

Office of the Secretary of State

Kate Brown
Secretary of State

Robert Taylor
Deputy Secretary of State



Audits Division

Gary Blackmer
Director

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

(503) 986-2255

January 21, 2015

James Bucholz, Director
Oregon Department of Revenue
955 Center Street NE
Salem, Oregon 97301-2555

Dear Mr. Bucholz:

We have completed audit work of selected financial accounts at your department for the year ended June 30, 2014. This audit work was not a comprehensive financial audit of the department, but was performed as part of our annual audit of the State of Oregon's financial statements. We audited accounts that we determined to be material to the State of Oregon's financial statements.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements of the State of Oregon as of and for the year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, we considered the department's internal control over financial reporting as a basis for designing auditing procedures that are appropriate in the circumstances 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.

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 a combination of deficiencies, in internal control, 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. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any

deficiencies in internal control that we consider to be material weaknesses. We did identify the following deficiencies in internal control that we consider to be significant deficiencies.

Significant Deficiencies

Perform Cash Reconciliations on a Regular and Timely Basis

During fiscal year 2014, the department received, processed and deposited over \$7 billion in revenues from various tax programs. To facilitate efficient accounting, the department 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 that departments reconcile cash accounts on a regular basis. Cash reconciliations are an important internal control to provide assurance that cash received by the Treasury agrees to amounts recorded by the department.

The department's usual process is to perform monthly reconciliations between cash accounts in its subsidiary accounting system and related accounts at the Oregon State Treasury and the state accounting system. During the audit, we found the department completed monthly reconciliations of its subsidiary accounting system to the Revenue Suspense Account at the Oregon State Treasury for July 2013 through September 2013, but did not complete the reconciliations for October 2013 through June 2014. Department management reported staffing shortages and other priorities contributed to reconciliations not being completed. By not performing the monthly reconciliations, the department has less assurance errors will be detected and corrected in a timely manner.

We recommend department management ensure cash accounts in its subsidiary accounting system are consistently reconciled to Oregon State Treasury accounts.

Perform Management Review of Taxes Receivables Accruals

Department management must ensure proper accounting and reporting of receivables for the statewide annual financial statements. For this purpose, state agencies are to estimate and accrue receivables that are expected to be collected within 90 days of fiscal year end. Department management is responsible for ensuring the accuracy and completeness of the information that supports its year end accruals.

Each year, as part of its annual financial reporting process, the department prepares estimates of the taxes receivable accrual for department administered tax programs. These estimates involve many separate calculations and are based on several sources of data, including historical trends, uncollectible taxes, refunds payable, and other information contained in the department's subsidiary accounting system. Typically, these estimates are calculated by a Revenue Accountant and reviewed by a more senior Revenue Accountant or the Budget and Finance Manager. Because the calculations are fairly complex and interdependent, it is especially important a review is done to ensure the accruals are accurate. For fiscal year 2014, this review was not completed due to staffing shortages and other priorities.

In reviewing the taxes receivable estimates prepared for fiscal year 2014, we found multiple errors in the department's calculation, such as incorrectly calculated percentages and omitted amounts. Although the errors were not material to this year's financial statements, they impacted all five of the audited Taxes Receivable accounts.

We recommend department management perform effective and timely reviews of the taxes receivable estimates to ensure accrual calculations are accurate.

Other Issue

During the course of our audit, we became aware of the matter below that is considered an opportunity for improving operating efficiency. This matter does not require a written response from management.

Improve Accounting for Senior and Disabled Citizens' Property Tax Deferral Program

The Senior and Disabled Citizens' Property Tax Deferral Program allows participating individuals to borrow funds from the department to pay their property taxes. The department distributes these funds to the appropriate county to pay the property tax, and establishes a loan balance for the amount owed by the individual. Occasionally, the loan balances are reduced for reasons other than routine repayments made by the individuals or write offs due to uncollectibility. For example, a loan balance is reduced when a county returns an overpayment of an individual's property tax to the department.

The department currently accounts for these other reductions as allowances for uncollectible accounts instead of decreasing the *Distributions to Counties* account. Additionally, these returned payments are applied to an individual's loan interest balance first and then to principal, when the entire returned amount should be applied to principal. Applying the returned payment incorrectly results in overstated loan balances for these individuals.

We recommend the department review its accounting for the Senior and Disabled Citizens' Property Tax Deferral Program to ensure payments returned from the counties are recorded to the correct accounts and properly applied to participating individuals' loan balances.

The above significant deficiencies, along with your response for each finding, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2014. Please prepare a response to each finding and include the following information as part of your corrective action plan:

- 1) Your agreement or disagreement with the findings. If you do not agree with the audit findings 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 4, 2015.

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The purpose of this letter is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the department's internal control. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control. Accordingly, this letter is not suitable for any other purpose.

We appreciate your staff's assistance and cooperation during this audit. Should you have any questions, please contact Diane Farris or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

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

VDB:dbf

cc: Kristine Kautz, Deputy Director
Terrence Woods, CIO/Administrator, ASD
Jan Hunt, Budget and Finance Manager
Steve Bergmann, Internal Auditor
Michael J. Jordan, Director, Department of Administrative Services