DEPARTMENT OF REVENUE
STATE OF LOUISIANA

MANAGEMENT LETTER
ISSUED MAY 14, 2008

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Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

This document is produced by the Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. Six copies of this public document were produced at an approximate cost of $16.08. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's Web site at www.lla.state.la.us. When contacting the office, you may refer to Agency ID No. 3359 or Report ID No. 80070011 for additional information.

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LOUISIANA LEGISLATIVE AUDITOR
STEVE J. THERIOT, CPA

April 16, 2008

DEPARTMENT OF REVENUE
STATE OF LOUISIANA
Baton Rouge, Louisiana

As part of our audit of the State of Louisiana's financial statements for the year ended June 30, 2007, we considered the Department of Revenue's internal control over financial reporting; we examined evidence supporting certain accounts and balances material to the State of Louisiana's financial statements; and we tested the department's compliance with laws and regulations that could have a direct and material effect on the State of Louisiana's financial statements as required by *Government Auditing Standards*.

The Annual Fiscal Report of the Department of Revenue is not audited or reviewed by us, and, accordingly, we do not express an opinion on that report. The department's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

In our prior management letter on the Department of Revenue for the year ended June 30, 2006, we reported findings relating to a deficiency in disaster recovery/business continuity plan and inadequate controls over tax allocations to the Sports Facility Assistance Fund. These findings have not been resolved by management and are addressed again in this letter.

Based on the application of the procedures referred to previously, all significant findings are included in this letter for management's consideration. All findings included in this management letter that are required to be reported by *Government Auditing Standards* will also be included in the State of Louisiana's Single Audit Report for the year ended June 30, 2007.

Inaccurate Annual Fiscal Report

The Louisiana Department of Revenue (LDR) did not submit an accurate Annual Fiscal Report (AFR) to the Division of Administration for the year ended June 30, 2007. As authorized by Louisiana Revised Statute 39:79, the commissioner of administration through the Division of Administration's Office of Statewide Reporting and Accounting Policy (OSRAP) prescribes the content and format for preparing each agency's AFR, which is then used in compiling the state's Comprehensive Annual Financial Report (CAFR). Good internal control includes establishing a process to ensure that these financial statements are accurately prepared and reviewed. However, LDR's AFR submitted to OSRAP on August 31, 2007, included the following errors:

- Net refunds payable were overstated by $17.3 million.
- Net receivables were overstated by $16 million.
- Net revenues were understated by $10.1 million.

LDR management has not ensured that reports from its claims processing system that support the amounts in the AFR are properly designed, and management has not ensured that its AFR was properly prepared and reviewed for errors. Failure to submit an accurate AFR can delay the compilation and issuance of the state's CAFR. Furthermore, misstatements from errors or fraud may occur and remain undetected.

LDR management should ensure that its AFR is properly prepared and should review the financial information and note disclosures in its AFR to identify and correct errors before submitting it to OSRAP. Management concurred in part with the finding and recommendations and outlined a plan of corrective action. Management further stated, "The impact of the understatement of Net Revenues on the financial report was approximately one-tenth-of-one-percent of the $8.8 billion in cash deposits accounted for by the Department of Revenue. Rarely are miscalculations of this nature ever considered material enough to warrant any type of notification to the user of the financial data." (See Appendix A, pages 1-2.)

Additional Comment: We agree that the understatement of net revenues is less than 0.10% of cash deposits for LDR. However, the overstatements for net refunds payable and net receivables represented 9.7% of total long-term refunds payable and 2.4% of net receivables, respectively, reported in the note disclosures in LDR's AFR. Management of LDR is responsible for ensuring that adequate internal controls over the preparation and review of its AFR are in place and operating effectively, enabling management to identify and correct errors such as those identified above. However, those errors were not detected by management's review of LDR's AFR, and we believe that this deficiency in internal control results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

Deficiency in Disaster Recovery/Business Continuity Plan

For the fifth consecutive year, LDR has deficiencies in its comprehensive disaster recovery/business continuity plan. The state Office of Information Technology Policy Number 11 requires each state agency to develop, test, and maintain a disaster recovery/business continuity plan that is designed to ensure the availability of mission-critical services and functions in the event of a disaster or other event that would impact the agency's information technology (IT) and telecommunications systems.

Though LDR has developed and implemented a formal disaster recovery plan, the plan does not include access to a remote facility with the same operating system so that data can be processed and operations can continue with minimal disruption of services. Failure to include such a facility in the comprehensive disaster recovery plan increases the risk that in the event of a disaster, there may be excessive delays in collecting taxes owed to the state and in processing critical data needed to ensure the accurate collection of taxes.

