Office of the Secretary of State

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March 3, 2008

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

Dear Ms. Harchenko:

We have completed the statewide single audit that included selected financial accounts at the Oregon Department of Revenue (department) for the year ended June 30, 2007.

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, 2007, 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 and transactions 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
General Fund		
0065	Unreconciled Deposit	$ 129,128,711
0070	Cash on Deposit With Treasurer	54,754,885,961
0410	Taxes Receivable – Current	279,044,719
0411	Allowance for Uncollectible Taxes – Current	(36,357,502)
0420	Taxes Receivable – Noncurrent	445,134,719

SFMA Account	Description	Audit Amount
General Fund (continued)		
0937	Allowance for Uncollectible Taxes – Noncurrent	$ (49,353,402)
1215	Accounts Payable	(1,146,148,315)
0111	Personal Income Taxes	(4,519,182,508)
0115	Corporate Excise and Income Taxes	(518,276,305)
0121	Cigarette Taxes	(45,435,287)
Business Development Fund		
0075	Cash on Deposit – Suspense Acct at Treasury	(131,698)
Health And Social Services Fund		
0075	Cash on Deposit – Suspense Acct at Treasury	31,147,963
0121	Cigarette Taxes	(199,860,959)
Government-Wide Reporting Fund		
0410	Taxes Receivable – Current	88,515,846
0420	Taxes Receivable – Noncurrent	(88,515,846)

Our consideration of internal control was for the limited purpose described in the preceding paragraphs 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:

Taxes Receivable – Year End Financial Reporting

Guidance in the *Oregon Accounting Manual* for the year end closing process indicates that accounting estimates used for accruals should be fundamentally sound, sufficiently documented, able to be audited, and conform with generally accepted accounting principles. The quality of the state's Comprehensive Annual Financial Report depends on the accuracy and completeness of year end closing activities, including the preparation of accruals. Agency management is responsible for ensuring the accuracy and completeness of the information that supports its year end adjustments.

Furthermore, governmental accounting standards require assets from income tax revenue transactions to be recognized in the period when the taxpayer earned the income. This indicates that, at fiscal year end, the accrual for taxes receivable would include an estimate of future collections of taxes due that may not yet be identified by the department.

For 2007, the department's accrual for taxes receivable equated to the sum of outstanding taxpayer liabilities identified by the department plus a portion of the receipts the department recorded in July following the fiscal year end. The department's accrual methodology could be improved by including steps to estimate collections of taxes due that might not be identified by the department at fiscal year end, but the department could reasonably estimate, such as amounts from future tax audits. The department could further improve its methodology by comparing prior accruals with subsequent collections and using the results to evaluate its methodology. The comparison could also provide the department with assurance about the reliability of its estimate.

We recommend department management reconsider its methodology for accruing taxes receivable at fiscal year end and consider whether modifications are indicated. In addition, management should implement a procedure to compare prior accruals with subsequent collections and use the results to assess the reliability of the accrual and to make further modifications to the methodology as needed.

The significant deficiency, along with your response, will be included in our Statewide Single Audit Report For the Fiscal Year Ended June 30, 2007. Including your response 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 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 March 7, 2008.

This communication is intended solely for the information and use of management and others within the department and is not intended to be and should not be used by anyone other than the specified parties.

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

Sincerely,
OREGON AUDITS DIVISION

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

VDB:brk
cc: Karen Gregory, Deputy Director
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Kris Kautz, Interim Director, Department of Administrative Services