

Office of the Secretary of State

Kate Brown
Secretary of State

Barry Pack
Deputy Secretary of State



Audits Division

Gary Blackmer
Director

255 Capitol Street NE, Suite 500
Salem, OR 97310

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RECEIVED

FEB 18 2010

DEPARTMENT OF STATE LANDS

February 16, 2010

Louise Solliday, Director
Department of State Lands
775 Summer Street NE, Suite 100
Salem, Oregon 97301-1279

Dear Ms. Solliday:

We have completed audit work of selected financial accounts at the Department of State Lands (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
<u>Special Revenue Fund – Common School Fund (GAAP fund 1113)</u>		
0810	Income from Investments	(26,637,100)
0830	Net Increase (Decrease) in FV of Investments	71,738,290
0929	Investments-Noncurrent	23,477,596
2340	Gain/Loss on Sale of Investments	154,798,990
0240/0245	Investments – Designated	724,636,168
0350	Securities Lending Cash Collateral	58,644,810
0503	Accounts Receivable – Other Unbilled	78,054,878
1551	Deposit Liability – Without DF Support	(338,060,463)
1600	Obligations Under Security Lending	(58,644,810)
1854	Transfers Out to Dept of Education	40,637,985
<u>Special Revenue Fund – Environmental Management Fund (GAAP fund 1107)</u>		
0070	Cash on Deposit with Treasurer	3,521,472

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. We consider the following deficiency to be a significant deficiency in internal control:

Inadequate System Of Internal Controls Over Investment Transactions

The Oregon Constitution dedicated revenues from the sale and management of some state-owned rangelands, forest lands, waterways and other types of lands to the Common School Fund, with earnings distributed to Oregon’s public schools. The Common School Fund is managed by the State Land Board, with the Department of State Lands (department) serving as the administrative agency of the fund. The State Treasurer and the Oregon Investment Council manage the investments of the Common School Fund and the department accounts for the investments. The fair value of the Common School Fund portfolio as of June 30, 2009, was \$748 million.

We reviewed the department’s processes and controls in place over investments. We found that the department was not properly recording all of its monthly investment activity. Specifically, the department was only recording monthly activity for one of its thirteen investment funds and some of that recorded activity was not properly accounted for as a purchase, sale, investment income, or a gain/loss on the sale of investments. Upon inquiry, fiscal staff and management were unaware that they were not reporting all of their investment activity and were not aware of the investment activity reports they were receiving from the Office of the State Treasurer.

With assistance from the Department of Administrative Services controller's division, the department prepared year-end closing entries related to its investments and accurately reported investments at fiscal year-end. However, we found that investment-related activity associated with investment income, unrealized gains and losses for investments and investment expenses were not always properly classified in the state's accounting system.

Without an adequate system of internal control in place, management does not have assurance that transactions are accurately, completely, and properly recorded in the accounting system in accordance with generally accepted accounting principles.

We recommend department management obtain an understanding of their investment portfolio and the financial reporting standards and implement controls to ensure that their investments and investment-related transactions are accurately, completely, and properly recorded in the accounting system.

In addition to the significant deficiency identified above, we identified another matter that management should consider for improving internal controls. This matter does not require a written response. We will follow up on the department's progress in addressing this matter during the next fiscal year audit.

Lack of Reconciliation Between Unclaimed Property System to Accounting System

Under Oregon's Unclaimed Property Act, the department holds in trust abandoned funds such as bank accounts, lost securities, uncashed checks and estates of people who die without wills and without known heirs. These assets are reported in the Common School Fund and the interest earned on these assets is distributed to schools. The department uses the Unclaimed Property System (UPS) to record the receipt and disbursement of unclaimed property. The UPS is a subsidiary system of the state's accounting system and provides the underlying detailed information for the department's financial records.

