

DEPARTMENT OF REVENUE
STATE OF LOUISIANA



FINANCIAL AUDIT SERVICES
MANAGEMENT LETTER
ISSUED NOVEMBER 26, 2014

**LOUISIANA LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397**

LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

**FIRST ASSISTANT LEGISLATIVE AUDITOR
AND STATE AUDIT SERVICES**
PAUL E. PENDAS, CPA

DIRECTOR OF FINANCIAL AUDIT
THOMAS H. COLE, CPA

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

November 26, 2014

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Charles E. "Chuck" Kleckley,
Speaker of the House of Representatives
Mr. Tim Barfield, Secretary
Louisiana Department of Revenue

Dear Senator Alario, Representative Kleckley, and Mr. Barfield:

This report includes the results of the procedures we performed at the Louisiana Department of Revenue (LDR) for the period from July 1, 2013 through June 30, 2014, to evaluate its accountability over public funds. The procedures are a part of our audit of the State of Louisiana's financial statements and the Single Audit of the State of Louisiana for the year ended June 30, 2014. I hope the information in this report will assist you in your legislative and operational decision-making processes.

We would like to express our appreciation to the management and staff of LDR for their assistance during our work.

Sincerely,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

BDM:EMS:BQD:THC:aa

LDR 2014

Louisiana Legislative Auditor

Daryl G. Purpera, CPA, CFE

Department of Revenue

November 2014



Audit Control # 80140042

Introduction

As a part of our audit of the state of Louisiana's financial statements and the Single Audit of the State of Louisiana (Single Audit) for the year ended June 30, 2014, we performed procedures at the Louisiana Department of Revenue (LDR) to provide assurances on financial information that is significant to the state's financial statements, evaluate the effectiveness of LDR's internal controls over financial reporting and compliance, and determine whether LDR complied with applicable laws and regulations.

LDR is the state agency charged with the assessment, collection, administration, and enforcement of taxes, fees, licenses, penalties, and interest due to the state of Louisiana. The department's mission is to fairly and efficiently collect state tax revenues to fund public services; to regulate charitable gaming and the sale of alcoholic beverages and tobacco; and to support state agencies in the collection of overdue debts.

Results of Our Procedures

Current-Year Findings

Ineffective Controls over Refunds from Legal Settlements

LDR did not have effective controls in place during fiscal year 2014 to ensure that interest on refunds from legal settlements was accurately calculated, resulting in two corporate refund overpayments totaling \$22,587,807.

LDR's written policy for refunds over \$5 million requires five levels of review and approval before refund payments are issued to the taxpayer. As part of our test of corporate tax refunds, we identified two legal settlement refunds in excess of \$5 million that included overpayments resulting from interest calculation errors. These two refunds passed five levels of review and approval and were issued with interest overpayments of \$1,818,768 and \$20,769,039, respectively. In both cases, the department was unaware of the errors until the taxpayers recognized the mistakes and returned the overpayments.

Management should improve the design and execution of its refund approval process to ensure that an adequate review is performed before the issuance of refunds. Additionally, monthly

reconciliation procedures across all taxpayer service areas may help to detect errors such as these. Management concurred with the finding and provided a corrective action plan (see Appendix A, pages 1-2).

Inadequate Controls over LaCarte Card Purchases

LDR did not effectively implement or adequately monitor controls over LaCarte card purchases during fiscal year 2014, resulting in unauthorized purchases, inadequate documentation, an increased risk of errors and fraud, and non-compliance with state guidelines.

A review of 33 monthly cardholder statements for 21 LDR LaCarte cardholders, including one for the Louisiana Office of Alcohol and Tobacco Control (ATC), disclosed the following:

- Fourteen monthly statements, including seven for an ATC cardholder, included \$42,412 in purchases without adequate supporting documentation to evidence proper approvals and/or verification for the receipt of items by the department. Of the seven for the ATC cardholder, two included multiple items totaling \$1,368 that were purchased using another employee's Amazon.com account and delivered to that employee's personal address, including a \$980 gaming desktop computer.
- Eighteen monthly statements, including six for an ATC cardholder, with \$56,524 in purchases, did not have evidence of a timely reconciliation by the cardholder of the purchases made to the cardholder statement received by the bank.
- Twenty-two monthly statements, including seven for an ATC cardholder, with \$65,572 in purchases, did not have evidence of a timely review and approval of the cardholder reconciliation by the supervisor and/or program administrator to support the payment of charges to the bank.
- One cardholder made a \$34 purchase on their LaCarte card in May 2014, two months after being transferred to another state department.

