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STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

REVIEW REPORT

OF

DEPARTMENT OF REVENUE

STATE OF INDIANA

July 1, 2005 to June 30, 2007

FILED
02/29/2008

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AGENCY OFFICIALS

Office	Official	Term
Commissioner	John Eckart	02-22-05 to 01-11-09

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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF THE DEPARTMENT OF REVENUE

We have reviewed the receipts, disbursements, and assets of the Department of Revenue for the period of July 1, 2005 to June 30, 2007. Department of Revenue's management is responsible for the receipts, disbursements, and assets.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the receipts, disbursements, and assets. Accordingly, we do not express such an opinion.

Financial transactions of this office are included in the scope of our audits of the State of Indiana as reflected in the Indiana Comprehensive Annual Financial Reports.

Based on our review, nothing came to our attention that caused us to believe that the receipts, disbursements, and assets of the Department of Revenue are not in all material respects in conformity with the criteria set forth in the Accounting and Uniform Compliance Guidelines Manual for State Agencies, and applicable laws and regulations except as stated in the review comments.

STATE BOARD OF ACCOUNTS

October 23, 2007

INTERNAL CONTROLS OVER OVERSIZE/OVERWEIGHT FEES

Indiana roads and highways were constructed to accommodate certain vehicles. Whenever a vehicle exceeds the legal size or weight established by law, an Oversize/Overweight (OS/OW) permit is required. Permit fees are collected by the Department of Revenue and deposited into a holding fund/center, transferred to the Oversize/Overweight fund/center after an account reconciliation, and later distributed to the Department of Transportation to finance various state and local road improvement and maintenance projects. The Motor Carrier Services Division of the Department of Revenue began collecting a portion of the OS/OW permit fees through the One Stop Shop (OSS) system in December 2006.

From our testing of OS/OW fees, we found that the Motor Carrier Services Division had not transferred from the holding fund/center to the OS/OW fund/center any of the OS/OW fees collected through the OSS system during our review period. Transfers were not made due to reconciliation issues and system errors. Subsequent to our review period, on October 18, 2007, the Department of Revenue transferred $4,562,754.95 to the OS/OW fund/center for all OS/OW fees processed through the OSS system from implementation in December 2006 through October 18, 2007.

A lack of adequate internal controls over reconciliations and timely transfers of OS/OW fees processed through the OSS system could impact the state's ability to fund various highway projects.

Each agency, department, quasi, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, safeguarding controls over cash and all other assets, and forms processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 1)

INTERNAL CONTROLS OVER IFTA FEES

The International Fuel Tax Agreement (IFTA) is an agreement between various taxing jurisdictions for intrastate and interstate commercial vehicles traveling within and across state lines. IFTA fees are based on the number of miles traveled in each state as well as the amount of fuel purchased and consumed. Monthly, each state distributes to the other states the amount of the fees they collected on behalf of the other states. The Department of Revenue receives IFTA fees from other states for commercial vehicles registered in other states that traveled through Indiana and sometimes for commercial vehicles registered in Indiana that traveled through other states. These fees are deposited into an IFTA holding fund/center and later transferred to a number of the Department of Transportation fund/centers used to finance various state and local road improvement and maintenance projects.

During our review period, the Department of Revenue discovered they had overdrawn the IFTA holding fund/center by making duplicate transfers from the holding fund/center into the Department of Transportation's fund/centers. Duplicate transfers were made from January 1, 2004 through June 28, 2006, for fees received from other states for vehicles registered in other states as well as vehicles registered in Indiana. To correct the shortage in the IFTA holding fund/center, on May 29, 2007, the Department of Revenue made two adjustments to the Department of Transportation's fund/centers totaling $17,028,140.32 to restore the correct balance in the IFTA holding fund/center.

A lack of adequate internal controls over receipt of IFTA fees received from other states could impact the state's ability to fund various highway projects.