In prior audits, we found the department had not performed reconciliations between balances in the UPS and the accounting system. Although the department has made improvements including designing and implementing a reconciliation process, the current year audit found the reconciliation process had not been performed since September 2008. Department management was unaware the quarterly reconciliation was not being conducted. While the department has continued a process to identify "unmatched" transactions and records between UPS and the accounting system, we found no procedures in place to ensure that the necessary corrections were being made. As of 2009 fiscal year-end, a difference of \$2,050,811 existed between the two systems.

An effective internal control system includes performing regular reconciliations between accounting records and underlying detail records. By not performing reconciliations, the department may not be able to timely identify and correct errors or potential misappropriation of unclaimed property.

We recommend department management ensure the reconciliation between the two systems is timely performed and that reconciling differences are addressed.

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 February 24, 2010. The other matter does not require a written response. We will follow up on the department's progress in addressing these issues during the next fiscal year audit.

This communication is intended solely for the information and use of management, the State Land Board, 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 your staff for their assistance and cooperation during the conduct of the audit. Should you have any questions, please contact Jamie Ralls or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION



Kelly L. Olson CPA
Audit Manager

KLO:sms

cc: Cyndi Wickham, Assistant Director, Finance and Administration Division
Vena McCoy, Internal Auditor
Pamela Konstantopoulos, Fiscal Services Manager
Scott Harra, Director, Department of Administrative Services
Ted Kulongoski, Governor of Oregon, Oregon State Land Board



Oregon

Theodore R. Kulongoski, Governor

Department of State Lands

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State Land Board

Theodore R. Kulongoski
Governor

Kate Brown
Secretary of State

Ben Westlund
State Treasurer

February 22, 2010

Gary Blackmer, Director
Secretary of State Audits Division
225 Capitol St NE
Salem, OR 97310

Dear Mr. Blackmer:

This letter is in response to the Audit Findings and Recommendations directed to the Department of State Lands resulting from the recent audit of selected financial accounts for the year ended June 30, 2009.

Recommendation:

"We recommend department management obtain an understanding of their investment portfolio and the financial reporting standards and implement controls to ensure that their investments and investment-related transactions are accurately, completely, and properly recorded in the accounting system."

Response:

The Department of State Lands agrees with the recommendation and has hired an independent consultant with extensive experience with state of Oregon accounting policies, procedures and systems and investment accounting expertise to work with management and staff to achieve the recommendation.

Analysis of the investment portfolio, determination of the appropriate accounting entries and development of monthly procedures have all been completed. The Department anticipates implementation by March 31, 2010. Department contacts responsible for the corrective action are Pamela Konstantopoulos, Fiscal Manager and Cynthia Wickham, Assistant Director.

Reconciliation between Unclaimed Property System and Accounting System:

The recommendation to management to ensure the reconciliation between the Unclaimed Property System and the Accounting System does not require a written response, however the Department would like to include in this letter that it does agree with the recommendation. The Department has taken corrective

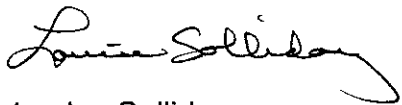


Gary Blackmer, Director
February 22, 2010
Page 2

action. The Department contacts are Patrick Tate, Unclaimed Property Manager and Cynthia Wickham, Assistant Director.

The Department of State Lands appreciates the opportunity to respond to and address the recommendations in the audit report. If we can be of further assistance, please contact Cyndi Wickham at (503) 986-5227 or me at (503) 986-5224.

Sincerely,

A handwritten signature in cursive script, appearing to read "Louise Solliday".

Louise Solliday
Director

cc. Vena McCoy, Internal Auditor
Cyndi Wickham, Assistant Director

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

January 28, 2011

Louise Solliday, Director
Department of State Lands
775 Summer Street NE, Suite 100
Salem, Oregon 97301-1279

RECEIVED

JAN 31 2011

DEPARTMENT OF STATE LANDS

Dear Ms. Solliday:

We have completed audit work of selected financial accounts at the Department of State Lands (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.

