Office of the Secretary of State

Kate Brown
Secretary of State

Barry Pack
Deputy Secretary of State

Audits Division

Charles A. Hibner, CPA
Director

255 Capitol St. NE, Suite 500
Salem, OR 97310

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

February 10, 2009

Elizabeth Harchenko, Director
Department of Revenue
955 Center St. NE
Salem, OR 97301-2555

Dear Ms. Harchenko:

We have completed audit work of selected financial accounts at the Department of Revenue (department) for the year ended June 30, 2008.

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.

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 (0001)		
0111	Personal Income Taxes	$(6,066,571,070)
0115	Corporate Excise and Income Taxes	(447,728,926)
0121	Cigarette Taxes	(41,001,088)
0410	Taxes Receivable – Current	297,132,820
0411	Allowance for Uncollectible Taxes – Current	(39,281,815)
0420	Taxes Receivable – Noncurrent	486,291,505
0937	Allowance for Uncollectible Taxes – Noncurrent	(49,677,143)
1603	Deferred Revenue	(436,614,362)

SFMA Account	Description	Audit Amount
Health and Social Services Fund (1108)		
0075	Cash on Deposit – Suspense Acct at Treasury	20,924,639
0121	Cigarette Taxes	(180,984,653)
1819	Transfer to Military	39,567,717
Government Wide Reporting Fund (8500)		
0410	Taxes Receivable – Current	116,995,953
0420	Taxes Receivable – Noncurrent	(116,995,953)

In planning and performing our audit of the selected financial accounts at the department as of and for the year ended June 30, 2008, 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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 and another deficiency that we consider to be a material weakness.

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:

Timeliness of Cash Reconciliations

During state fiscal year 2008, the 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 these tax programs. Much of the cash received is processed through the Revenue Suspense Account at the Oregon State Treasury before being transferred to the general fund or other funds, as appropriate. State policy recommends agencies reconcile cash accounts on a regular basis and, if an agency uses a subsidiary accounting system, reconcile the subsidiary system to the state accounting system. 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.

The department's typical process is, on a monthly basis, to reconcile cash accounts in its subsidiary system to related accounts at the Oregon State Treasury and then reconcile the department's subsidiary system to the state accounting system. During the audit, however, we found that the department did not routinely reconcile its subsidiary system's cash accounts to the state accounting system. Instead, the department prepared one reconciliation in April 2008 to cover the eight months from July 2007 through February 2008. Furthermore, the department did not prepare the June 2008 reconciliation until October 2008. In bypassing the control of a monthly reconciliation, the department was not in compliance with state policy and had less assurance that errors would be detected and corrected in a timely manner.

We recommend department management comply with state policy and ensure the cash accounts in its subsidiary system are routinely reconciled to the state accounting system.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiency constitutes a material weakness:

Taxes Receivable – Year End Financial Reporting

State policy for year-end closing processes 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.

Each year, as part of its annual financial reporting process, the department prepares estimates as of June 30 of the taxes receivable accrual for tax programs under its purview. The estimates involve many separate calculations and are based on several sources of data, including historical trends, uncollectible taxes, estimated refunds payable, and other information contained in the department's subsidiary accounting system.

In reviewing the estimates prepared for state fiscal year 2008, we found multiple errors and methodology issues in the department's calculations, such as double counting and incorrect and omitted amounts. As a result of these errors, the taxes receivable amount for the government-wide financial statements was misstated by approximately $32 million and required an audit adjustment to be fairly stated in accordance with generally accepted accounting principles.

We recommend department management ensure the year-end calculations of the taxes receivable estimate are adequately reviewed to ensure errors are identified and corrected in a timely manner. Furthermore, the methodology used to calculate the estimate should be reviewed annually to ensure all relevant information is included.

<u>Prior Audit Finding</u>

In the prior fiscal year, we reported a significant deficiency to the department in a letter dated March 3, 2008, related to the department's year end financial reporting for taxes receivable. This finding can also be found in the Statewide Single Audit Report for the fiscal year ended June 30, 2007; see Secretary of State Audit Report number 2008-03, finding number 07-14. During the current fiscal year, the department made progress in correcting this finding. This finding will be reported in the Statewide Single Audit Report for the fiscal year ended June 30, 2008, with a status of partial corrective action taken.

The significant deficiency and material weakness, along with your responses, will be included in our Statewide Single Audit Report For the Fiscal Year Ended June 30, 2008. Including your responses satisfies the federal requirement that management prepare a <u>Corrective Action Plan</u> (CAP) covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the response to each significant deficiency and material weakness includes the information specified by the federal requirement, and only if the responses are 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 an 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 20, 2009.

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.

Should you have any questions, please contact Michelle Rock 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
Larry Hinton, ASD Administrator
Ken Ross, Finance Section Manager
Jason Robinson, Internal Auditor
Scott Harra, Director, Department of Administrative Services