DEPARTMENT OF REVENUE

STATE OF LOUISIANA

FINANCIAL AUDIT SERVICES
MANAGEMENT LETTER
ISSUED DECEMBER 23, 2019

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Louisiana Legislative Auditor
Daryl G. Purpera, CPA, CFE

Department of Revenue

December 2019 *Audit Control # 80190101*

Introduction

As a part of our audit of the State of Louisiana's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2019, we performed procedures at the Louisiana Department of Revenue (LDR) to provide assurances on financial information that is significant to the state's CAFR; evaluate the effectiveness of LDR's internal controls over financial reporting and compliance; and determine whether LDR complied with applicable laws and regulations. In addition, we determined whether management has taken actions to correct the finding reported in the prior year.

Results of Our Procedures

Follow-up on Prior-year Finding

Our auditors reviewed the status of the prior-year finding reported in the LDR management letter dated December 19, 2018. The prior-year finding related to Inadequate Preparation of the Annual Fiscal Report has not been resolved and is addressed again in this letter.

Current-year Findings

Inadequate Preparation of the Annual Fiscal Report

LDR incorrectly reported accounts receivable balances in its 2019 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 CAFR. Gross receivables were understated by $34.4 million, and the allowance for uncollectibles for Qualified receivables was understated by approximately $166.6 million. Failure to accurately report financial information in LDR's AFR can result in misstatements of the state's CAFR.

In fiscal year 2019, LDR's Financial Services began using a new report from the Delta tax information system to compile receivables for inclusion in the AFR. However, LDR failed to detect significant differences in the population of the new report which created inconsistencies in the methodology used to report receivables. As a result, Financial Services erroneously excluded receivables that would have been included in prior years. Gross receivables were understated by $34.4 million. Qualified receivables, which are tax receivables generally based on an actual tax return, were understated by $17.5 million, and proposed assessments, which are estimated tax receivables, were understated by $16.9 million. This error occurred due to the heavy reliance on system reports during AFR preparation without an adequate understanding of the information included in the reports.

In addition, the allowance for uncollectibles reported in the fiscal year 2019 AFR for Qualified receivables was less than 1%. A review of historic collections for Qualified receivables revealed that the collection percentage is much lower than the 99% rate indicated by the recorded allowance. Together with LDR, we reviewed the reports used to calculate the net receivables balance as well as five-year historical collections data related to reported receivables. Based on these procedures, a new methodology was agreed upon by LLA and LDR, resulting in a $166.6 million adjustment to the reported allowance. This error occurred because LDR did not have an adequate process for estimating uncollectible accounts.

Louisiana Revised Statute 39:79 requires all state agencies to provide the Commissioner of Administration a sworn statement (AFR) of all monies received and from what sources, all monies expended and for what purposes, all revenue due and not collected, and all obligations incurred and not paid. 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, including adequate controls over establishing an estimate of uncollectible accounts; adequate training, including training on information systems, 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 information entered into OSRAP's AFR Portal and any additional schedules provided as supplements to the AFR are reviewed in detail prior to its submission to OSRAP. Management should also provide training to improve the preparer's knowledge and understanding of the balances, calculations, and system reports used in preparing the AFR and should ensure a sufficient evaluation of the history of collections on receivable balances upon which to base the reported estimate of uncollectible accounts. Management concurred in part with our finding, stating that "LDR disagrees with the LLA's characterization of its use of the direct write-off method as being inadequate." See Appendix A, pages 1-2.

Additional Comments: The issue reported in the finding does not relate to the use of the direct write-off of accounts, but rather inadequate support for an estimated allowance reported in the financial statements. LDR's methodology used to report an allowance of less than 1% of total Qualified receivables reported in fiscal year 2019 was not representative of the true collectability of the reported receivables. After auditors presented evidence to LDR regarding the reports used in the original estimate and historical collection trends of Qualified receivables, LDR agreed that the estimation methodology should be changed and the reported allowance should be adjusted.

Duplicate Individual Income Tax Refunds

Effective controls had not been implemented over the approval and release of refund ACH batch files to prevent duplicate refund payments. In March 2019, a failed nightly Delta system job stream led to the creation of a duplicate direct deposit file. The failure to detect the duplication caused 66,780 individual income tax refunds totaling $26.9 million to be processed and refunded to taxpayers twice. Immediately following the error, LDR began implementing additional control procedures to prevent future errors and began efforts to recover the refunds made in error. As of November 8, 2019, 6,295 refunds totaling $1,953,570 were still not recovered by LDR.