As required by the state of Louisiana's LaCarte Purchasing Card Policy, LDR has established policies documenting all internal procedures for cardholders, supervisors, and the program administrator. LDR's policies are written to ensure that the department is in accordance with state program guidelines and include prohibiting the use of a LaCarte card by anyone other than the cardholder; requiring supervisors to approve all purchases prior to the purchase being made; requiring cardholders to maintain an internal log of transactions to facilitate monthly reconciliation to the cardholder statement which should be submitted to the supervisor within three days of receipt of the statement; and requiring supervisors to review that reconciliation within two business days of receipt from the cardholder, approve the reconciliation, and forward it to the Program Administrator, authorizing the payment of these charges. These policies, however, are not being enforced and are therefore not effectively implemented and monitored by LDR.

LDR management should consider suspending cardholder privileges when established procedures are not followed by both the cardholder and the supervisor. Card limits should also be evaluated on an ongoing basis for business need, and LDR should monitor established controls to reduce the risk of error and fraud in the program. Management substantially concurred with the finding and provided a corrective action plan (see Appendix A, pages 3-4).

Inadequate Preparation of the Annual Fiscal Report

LDR understated refunds payable by \$20 million and pending litigation by \$116 million in its 2014 Annual Fiscal Report (AFR), which is used by the Division of Administration (DOA), Office of Statewide Reporting and Accounting Policy (OSRAP) to compile the state of Louisiana's Comprehensive Annual Financial Report (CAFR). Misstatements in LDR's AFR can result in misstatements of the state's CAFR.

The understatement of refunds payable occurred due to an error in the calculation of estimated refund denials. As part of the calculation of estimated denials, a percentage was erroneously applied to the wrong balance and the calculation worksheet was not adequately reviewed before being used in the final calculation of refunds payable. As a result, estimated corporate denials were overstated and refunds payable understated by \$20 million.

Pending litigation was understated by \$116 million due to numerous formula errors in the spreadsheet used to compile case data for the agency summary form submitted to the state's Attorney General for the year ended June 30, 2014. The department's litigation division submitted this erroneous agency summary form to the state's Attorney General and provided the report to the department's Revenue Reporting division. Prior to using the report for the AFR, it was not reviewed for accuracy; therefore, the formula errors were not discovered and the liability was understated by \$116 million in the department's AFR.

Good internal controls over financial reporting should include adequate procedures to record, process, and compile financial data needed to prepare an accurate and complete AFR; adequate training and supervision of staff; and an effective review of the AFR so that errors can be detected and corrected before submitting the AFR to OSRAP for inclusion in the state's CAFR.

Management should ensure that the AFR is carefully prepared by qualified staff and reviewed in detail prior to its submission to OSRAP. Emphasis should also be placed on improving the preparers' knowledge and understanding of the balances and calculations used in preparation of the AFR. Management concurred with the finding and provided a corrective action plan (see Appendix A, pages 5-6).

Ineffective Internal Audit Function

During fiscal year 2014, LDR did not have an effective internal audit function, increasing the risk that errors and/or fraud could occur and remain undetected.

LDR's Internal Audit Division did not perform any projects focused on the identification, operation, review, and/or improvement of internal controls for fiscal year 2014. Audits listed by LDR as audits in progress during fiscal year 2014 were actually performed in 2012 and 2013,

closed before fiscal year 2014 began, and were awaiting review. Internal audit resources were dedicated to the preparations for the Internal Revenue Service Security Review during the first six months of the fiscal year and then to other special projects at the request of management in the latter part of the year.

An agency with an appropriation level of \$30 million or more is required by Act 14 of the 2013 Regular Session of the Louisiana Legislature to have an internal audit function. LDR's fiscal year 2014 appropriation totaled more than \$82 million. An effective internal audit function is important to ensure that LDR's assets are safeguarded and that management's policies and procedures are uniformly applied.

In March 2014, LDR's Internal Audit Division was separated into two new divisions, Compliance and Internal Audit, to allow for the growth of internal audit and to further separate internal audit from other operational tasks and compliance work. Although operational tasks and compliance work may be vital to LDR, we recommend that management continue to improve the internal audit function to ensure that LDR's assets are adequately safeguarded and that management's policies and procedures are uniformly applied. Management concurred in part with our finding and recommendations and outlined a plan of corrective action. (see Appendix A, pages 7-8).

