**Office of the Secretary of State**

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**Audits Division**

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503-986-2255

February 8, 2021

Betsy Imholt, Director
Oregon Department of Revenue
955 Center Street NE
Salem, Oregon 97301-2555

Dear Ms. Imholt:

We have completed audit work of selected financial accounts at your department for the year ended June 30, 2020. 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, 2020, 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.

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 and therefore, material weaknesses may exist that have not been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

## Material Weaknesses

### *Consider historic percentages in accruals when methodology requires adjustments*

As part of the state's financial reporting process, state agencies are responsible for making year-end entries in the accounting system to facilitate financial reporting. The Department of Revenue (department) uses an accrual process designed to identify outstanding tax debt as of June 30, and using historical data determines how much of the outstanding debt should be classified as current or noncurrent.

The extension of the tax return due date from April 15 to July 15 necessitated a departure from the department's existing accrual process. We identified the following issues with the department's year-end accrual:

- The accrual process begins with known receivables at June 30 and taxes collected after June 30. The department obtains a report of net taxes collected after June 30 and reduces it by a historical percentage to estimate the portion related to taxes receivables known at June 30. Due to the extension of the tax date to July 15, the historical percentage was not accurate. As a result, the department included approximately $160 million in taxes receivable that had already been recorded, requiring adjustments to personal income tax, corporate excise and income tax, and inheritance tax revenue accounts.

- For taxes receivable known at June 30, the department estimates the portion of current taxes expected to be collected within 90 days after June 30 using historical percentages. Due to the extension of the tax return due date to July 15, the historical percentage was not accurate. Looking at actual receipts collected, the department understated current taxes receivable by approximately $75 million, resulting in adjustments to personal income tax and corporate excise and income tax revenue accounts.

**We recommend** department management consider all historical percentages used in its taxes receivable accrual methodology when unusual changes occur, such as extensions to tax return due dates, to ensure its estimate is reasonable and more accurate.

### *Improve review of entries when implementing new accounting standards*

Department of Revenue (department) management was responsible for implementing Governmental Accounting Standards Board (GASB) pronouncement 84, accounting for fiduciary activities, in fiscal year 2020. This required reclassification of certain fiduciary assets and liabilities into a new reporting framework.

The department reviewed various taxes it collects on behalf of other governments and state agencies and correctly determined which taxes should be reported as a fiduciary activity in accordance with GASB Statement 84. The department's subsidiary system (Gentax) accurately reflected that revenues and expenses for fiduciary activities should be about $431 million at June 30, 2020. The department, however, incorrectly recorded fiduciary activity in the accounting system, resulting in reporting over $4 billion in fiduciary revenues and expenses at year-end. This was partially due to the department incorrectly including activity for fiscal years 2018 and 2019 as part of its year-end adjusting accounting entry and incorrectly recording activity for taxes determined not to be a fiduciary activity.

The department did not correctly implement the accounting standard due to turnover in the accounting manager position, insufficient accounting entry support, and lack of review in year-end tax program balances.

**We recommend** department management perform sufficient review to ensure journal entries are accurate, supported, and agree with department decisions when implementing new accounting standards.

### *Perform key reconciliations on a timely basis*

The Department of Revenue (department) is estimated to collect $19. 5 billion in personal income and corporate excise and income taxes in the 2019-2021 biennium. The department records the receipt of cash and related revenue in its subsidiary system (Gentax). The department does not record the revenue and related cash in the state's accounting system (SFMS) until it is transferred from treasury cash accounts to the General Fund or other funds, as appropriate. When the monies are transferred the department makes manual entries in SFMS to record the cash and revenue. In most years, these transfers happen monthly. However, starting in April 2020 the department did not make the monthly transfers of personal income and corporate tax funds to the General Fund. This decision was made to ensure adequate cash was available to the department for potential refunds as a result of the State's $1. 6 billion tax surplus credit and the extension of the tax return due date to July 15. At June 30, the department had not transferred over $2. 8 billion.

State policy recommends departments perform monthly reconciliations of treasury cash accounts and requires suspense account ending balances be entered in the state accounting system by June 30. Timely cash reconciliations are an important internal control to identify and address errors or other problems that may have occurred; all the more important when manual entries and large balances are involved.

The department's process is to monthly reconcile cash in Gentax with the Treasury cash balance. The department also reconciles revenue balances between Gentax and SFMS. However, there is no reconciliation of the cash in SFMS to Treasury. Without this reconciliation, there is the potential that an error in the accounting system would not be detected.

We reviewed the reconciliations prepared by the department and identified the following issues:

- The June 2020 Gentax to Treasury reconciliation had an unidentified difference of over $2. 3 million. The department identified that an error in its scanning system interface to Gentax was the cause of the majority of this difference starting in March. There is the potential for error related to multiple tax programs recorded in Gentax and SFMS.
- Additionally, the June reconciliation contained over 200 unreconciled differences, with some dating to December 2018. Failure to timely correct identified reconciling items results in ongoing errors in the department's records.
- The Gentax to Treasury cash reconciliations were generally completed one to two months late. The department completed the April-June reconciliations after the close of the fiscal year. The July 2019 Gentax to SFMS reconciliation was not completed until January 2020. The department completed all Gentax to SFMS monthly reconciliations by August 2020 but only the June reconciliation was reviewed. Late reconciliations, an outstanding audit finding since 2014, can result in material errors not being detected timely and make it more difficult to identify and resolve reconciling items.

According to management, numerous technical issues with Gentax contributed to the carryover of unresolved differences, making each reconciliation more labor intensive, thus creating delays in performance and review. Continual change in accounting staff and management also caused delays in the performance and review of reconciliations.

**We recommend** department management design and implement a cash reconciliation between Treasury and the state accounting system (SFMS). We also recommend department management ensure revenue subsidiary account reconciliations are performed and reviewed consistently and timely.

The above material weaknesses, along with your response for each finding, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2020. 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 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 provide a response to Kelly Olson by February 18, 2021 and provide Rob Hamilton, Statewide Accounting and Reporting Services (SARS) Manager, a copy of your Corrective Action Plan.

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 Kelly Olson, Audit Manager or Janet Lowrey, Senior Auditor at (503) 986-2255.

Sincerely,

Office of the Secretary of State, Audits Division

cc: Satish Upadhyay, Deputy Director
Ralph Amador, Chief Financial Officer
Marie Trucco, Chief Audit Executive
Katy Coba, Director, Department of Administrative Services
Robert Hamilton, SARS Manager, Department of Administrative Services