System configurations dictate the creation of direct deposit files. In this instance, the unprecedented timing of the job stream resulted in the inclusion of the refunds in two separate direct deposit files in the eservices bank management software. On March 11, 2019, the job stream to process individual income tax refunds stopped unexpectedly prior to completion due to a connection timeout error. The job stream is configured to continue processing after a job failure and was completed successfully on the morning of March 12, 2019. However, the timing of the March 11 run, which finished after 8:00 a.m. on March 12, allowed the inclusion of the March 11 refunds in the March 12 processing file.

Though this configuration has been in place since 2008, the job stream had never completed as late as it did on this day, and LDR and Division of Administration – Office of Technology Services (OTS) personnel were unaware that the file would be moved to the processing directory for a second time. LDR and OTS personnel involved in the daily operations of Delta system processing were aware of the job failure; however, the OTS staff responsible for the release of the files to the bank did not recognize the duplication and released the files. LDR was unaware of the duplicate files until taxpayers and financial institutions began reporting duplicate direct deposits on the afternoon of March 13, 2019.

LDR is authorized to adopt rules and regulations to administer individual income tax. Effective controls should ensure that personnel exercise due care when processing refunds and that supervisors thoroughly review the accuracy of direct deposit files prior to approval and processing.

Management should consider creating additional procedures, including supervisory level reviews, to further verify the accuracy of direct deposit files prior to the refunds being processed.

Responses were obtained from both LDR and OTS management. LDR management did not concur, stating that, “The process of monitoring and releasing the direct deposit files in question was the sole responsibility of the Division of Administration – Office of Technology Services” and that “LDR did not have a role in approving the direct deposit files for release to the bank.” Management did not dispute the occurrence of the event, nor did it dispute the quantitative impact of the error. OTS management responded that, “While OTS acknowledges their part in the duplicate tax refunds having been generated, this responsibility was shared with LDR.” and explained that corrective action has now been put in place (see Appendix A, pages 3-5).

Additional Comments: Effective controls were not in place through LDR and/or OTS to prevent the duplicate release of refunds and, as a result, $26.9 million was released to taxpayers in error. LDR, as the department responsible for the collection of state taxes and the remittance of related refunds back to the taxpayers, should have implemented additional review and reconciliation of the bank files as part of a cooperative effort with OTS. As mentioned in both LDR and OTS responses, these additional controls have now been implemented to prevent future duplications.

Comprehensive Annual Financial Report – State of Louisiana

As a part of our audit of the CAFR for the year ended June 30, 2019, we considered internal control over financial reporting and examined evidence supporting certain account balances and classes of transactions as follows:

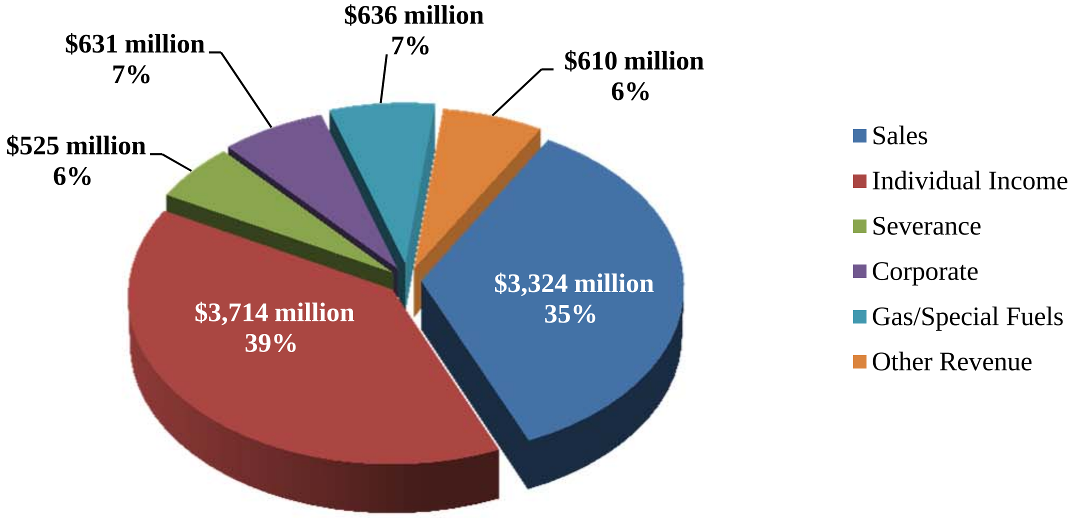
> **Revenues** - Corporate Income and Franchise tax, Individual Income tax, Sales tax, Severance tax, and Gasoline and Special Fuels tax
>
> **Receivables** - Full Accrual and Modified Accrual Receivables on the revenues listed above
>
> **Note Disclosures** - Refunds Payable and Tax Abatement Programs