Financial Statements - State of Louisiana

As a part of our audit of the state of Louisiana's financial statements for the year ended June 30, 2014, we considered LDR's internal controls over financial reporting and examined evidence supporting certain account balances and classes of transactions as follows:

Revenues - Corporate income and franchise tax, individual income tax, sales tax, severance tax, and gasoline and special fuels tax

Receivables - Full accrual and modified accrual receivables

Note Disclosures - Refunds payable and judgments, claims, and similar contingencies

Our audit included tests of LDR's compliance with laws and regulations that could have a direct and material effect on the financial statements, as required by *Government Auditing Standards*.

Based on the results of these procedures on the financial statements, we reported findings related to ineffective controls over refunds from legal settlements; inadequate controls over LaCarte card purchases; inadequate preparation of the annual fiscal report; and ineffective internal audit function. The findings related to ineffective controls over refunds from legal settlements and inadequate preparation of the annual fiscal report will also be included in the state of Louisiana's Single Audit Report for the year ended June 30, 2014.

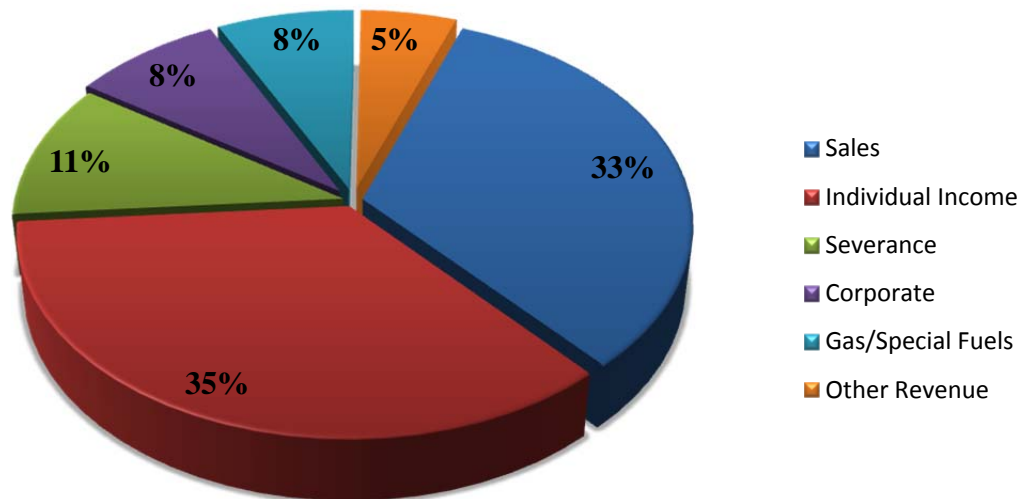
In addition, the account balances and classes of transactions tested, as adjusted, are materially correct.

Trend Analysis

We compared the most current- and prior-year financial activity using LDR’s annual fiscal reports and/or system-generated reports and obtained explanations from LDR management for any significant variances. We also prepared an analysis of major revenues over the last five years.

