have any questions, please contact me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Julianne Kennedy, CPA
Audit Manager

JK:jas

cc: Sarah Jo Chaplen, Deputy Director, Department of Administrative Services
Joy Sebastian, Acting State Controller, Department of Administrative Services
Bret West, Operations Division Administrator, Department of Administrative Services
James Russell, Accounting Manager, Department of Administrative Services
Pam Stroebel, Chief Audit Executive, Department of Administrative Services