Based on the results of these procedures, we reported findings related to Inadequate Preparation of the Annual Fiscal Report and Duplicate Individual Income Tax Refunds, as described previously. These findings will also be included in the Single Audit of the State of Louisiana for the year ended June 30, 2019. 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 fiscal year 2019 tax revenue collections. The majority of revenues collected by LDR, 74% of total tax revenues, is generated by the collection of Individual Income tax and Sales tax.

Fiscal Year 2019 Collections



Source: Fiscal Year 2019 Department of Revenue Annual Fiscal Report

The recommendations in this letter 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.

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

Respectfully submitted,

Thomas H. Cole, CPA
First Assistant Legislative Auditor

ARC:EMS:BQD:EFS:aa

LDR2019

APPENDIX A: MANAGEMENT’S RESPONSES

State of Louisiana
Department of Revenue

JOHN BEL EDWARDS
Governor

KIMBERLY LEWIS ROBINSON
Secretary

December 11, 2019

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: Louisiana Department of Revenue's (LDR) Response to Inadequate Preparation of the Annual Fiscal Report

Dear Mr. Purpera:

This correspondence serves as the LDR's official response to the finding referred to above. Key points in the summation supporting the Louisiana Legislative Auditor's (LLA) finding will be addressed to provide perspective as it relates to our position on the issue(s). Basically, we **concur in part** with the finding and submit the following information for contextual purposes:

As stated in your analysis, gross receivables were understated by $34.4 million or 2.2 percent. This error did occur as a result of our reliance on reports that had not been used for AFR preparation purposes in the past. However, it is our position that agency personnel acquired adequate knowledge and understanding of the information contained in the reports prior to relying on them for AFR compilation purposes. In fact, these reports had been tested for at least two years prior to utilizing them for this purpose. We accept full responsibility for the oversight and have made the necessary revisions in our data compilation and validation processes to ensure this does not occur in the future.

In consultation with the LLA, LDR has agreed to change the methodology utilized in determining the allowance for uncollectible receivables. Our **concurrence in part** is due primarily to the LLA's characterization that "LDR did not have an adequate process for estimating uncollectible accounts". For financial statement preparation and presentation purposes, there are two widely-recognized methods used in accounting for uncollectible accounts: (1) the Direct Write-off Method and (2) the Allowance Method. The direct write-off method is used when there is less emphasis placed on this method's impact on the income statement and balance sheet. Conversely, the allowance method is usually used because it provides a better matching of expenses and revenues on the income statement and ensures that receivables are stated at their cash realizable value on the balance sheet. Immediately, one can ascertain the methodology most important and useful when considering the type of entity for which the financial statements are prepared. The methodology utilized is commonly determined by management of the entity in question and factors important to stakeholders are of primary importance when making that determination. For more than 15 years, LDR utilized the direct write-off method for determining its allowance for doubtful accounts. During this time, the Louisiana Legislature provided numerous enforcement tools for collection of delinquent accounts. These tools allowed for a lengthier collection period for unpaid taxes. As a result, fewer accounts were designated as uncollectible due to the lengthened assessment and evaluation period. In summary, LDR disagrees with the LLA's characterization of its use of the direct write-off method as being inadequate.

As mentioned herein, LDR in conference with the LLA has agreed to a new methodology for determining the allowance amount related to the qualified component of accounts receivable. This new method involves utilizing the LDR's new accounts receivable reports along with a minimum 5-year historical data collection assessment for determining the allowance account. As more data analytics tool become available as a result of anticipated upgrades to its integrated tax processing system, DELTA, LDR management will continue to evaluate these and other processes.

LDR management understands and fully accepts the responsibility and expectations as enacted per Louisiana Revised Statute 39:79. Management will continue its efforts to continuously improve the knowledge of staff and internal controls regarding processes and financial reporting.

We will continue to evaluate other recommendations mentioned in your report and make the necessary adjustments as warranted by our analysis. In addition, we welcome and appreciate your participation and partnership currently and in the future.

Clarence Lymon, Undersecretary, is the person responsible for implementing the corrective actions discussed above.