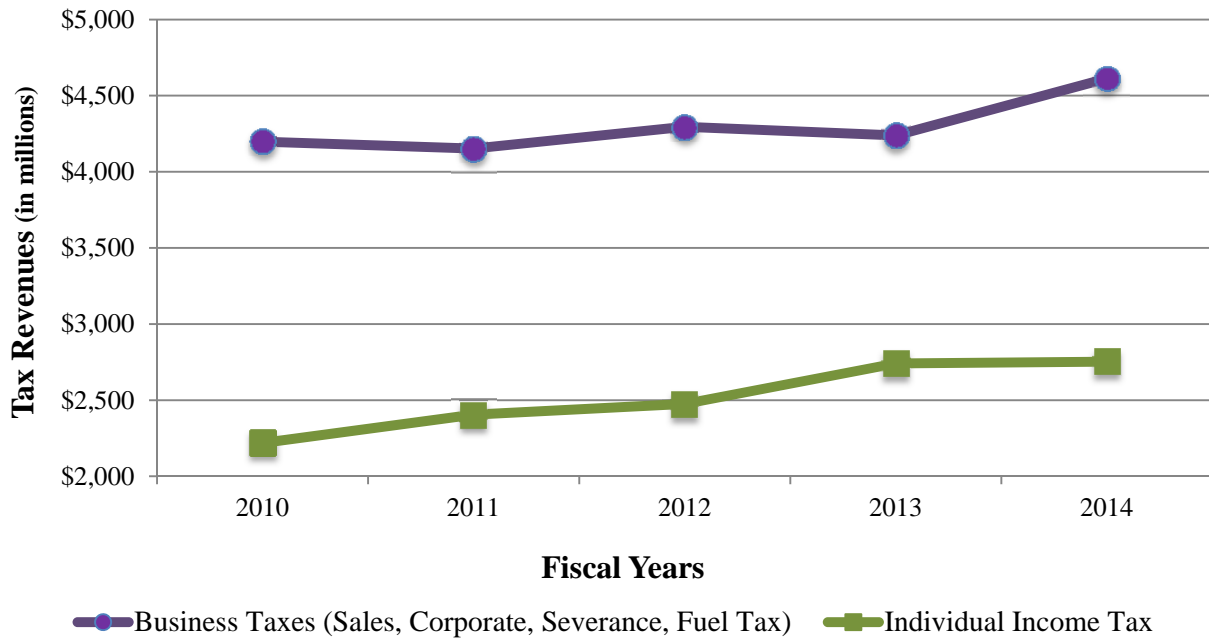
The majority of revenues collected by LDR, 95% of total tax revenues, are composed of Individual Income tax and major business taxes including Sales tax, Corporate Income and Franchise tax, Severance tax, and Fuel tax revenue. Based on a five-year analysis, major tax revenues increased by a combined \$949 million since 2010. Business tax collections increased by \$374 million during FY 2014, due to a tax amnesty program administered by the department.

Exhibit 1
Fiscal Year 2014 Collections



Source: Fiscal Year 2014 Department of Revenue Annual Fiscal Report

**Exhibit 2
Five-Year Major Revenue Trend**



Source: Department of Revenue Annual Fiscal Reports, as adjusted

The recommendations in this report represent, in our judgment, those most likely to bring about beneficial improvements to the operations of LDR. The nature of the recommendations, their implementation costs, and their potential impact on the operations of LDR should be considered in reaching decisions on courses of action. The finding relating to the department’s compliance with laws and regulations should be addressed immediately by management.

Under Louisiana Revised Statute 24:513, this report is a public document, and it has been distributed to appropriate public officials.

APPENDIX A: MANAGEMENT'S RESPONSES

BOBBY JINDAL
Governor



TIM BARFIELD
Secretary

State of Louisiana
Department of Revenue

October 20, 2014

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
1600 N. 3rd Street
Baton Rouge, LA 70804

RE: Ineffective Controls over Refunds from Legal Settlements

Dear Mr. Purpera:

On November 13, 2013 the agency reached a settlement with a taxpayer for a refund of \$68,235,452.30 in corporate income tax paid under protest. The refund check for \$89,236,307.22 was issued to the taxpayer on December 18, 2013. The agency's management became aware of this particular event in January of 2014 and began an inquiry of the event at that time. Corrections were made to the taxpayer's account at that time and discussions for corrective action to operational processes began.

The settlement included \$6,382,572.18 of tax paid to the agency through the Tax Amnesty Program. The unique nature of the Amnesty Program contributed to the error. In addition, the interest amount per the terms of the settlement was different than the normal interest calculation method traditionally followed in our integrated tax system. The controls going forward for upcoming amnesty have been enhanced to include increased cooperation involving both our Field Audit and Litigation Divisions to approve the final reconciliation. This cooperation has also been included in all refunds that are initiated as a result of any settlement.

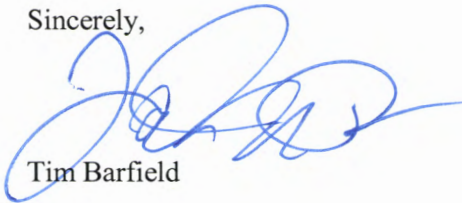
The agency concurs with the finding but wishes to point out that agency does not directly administer programs that expend federal funds that would qualify under the Single Audit Act of 1984 (OMB circular A-133). The leadership team of the agency recognizes the importance of controls over all processes especially those related to the distribution of funds. Regardless of whether these distributions are as part of general administration expenditures or refund of taxpayer dollars, the importance is acknowledged.

The agency has had controls and procedures over refund distribution for several years and several audit cycles. These procedures are outlined in PPM 30.1.2 and these specific levels of approval authority are programmed into our integrated tax system. Our procedures have been modified in order to address these extremely rare types of settlements; notwithstanding the manner the error was unearthed.

