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Auditing for a Better Oregon

January 12, 2007

Elizabeth Harchenko, Director
Oregon Department of Revenue
955 Center St. NE
Salem, Oregon 97301

Dear Ms. Harchenko:

The statewide single audit that included selected financial accounts at the Department of Revenue (department) for the year ended June 30, 2006, has been completed.

This statewide single audit work is not a comprehensive audit of the department. 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 will continue on a periodic basis.

The following department 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
GAAP Fund 0001 – General Fund		
Compt Obj 0111	Personal Income Taxes	$ 5,442,458,057
Compt Obj 0115	Corporate Excise and Income Tax	427,151,146
Compt Obj 0121	Cigarette Taxes	41,616,493
GL Acct 0065	Unreconciled Deposit	348,944,928
GL Acct 0070	Cash On Deposit with Treasurer	48,413,334,699
GL Acct 0410	Taxes Receivable – Current	263,263,844
GL Acct 0411	Allowance for Uncollectible Taxes – Current	(27,045,753)
GL Acct 0420	Taxes Receivable – Noncurrent	474,666,337
GL Acct 0937	Allowance for Uncollectible Taxes – Noncurrent	(43,651,386)
GAAP Fund 1108 – Health and Social Services Fund		
Compt Obj 0121	Cigarette Taxes	$183,284,880
Compt Obj 1822	Transfers Out to Oregon State Police	38,478,240
GL Acct 0075	Cash on Deposit – Suspense Acct at Treasury	29,506,997

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Based on our audit, we identified one reportable condition and two other conditions needing 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 Single Audit Report for the year ended June 30, 2006. 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 conditions are issues of lesser significance that we wanted to communicate to department management. These conditions do not require a Corrective Action Plan. We will follow up on the department's progress in addressing these issues during the next fiscal year audit.

For the reportable condition, please respond by January 29, 2006.

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

Sincerely,
OREGON AUDITS DIVISION

V. Dale Bond, CPA, CISA, CFE
Audit Manager

VDB:bk
enclosure
cc: Susan Browning, Deputy Director
John Paul Jones, Finance Section Manager
Jason Robinson, Internal Auditor
Lindsay Ball, Director, Department of Administrative Services

Audit Findings and Recommendations Summary
Department of Revenue Statewide Audit
State Fiscal Year 2006

REPORTABLE CONDITION

Timeliness of Cash and Other Reconciliations

During state fiscal year 2006, the Department of Revenue (department) received, processed, and deposited over $6 billion in revenues from various tax programs. To facilitate more efficient accounting, the department has set up specific cash accounts for most tax programs. Much of the cash received is processed through the Revenue Suspense Account before being transferred to the General Fund or other funds as appropriate.

According to the Oregon Accounting Manual (OAM), state agencies should regularly reconcile cash balances in the State Financial Management Application (SFMA) to the balances maintained by the Oregon State Treasury (Treasury). Cash reconciliations are an important internal control that provides assurance that account balances are accurate and agree to the actual assets in the custody of the state. Similarly, when agencies use subsidiary accounting systems in addition to SFMA, the OAM requires that the agencies reconcile the subsidiary system to SFMA to ensure all financial data is recorded in SFMA. During the audit, we found that at the end of September 2006, the department had not reconciled the Revenue Suspense account to Treasury balances since January 2006. Additionally, we found that 67 of 127 cash reconciliations reviewed (53 percent) were not prepared timely. Also, the subsidiary accounting system, ITA, was not reconciled to SFMA at any time during state fiscal year 2006, and reconciliations for only seven of the twelve months were completed by mid-October 2006. As a result of the untimely reconciliations, we noted one instance where the department collected approximately $25 million in December 2005, but did not transfer those funds to the state's general fund until June 2006, creating the possibility of funding shortfalls for other programs.

We recommend department management ensure that the necessary reconciliations are prepared and reviewed in a timely manner to provide assurance that cash balances and financial records are complete and accurate and to ensure that funds collected are provided to other state programs in a timely manner.

OTHER CONDITIONS

Taxes Receivable Calculations

Each year, as part of the state's annual financial reporting, the Department of Revenue (department) prepares estimates of the taxes receivable for each tax program as of June 30 to ensure financial reporting is in accordance with generally accepted accounting principles. The estimates involve many separate calculations and are based upon several sources of data, including historical trends, delinquent tax payments, estimated refunds payable, and other information contained in the department's subsidiary accounting application, ITA.

In reviewing the calculations and estimates made for state fiscal year 2006, we noted numerous errors. In some cases, department staff:

- did not properly reverse the previous year's estimates, causing current year balances to be overstated;

- used amounts in the calculations that did not agree to ITA and other source documentation; and
- used incorrect formulas to calculate the estimates.

As a result, the taxes receivable accounts were materially misstated and required significant audit adjustments before the balances reported were in accordance with generally accepted accounting principles.

We recommend department management ensure that the calculations for the taxes receivable estimates are adequately reviewed to ensure that prior year estimates are reversed as appropriate; amounts used in the calculations agree to the source documentation and are adequately supported; and formulas used in preparing the estimates are appropriate.

Accounting Treatment of Corporate Kicker Refund

Following the end of the 2003-2005 biennium, the State of Oregon issued a refund of Corporate Excise and Income Taxes, commonly referred to as the "kicker," in accordance with Oregon Revised Statutes. The determination of whether a kicker is warranted and the amounts to be refunded are based on information provided by the Department of Revenue (department), as well as the Department of Administrative Services. In conducting the audit, we did not review the calculation of the kicker refund and relied on the Department of Administrative Services' estimate. We did, however, note significant errors in the financial reporting for the refund.

Under Oregon Revised Statute 291.349, the corporate kicker is returned to the taxpayers in the form of a tax credit on their next tax return. Because the refund is based upon past tax information applied towards future years, there is the possibility that the final amount of the refund actually paid will differ from the initial estimate and need to be adjusted accordingly. Such was the case this year. However, department staff did not monitor changes in the estimate and adjust the $101 million recorded in state fiscal year 2005 to the most recent estimate of $134 million. Additionally, because the total amount of the kicker refund had not been credited towards taxpayers' tax liabilities as of June 30, 2006, the accounts/refunds payable account was understated by approximately $121 million. Although adjustments were later made to bring the account balances in accordance with generally accepted accounting principles, the balances for Corporate Excise and Income Taxes and Accounts Payable accounts were both materially misstated as of June 30, 2006.

We recommend the department monitor the 2003-2005 corporate kicker refund, as well as any future kicker refunds, to ensure that related accounting events and transactions are recorded and reported in accordance with generally accepted accounting principles.