Sincerely,

Kimberly Lewis Robinson
Secretary

cc: C. Lymon

JOHN BEL EDWARDS
Governor

KIMBERLY LEWIS ROBINSON
Secretary

December 12, 2019

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: Louisiana Department of Revenue's (LDR) Response to Bank Management System Refund Issue

Dear Mr. Purpera:

This correspondence serves as the LDR's official response to the finding referred to above. Key points in the summation supporting the Louisiana Legislative Auditor's (LLA) finding will be addressed to provide perspective as it relates to our position on the issue(s). Basically, we **do not concur** with the finding and submit the following information in support of our position:

The process of monitoring and releasing the direct deposit files in question was the sole responsibility of the Division of Administration - Office of Technology Services (DOA-OTS). As such, the process in question should be evaluated as a component of the LLA's audit of the DOA-OTS. LDR did not have a role in approving the direct deposit files for release to the bank.

In an effort to prevent this from happening again, LDR and OTS have implemented additional reviews, approvals and segregation of duties as enhancements to the process. The process in question has been improved by adding the following procedures:

- An email will be sent to all stakeholders with the counts of the files scheduled to go to the bank as compared to the total sent daily with the refunds generated total out of the job stream.

- LDR will approve the release of the file to the bank via email until such time that authority is given to log into Chase's Infodex system and release the daily file.

    - Any discrepancy in the comparison counts will initiate an escalation to all stakeholders for research and a final decision as to how to proceed.

    - Manual review of the directories is performed.

- The release of the refund files to the bank has been removed from the DOA-OTS and is now being performed by the Department after a reconciliation of totals of the file created by the job stream and totals of the file created by the Bank Management System (BMS).

- A job step has been added to the BMS to search for duplicate file names in the archive folder. If a duplicate file name is identified, an exception will be thrown and research performed on the duplicate file.

LDR and DOA-OTS management and staff are committed to continuously evaluating and improving our processes in an effort to safeguard taxpayer data and protect the State's resources. LDR's authority to adopt rules and regulations to administer individual income tax is not at issue. In addition, it would be inappropriate to address the internal operations of the tax processing and bank management software in the regulatory domain as implied in the finding. The comment to that effect in the LLA finding is misplaced. Further, the controls over the processing of the refunds by LDR is not in question or impacted. The LLA has conflated the separate issue of releasing a payment file to the bank with the very detailed and methodical process employed by LDR in reviewing and approving individual income tax refunds. There were no errors in the latter process nor a lack of effective controls in place.

We will continue to evaluate other recommendations mentioned in your report and make the necessary adjustments as warranted by our analysis.

Clarence Lymon, Undersecretary, is the person responsible for collaborating with OTS on this matter.

Sincerely,

Kimberly Lewis Robinson
Secretary

cc: C. Lymon

Office of Technology Services
State of Louisiana
Division of Administration

JOHN BEL EDWARDS
GOVERNOR

JAY DARDENNE
COMMISSIONER OF ADMINISTRATION

December 20, 2019

Daryl G. Purpera, CPA CFE
Louisiana Legislative Auditor
1600 North Third Street
Baton Rouge, LA 70804

RE: LDR – Duplicate Individual Tax Refunds

Dear Mr. Purpera,

We received the reportable audit finding captioned above, dated December 17, 2019, resulting from an audit of Louisiana Department of Revenue (LDR) in which the Office of Technology Services was named as being the "sole responsible party" for this release of duplicate tax refunds.

While OTS acknowledges their part in the duplicate tax refunds having been generated, this responsibility was shared with LDR. The lack of institutional control by LDR over tax refunds has since been corrected as of May 2019. A root cause analysis was conducted and a new process was established which addresses additional reviews, approvals and separation of duties to ensure that this does not happen again. The responsibility for approving financial transactions has been appropriately given back to the agency.

We thank you for the opportunity to respond to this finding and consider this issue resolved.

Sincerely,

Richard Howze

Richard "Dickie" Howze
Chief Information Officer
Office of Technology Services

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APPENDIX B: SCOPE AND METHODOLOGY

We performed certain procedures at the Louisiana Department of Revenue (LDR) for the period from July 1, 2018, through June 30, 2019, 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. Our procedures, summarized below, are a part of the audit of the CAFR for the year ended June 30, 2019.

- 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 account balances and classes of transactions to support our opinions on the CAFR.

- 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 CAFR, upon which the Louisiana Legislative Auditor expresses opinions.