As part of our corrective action plan, initial meetings between the leadership team, Field Audit Services and Litigation have taken place. The divisions associated with Field Audit Services and Litigation will be working in a partnership to ensure all refunds from settlements are entered correctly and approved by a key member of the Division of Litigation prior to being placed in the approval workflow. These new procedures and system of accountability have been in place since the discovery of the error. We have assigned the Director of Litigation, Monica Doss, and the Director of Audit Review, Jay Frost, as contacts for the development, implementation and monitoring of this corrective action.

Please feel free to reach out to our agency for any additional information or clarification is required by your office.

Sincerely,



Tim Barfield
Secretary

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617 North Third Street, Post Office Box 201, Baton Rouge, Louisiana 70896 • (225) 219-4059 • Fax (225) 219-2708 • TDD (225) 219-2114
www.revenue.louisiana.gov

BOBBY JINDAL
Governor



TIM BARFIELD
Secretary

State of Louisiana
Department of Revenue

November 13, 2014

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
1600 N. 3rd Street
Baton Rouge, LA 70804

RE: Inadequate controls over LaCarte Card Purchases

Dear Mr. Purpera:

The management team of the Department of Revenue recognizes the importance of controls over the LaCarte Card Program. This method of obtaining necessary supplies for operations is essential to the overall efficient operation of our agency.

The senior management team does concur that there are some improvements that can be made to the LaCarte Card program within the agency to ensure more control over this program and encourage voluntary compliance with the requirements of the program. This concurrence is with the exception of the purchase by a non-department employee. This individual was part of the IT Consolidation and while she was transferred to DOA, was still responsible for making purchases and performing duties solely for the Department of Revenue.

The agency will implement a corrective action plan to address these errors and start on a path of compliance that eliminates these violations. The Undersecretary has instructed the Controller Division and the LaCarte Card Administrator to report monthly on all cardholders/approvers with noncompliance issues to the Undersecretary. Any cardholders with non-compliance issues will have their purchasing authority suspended and may be required to take training. Issues will be tracked and habitual offenders will lose purchasing authority. Purchases that are delivered to a non-agency address will be subject to additional scrutiny and require additional justification and be subject to unannounced inspection by the Property Manager and/or the Division of Internal Audit.

Inadequate controls over LaCarte Card Purchases
Page 2 of 2

Please feel free to reach out to our agency for any additional information or clarification is required by your office.

Sincerely,



Tim Barfield
Secretary

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BOBBY JINDAL
Governor



TIM BARFIELD
Secretary

State of Louisiana
Department of Revenue

November 10, 2014

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
1600 N. 3rd Street
Baton Rouge, LA 70804

RE: Inadequate Preparation of the Annual Fiscal Report

Dear Mr. Purpera:

The management team of the Department of Revenue understands the importance of accurate financial reporting. This would include the preparation of the Annual Fiscal Report and accompanying notes, schedules and exhibits.

The agency concurs with the finding but wishes to point out that agency does not directly administer programs that expend federal funds that would qualify under the Single Audit Act of 1984 (OMB circular A-133). We would also like to state that the corrections were made and the errors on the AFR will not impact the State CAFR.

The agency will implement a corrective action plan to address these errors and to ensure they will not happen in the future. The Undersecretary has instructed the Financial Reporting to review all work paper templates to improve overall layout and calculations thus reducing the likelihood of basing calculations on incorrect dollar amounts. In addition, all internal due dates for reports from divisions with contributions to the AFR will be moved up one to two weeks to allow for additional time to review due to the limited window of time from the ending of the yearly accrual period to prepare and review the AFR. In order to improve the review function of the end of year close out, all applicable detail used or created by participating divisions to determine specific balances will be provided to Financial Reporting in both spreadsheet and PDF format for analysis and review for reasonableness and accuracy. Assigned individuals for the corrective action plan, as it relates to Litigation and Financial Reporting, are respectively Monica Moss and Stewart Zachery.

Inadequate Preparation of the Annual Fiscal Report
Page 2 of 2

Please feel free to reach out to our agency for any additional information or clarification is required by your office.