Controls over the receipting, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements and incorrect decision Chapter 3)

Each agency, department, quasi, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, safeguarding controls over cash and all other assets, and forms processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 1)

DISTRICT OFFICE FINANCIAL REPORTING

The Department of Revenue has district offices located throughout the state that collect tax revenue. Each district office deposits daily collections at an approved local depository in a Treasurer of State bank account. The district offices have been instructed to submit by fax or email a report of their financial activity to the Finance Division daily. The Finance Division needs these reports to prepare a Report of Collection to appropriately classify the revenue to the Treasurer of State and Auditor of State. The Department of Revenue's Audit Section is responsible for monitoring the district offices.

During our review of district office reporting, we determined that not all district offices submitted a financial activity report to the Finance Division the morning following a day's business and that the Finance Division did not notify the Audit Section about days not being reported by the district offices. The Finance Division would assume that, if no financial activity was reported by a district office, the district office had no transactions that day. The Finance Division would rely on the Treasurer of State's reconcilements to detect unaccounted for deposits or inaccurately reported financial activity before contacting the district offices directly. We found district office deposits that had not been appropriately classified for up to six months after the date of activity.

For proper accountability of revenue, the Finance Division should notify the Audit Section of district office noncompliance with reporting procedures and the Audit Section should take appropriate action to ensure district office compliance.

Controls over the receipting, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements and incorrect decision making. Basic procedures required for all agencies should include: . . . 8. Collections and accountable items be reconciled to the bank statements and/or Auditor of State records (Accounting and Uniform Compliances Guidelines Manual for State and Quasi Agencies, Chapter 3)

An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 1)

PERSONAL USE OF STATE OWNED VEHICLES

According to state travel rules, an employee's assigned station is the location of his/her permanent office. Employees may use state-owned vehicles for travel from the office to another work-related destination. For agencies with a commuting use policy, employees who are permanently assigned a state vehicle must pay for commuting miles when driving the vehicle from their home to the office. If an employee qualifies for a remote work station, an agency head may submit notification to the Auditor of State (AOS) with copies to the Department of Administration (DOA) and the State Personnel Department (SPD) annually. Employees who meet the criteria for remote work stations designate their homes as their station and would not be required to pay for commuting miles when driving permanently assigned vehicles from their homes to the office.

During our review of state-owned vehicles, we found that 12 of the Department of Revenue's state-owned vehicles were permanently assigned to investigative personnel. We were told that the station of these employees was their homes. The Department of Revenue could not provide documentation that the agency head determined these employees met the criteria for a remote work station and submitted proper notification to AOS, DOA, and SPD. Should it be determined that these employees do not qualify for a remote location, then the employees must pay for commuting miles when driving state-owned vehicles from their homes to the office.

Financial Management Circular: 2003-1, Section 8-2, states that: "An Agency Head may wish to designate the work station of an employee to be a place other than the central office or a branch office of the Agency. A State Traveler can qualify for a remote work station under the following conditions: A) If an employee spends less than fifty percent of the time, over a period of at least ninety (90) days, within thirty (30) miles of an office of the Agency; B) If the Agency Head explains in writing how the designation maximizes efficiency and economy for the State; and C) If the determination is made at least once per fiscal year and submitted to the Auditor of State with copies to the Department [of Administration] and the State Personnel Department."

The Internal Revenue Service has established that commuting use is taxable income to the employee using state-owned vehicles for nonbusiness or commuting purposes and requires payroll tax withholding and compensation reporting (W-2). The value of each one way commuting use of the state provided vehicle is $1.50. Employees are required to maintain records and report on the number of one way (or round trip) commutes between the employee's home and place of work for each payroll period. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 11)

Each agency that owns their own vehicle has the responsibility to establish internal policies on recording and reporting the use of state vehicles. In establishing those policies, agencies should keep in mind their responsibility to ensure the vehicles are used for state business and that commuting or other personal use is reported for tax purposes. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 11)

FIXED ASSET INVENTORY

The Department of Revenue has not conducted a complete annual physical inventory of fixed assets owned for eight years.