<u>SFMA Account</u>	<u>Description</u>	<u>Audit Amount</u>
<u>GAAP Fund 1113 – Special Revenue Fund</u>		
0240	Investments	\$910,335,613
0245	Investments Valuation Account	71,517,503
0929	Investments – noncurrent	44,915,925
0830	Net Increase/Decrease Fair Value of Investments	72,117,125
0350	Securities Lending Cash Collateral	49,759,494

1600	Obligations Under Securities Lending	49,759,494
1551	Deposit Liability without DF Support	185,014,636
0810	Income From Investments	47,279,582
1854	Transfer Out to Education	50,450,033

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.

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.

Material Weakness

Incorrect accounting for Unclaimed Property held in the Common School Fund

The Department of State Lands (department) is responsible for recording and tracking all unclaimed property in Oregon. Banks and other institutions report unclaimed property to the department where it is recorded and then reported online for claimants to review. Claimants submit their claims to the department who then verifies the validity of the claim and sends the property to the claimant.

In the past, the department had been accounting for all unclaimed property not yet claimed as a liability. Further research found the current accounting treatment was not reflective of governmental accounting standards. According to standards, the liability should represent the best estimate of the amount ultimately expected to be reclaimed and paid. For year-end reporting purposes, the department developed an estimate of the amount of the unclaimed property they expect to be reclaimed. As a result, the department adjusted the fiscal year end account balance of \$371 million down to \$185 million.

We recommend the department continue to estimate the amount of unclaimed property expected to be claimed and revisit and update the methodology as needed.

The material weakness, along with your response, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2010. 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 material weakness 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:

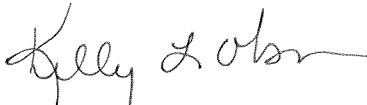
- 1) Your agreement or disagreement with the finding. If you do not agree with the audit finding or believe corrective action is not required, include in your response an explanation and specific reasons for your position.
- 2) The corrective action planned.
- 3) The anticipated completion date.
- 4) The name(s) of the contact person(s) responsible for corrective action.

Please respond by February 8th, 2011.

This communication is intended solely for the information and use of management, others within the organization, and State Land Board 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 Mary Doel or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION



Kelly L. Olson, CPA
Audit Manager

KLO:MED:nmj

cc: Cyndi Wickam, Assistant Director
Vena McCoy, Internal Auditor
Oregon State Land Board members
Kris Kautz, Acting Director, Department of Administrative Services



Oregon

John A. Kitzhaber, MD, Governor

Department of State Lands

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January 27, 2011

State Land Board

Gary Blackmer, Director
Secretary of State Audits Division
225 Capitol St NE
Salem OR 97310

John A. Kitzhaber, MD
Governor

Kate Brown
Secretary of State

Dear Mr. Blackmer:

This letter is in response to the Audit Findings and Recommendations directed to the Department of State Lands resulting from the recent audit of selected financial accounts for the year ended June 30, 2010.

Ted Wheeler
State Treasurer

Recommendation:

"We recommend the department continue to estimate the amount of unclaimed property expected to be claimed and revisit and update the methodology as needed."

Response:

The Department of State Lands generally agrees with the recommendation and developed an initial methodology to arrive at the adjusting entry made as a result of the audit. The Department will conduct further analysis to refine the methodology and make future adjusting entries on an annual basis as part of the year end closing process beginning with the current fiscal year ending June 30, 2011. The names of the contact persons responsible for the corrective action are Patrick Tate, Unclaimed Property Manager, and Cynthia Wickham, Assistant Director.

The Department of State Lands appreciates the opportunity to respond to and address the recommendation in the audit report. If we can be of further assistance, please contact Cynthia Wickham at (503) 986-5227 or me at (503) 986-5224.

Sincerely,

Louise Solliday
Director

- c. Vena McCoy, Internal Auditor
- Cynthia Wickham, Assistant Director