Sincerely,



Tim Barfield
Secretary

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BOBBY JINDAL
Governor



TIM BARFIELD
Secretary

State of Louisiana
Department of Revenue

October 8, 2014

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
1600 N. 3rd Street
Baton Rouge, LA 70804

RE: Ineffective Internal Audit Function

Dear Mr. Purpera:

Historically, the Louisiana Department of Revenue's Internal Audit division has also been responsible for the department's confidentiality and data access security functions. At the end of calendar year 2013, due to the rapidly increasing demands of agency compliance, driven in large part by the Louisiana Department of Revenue's use of Federal Taxpayer Information and the federal government requirements relating thereto, the agency's management team became concerned that the focus of Internal Audit Division was disproportionately weighted toward compliance functions. While access and use of Federal Taxpayer Information results in tens of millions of dollars a year in revenue to the state and compliance functions are vitally important to the Louisiana Department of Revenue, the agency's management believes that an effective Internal Audit function is equally important.

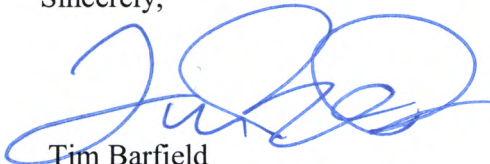
In February, 2014, the Louisiana Department of Revenue management applied to Civil Service to split compliance and internal audit functions into two divisions, and approval was received on March 3, 2014. On, March 16, 2014 the split into two divisions was implemented. Beth Heim, who served as Director of Internal Audit, became the Director of Compliance, and after completing the civil service recruitment process, Joyce Anderson, formerly the Louisiana Department of Revenue's Director of Financial Services, was name Director of Internal Audit on April 1, 2014. After an extensive recruitment process, David Helminiak was appointed as Audit Manager for the Internal Audit Division on June 23, 2014.

In addition to the aforementioned actions, several initiatives have been undertaken to strengthen the function of internal audit within the agency. In April 2014, the Director of Internal Audit reached out to the Institute of Internal Auditors to acquire their services in Quality Assurance Review of the efficiency and effectiveness of the internal audit activities. In May 2014 the agency received their proposal for these services and we now have a contract in place for this engagement to begin at the end of this calendar year. The Internal Audit Division has made a commitment to the executive management team to complete a minimum of twelve audits in fiscal year 2015. The vast majority of these will be audits of divisions within the Louisiana Department of Revenue. As of July 18, 2014, the Division of Internal Audit had completed extensive Formal Risk Assessment and is now meeting with individual directors to ensure programs, activities; functions and processes are properly documented by the audit staff and evaluated by the Secretary and senior management.

The agency concurs in part to the finding and recommendations. The agency acknowledges the disproportionate weight toward compliance that the leadership team identified in late 2013. The agency's management believes the steps that have been taken successfully address the issues raised. The recommendation to "*improve the internal audit function*" is extremely general but, the aforementioned steps taken not only precede the initial communication of this issue by the Legislative Auditor in August 2014, they also contribute to the overall improvement of the internal audit function. The Internal Audit Division is fully functioning and focused providing independent, objective assurance and consulting activity to the agency to add value and improve overall operation of the agency.

Please feel free to reach out to our agency for any additional information or clarification is required by your office.

Sincerely,



Tim Barfield
Secretary of Revenue

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APPENDIX B: SCOPE AND METHODOLOGY

We performed certain procedures at the Department of Revenue (LDR) for the period from July 1, 2013 through June 30, 2014, to provide assurances on financial information significant to the state of Louisiana's Comprehensive Annual Financial Report (CAFR) and to evaluate relevant systems of internal control in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. The procedures included inquiry, observation, and review of policies and procedures, and a review of relevant laws and regulations. Our procedures, summarized below, are a part of the audit of the CAFR and the Single Audit of the State of Louisiana for the year ended June 30, 2014.

- We evaluated LDR's operations and system of internal controls through inquiry, observation, and review of its policies and procedures, including a review of the laws and regulations applicable to LDR.
- Based on the documentation of LDR's controls and our understanding of related laws and regulations, we performed procedures to provide assurances on certain LDR account balances and classes of transactions to support the opinion on the state's financial statements.
- We compared the most current- and prior-year financial activity using LDR's annual fiscal reports and/or system-generated reports to identify trends and obtained explanations from LDR management for significant variances.

The purpose of this report is solely to describe the scope of our work at LDR and not to provide an opinion on the effectiveness of LDR's internal control over financial reporting or on compliance. Accordingly, this report is not intended to be, and should not be, used for any other purposes.

We did not audit or review LDR's Annual Fiscal Report and, accordingly, we do not express an opinion on that report. LDR's accounts are an integral part of the state of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.