Once a year a physical inventory is to be taken and compared to the master listing and the agency's listing of assets from their asset control system. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 10)

WITHHOLDING RECONCILIATION

As stated in the prior reports (most recently B26849 and B24294), the Department of Revenue's internal controls over the reconciliation of income tax withholding did not guarantee that adequate compliance was being maintained. Controls are still not adequate and may allow discrepancies to go undetected.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State and Quasi Agencies, Chapter 1)

DAILY DEPOSITS

As stated in prior reports (most recently B26849 and B24294), the Department of Revenue did not consistently deposit receipts collected for most tax remittance types within the following business day.

Indiana Code 5-13-6-1(b) states in part: ". . . all public funds . . . shall be deposited with the treasurer of state, or an approved depository selected by the treasurer of state not later than the business day following the receipt of the funds."

DEPARTMENT OF REVENUE
EXIT CONFERENCE

The contents of this report were discussed on November 26, 2007, with John Eckart, Commissioner; Darrel Anderson, Controller; and Don Atteberry, Deputy Controller. The official response has been made a part of this report and may be found on pages 9 and 10.

STATE OF INDIANA

DEPARTMENT OF REVENUE
OFFICE OF THE COMMISSIONER

Indiana Government Center North
100 North Senate Avenue, Room N248
Indianapolis, Indiana 46204-2253

January 18, 2008

Mr. Bruce Hartman, State Examiner
State Board of Accounts
Indiana Government Center South
302 W. Washington Street, E418
Indianapolis, IN 46204

Dear Mr. Hartman:

Please find attached the Indiana Department of Revenue's official response to the 2007 Audit by the State Board of Accounts. If I can be of further assistance, please contact me at your convenience.

Sincerely,

John Eckart

John Eckart
Commissioner
Indiana Department of Revenue
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Enclosure

INTERNAL CONTROLS OVER OVERSIZE/OVERWEIGHT FEES

As stated in the Comment, the Department is now processing OS/OW transfers on a timely and consistent basis. Internal control procedures are in place to ensure completion of reconciliations and continued timely transfer of fund.

INTERNAL CONTROLS OVER IFTA FEES

As stated in the Comment, this was resolved on May 29, 2007. The Department made the initial discovery of the problem, notified SBOA, and implemented the necessary corrections. Additional supervisory oversight has been added to ensure procedures are properly followed going forward.

DISTRICT OFFICE FINANCIAL REPORTING

District Offices are now sending in daily reports. Furthermore, a month-end e-mail report is sent to ensure that daily reports are not missed.

PERSONAL USE OF STATE OWNED VEHICLES

The Department is currently updating our written policy for vehicle use. Department wide compliance will be addressed.

FIXED ASSET INVENTORY

The Department has completed an electronic inventory at least annually for items that are connected to the network. We will review current procedures and make the necessary changes to ensure a more complete inventory.

WITHHOLDING RECONCILIATION

The Department continues to review withholding accounts for validity. Statistical samplings of employers who file magnetic media are being conducted. Efforts to improve the PC-based program for downloading magnetic media are currently under development. Returns identified by the system are examined; employer identification numbers are checked for validity and withholding registration. Meanwhile, the Returns Processing System automatically verifies monthly withholding remittance to the annual withholding reconciliation return. If a discrepancy exists, the account is flagged for review.

The Department continues to encourage electronic filing and pursue legislation in that direction. The Department also plans to pursue the acquisition of equipment needed to image paper returns and seeks the implementation of a data warehouse. These efforts are essential to improvement of our tax data crosscheck activities.

DAILY DEPOSITS

Each year the Returns Processing Center strives to deposit funds within 24 hours of receipt. During the peak period in April alone, the Department receives approximately one million (1,000,000) returns. At such a time, it is financially impossible to meet the 24-hour requirement. The cost of the personnel required to meet the requirement would be prohibitive. Nevertheless, the Department will continue to use as many resources as operationally feasible in an effort to ensure 100% of funds are deposited by the next business day. Again, legislation mandating electronic filing would greatly facilitate achievement of this goal.