OFFICE OF THE
SECRETARY OF STATE
Bill Bradbury
Secretary of State

AUDITS DIVISION
Cathy Pollino
State Auditor

(503) 986-2255
FAX (503) 378-6767

Auditing for a Better Oregon

January 12, 2004

Elizabeth Harchenko, Director
Department of Revenue
955 Center Street NE, Room 457
Salem, Oregon 97301-2555

Dear Ms. Harchenko:

The statewide single audit that included selected financial accounts at the Department of Revenue for the year ended June 30, 2003, has been completed.

This statewide single audit work is not a comprehensive audit of your agency. Instead, this audit permits us to give an opinion on the statewide financial statements contained in the State of Oregon's Comprehensive Annual Financial Report and to report on internal control and the state's compliance with laws and regulations. Regular audits of the Department of Revenue will continue on a periodic basis.

The following Department of Revenue accounts and transactions were audited to determine their fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements:

SFMA Account	Description	Audit Amount
General Fund		
0065	Unreconciled Deposit	$95,924,008
0070	Cash on Deposit with Treasurer	32,868,424,268
0410	Taxes Receivable – Current	164,774,504
0411	Allowance for Uncollectible Taxes – Current	32,039,699
0420	Taxes Receivable – Noncurrent	435,447,981
0937	Allowance for Uncollectible Taxes – NC	34,137,850
0111	Personal Income Taxes	4,008,314,546
0115	Corporate Excise and Income Taxes	213,297,333
Health and Social Services Fund		
0121	Cigarette Taxes	$184,780,341

255 Capitol Street NE • Suite 500 • Salem, Oregon 97310
INTERNET: Audits.hotline@state.or.us • http://www.sos.state.or.us/audits/audithp.htm

1822	Transfer to State Police	32,590,217

Based on our audit, we identified one reportable condition and two other conditions in need of corrective action. Our findings and recommendations are presented in the enclosed Audit Findings and Recommendations Summary accompanying this letter.

The reportable condition, along with your response, will be included in our statewide audit report. Including your response with responses from other state agencies satisfies the federal requirement that management prepare a Corrective Action Plan (CAP) covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the response to the reportable finding 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.

The other two conditions are issues of lesser significance that we wanted to communicate to agency management. These conditions do not require a Corrective Action Plan. We will follow up on the Department of Revenue's progress in addressing these issues during the next fiscal year audit.

For the reportable condition, please respond by Monday, January 26, 2004.

Should you have any questions, feel free to contact Geoff Hill or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Nancy L. Young, CPA, CISA
Audit Administrator

NLY:brk
cc: Susan Browning, Deputy Director
Jack Ogami, Administrator, Information Processing Division

Tricia Baxter, Manager, Finance Section
Valerie Wicklund, Internal Auditor
Gary Weeks, Director, Department of Administrative Services

Audit Findings and Recommendations Summary
Department of Revenue Statewide Audit
State Fiscal Year 2003

REPORTABLE CONDITION

Controls over Cigarette Tax Program

The Oregon Department of Revenue (department) should improve its system of internal controls over the cigarette tax program. Internal controls are the processes designed to provide reasonable assurance regarding the achievement of objectives relating to the reliability of financial reporting, effectiveness and efficiency of operation, and compliance with applicable laws and regulations.

Our audit found that the department has significant weaknesses in its system of internal controls relating to the cigarette tax program. Specifically, the department has not:

- Appropriately segregated key duties relating to the maintenance and record keeping of cigarette tax stamps;
- Adequately limited physical access to the tax stamps;
- Maintained adequate documentation of inventory records and records of destroyed tax stamps;
- Developed sufficient policies and procedures to ensure compliance with Oregon Administrative Rules relating to bonding levels for purchasers of cigarette tax stamps;
- Ensured that cigarette tax order forms contain all of the necessary information; and
- Maintained supporting documentation for the sale of all cigarette tax stamps.

Without an adequate system of internal controls, department management is less able to meet its business objectives and is at a higher risk for inaccurate reporting (i.e. errors or theft could go undetected and uncorrected that materially impact the financial statements), as well as increase the risk of lost revenue for the state.

During the course of our audit, we provided department management with a detailed list of recommendations addressing the above weaknesses.

We recommend that department management further evaluate and revise its system of controls over the cigarette tax program as previously recommended. The department's controls should ensure, at a minimum, that tax stamps are physically secure; key duties are separated; documentation is completed and retained regarding tax stamp purchases and destruction; staff perform a periodic inventory of the cigarette tax stamps; and bonding requirements meet administrative rule requirements and are periodically validated.

OTHER CONDITIONS

Timeliness in Banking

By statute, state funds are required to be deposited within one business day of receipt although provisions exist to authorize exceptions for legitimate business reasons. The Department of Revenue has filed for an exemption from the one-day banking requirement stating that its business is seasonal and that during its busy season, 97 percent of dollars received are deposited within three business days.

During statewide audit 2001, we noted that Corporate Income and Excise Tax (Corp) cash receipts were not deposited in a timely manner. During statewide audit 2002, we found that Personal Income Tax (PIT) and Cigarette Tax Stamp receipts were not deposited in a timely manner. In the current year, we found that 13 percent of the dollars tested for PIT were not deposited timely, and 7.5 percent of the dollars tested for Corp were not deposited timely. This represents 10.5 percent and 12.5 percent of the transactions tested, respectively. During our testing, we also looked at an additional sample of PIT transactions received during the week of April 15. We noted that 52 percent of the dollars (approximately $5,800) and 60 percent of the transactions tested from that week were not deposited within the timeframe of department's exemption statement, of which 25 percent of the transactions sampled (approximately $1,800) were not deposited for at least seven business days. Through our understanding of the internal controls, it appears that the volume of checks received and the complex nature of processing tax returns may cause delays in depositing payments in a timely manner.

We recommend that DOR identify the points within its cash receipt processing that cause delays in depositing the cash receipts and update policies and procedures to address those problems. If revising the policies and procedures does not result in increased timeliness, the department may wish to consider revising its exemption letter to reflect more realistic timeframes for deposits.

Inappropriate STAN Access

The department utilizes the State Treasury ACH Network (STAN) to facilitate various tasks in the daily accounting functions and operations. The STAN network has various internal controls built into the system that help to ensure that transactions are accurate and appropriately reviewed and approved by management.

During our testing, we noted that two employees who regularly use the STAN network in their daily activities have been granted administrative rights to the network. Such access would allow the employees to circumvent or modify the existing internal controls built into the STAN network, including the necessity for management approval of transactions.

We recommend that the department redistribute the STAN administrative access rights to employees who do not utilize the STAN system on a regular basis for their daily assignments.