Management of LDR should take the necessary measures to include access to a remote processing facility in its comprehensive disaster recovery/business continuity plan to allow critical operations to be reestablished within an acceptable time frame should a disaster or other event occur. Management concurred in part with the finding and recommendation and outlined a plan of corrective action (see Appendix A, pages 3-5).

Inadequate Controls Over Tax Allocations to the Sports Facility Assistance Fund

For the second consecutive year, LDR does not have adequate internal controls over the collection and allocation of income tax revenues to the Sports Facility Assistance Fund (SFAF). Louisiana Revised Statute (R.S.) 39:100.1 requires that the State Treasurer's Office pay to the SFAF an amount equal to the income taxes collected from the income earned in Louisiana by nonresident professional athletes and professional sports franchises. In addition, the statute authorizes LDR to establish regulations to identify and provide for the proper allocation of income taxes to the SFAF and to require income tax returns, schedules, and payments to carry out the purposes of the statute. In accordance with the statute, LDR requires that nonresident athletes use form IT-540B-NRA to file their returns, which enables LDR to identify those income taxes attributable to the SFAF. LDR prepares a listing of taxpayers who file nonresident athlete income tax returns and periodically transfers the tax revenues to the SFAF. However, LDR does not reconcile this listing to withholding taxes paid by professional athletic teams to ensure all nonresident athlete income taxes are transferred to the SFAF. Through September 2007, LDR reported nonresident athlete income taxes collected totaling $597,275.

Our review of selected nonresident athletes' 2005 calendar year income tax returns disclosed that 130 nonresident athletes filed regular nonresident returns (form IT-540B) instead of nonresident athlete returns (form IT-540B-NRA), which results in income taxes totaling $330,534 (net of film tax credits totaling $56,314) that have not been earmarked for transfer to the SFAF. In addition, our review also disclosed that three nonresident athletes filed the proper nonresident athlete returns (form IT-540B-NRA) for income taxes totaling $151,930, but LDR did not earmark these taxes for transfer to the SFAF.

Our review of 2005 calendar year withholding taxes paid for nonresident athletes by out-of-state National Football League (NFL) and National Basketball Association (NBA) teams disclosed that these teams paid withholding taxes totaling $455,246 for nonresident athletes, but these withholding taxes were not reconciled to individual nonresident athlete income tax returns. In addition, in our prior year finding, we identified 2004 calendar year withholding taxes paid by out-of-state NFL and NBA teams for nonresident athletes totaling $601,931 that had not been reconciled to the nonresident athlete income tax returns. These withholding taxes remain unreconciled. Because LDR has not reconciled the payments from NFL and NBA teams to income tax returns filed, the total amount due to the SFAF has not been determined.

Our tests were limited to nonresident income tax returns filed for the 2005 calendar year, regardless of the year in which the taxes were paid. Furthermore, we did not apply statistical sampling; therefore, we did not make a projection of the total potential error. In addition, we have not estimated the total amount of uncollected income taxes due to the SFAF.

Failure to maintain adequate controls over the collection and allocation of revenues due to the SFAF results in an understatement of the SFAF's revenues. LDR should establish controls over the collection and allocation of revenues to the SFAF to ensure compliance with R.S. 39:100.1. Management concurred with the finding and recommendation and outlined a plan of corrective action (see Appendix A, pages 6-7).

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

This letter is intended solely for the information and use of the department and its management, others within the entity, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,

Steve J. Theriot, CPA
Legislative Auditor

BDC:CGEW:THC:dl

REVENUE07

Management's Corrective Action Plans and Responses to the Findings and Recommendations

LDR
Louisiana Department of Revenue

Kathleen Babineaux Blanco
Governor

Cynthia Bridges
Secretary

January 10, 2008

Mr. Steve J. Theriot, CPA
Legislative Auditor
Office of the Legislative Auditor
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

RE: Inaccurate Annual Fiscal Report

Dear Mr. Theriot:

The Louisiana Department of Revenue concurs in part with your finding that the agency submitted an "Inaccurate Annual Fiscal Report." Basically, we agree with your finding in that Net Refunds Payable were overstated by $17.3 million; Net Receivables were overstated by $16 million; and Net Revenues were understated by $10.1 million. Our concurrence in part is due primarily to statements in the finding suggesting that "management has not ensured that reports from its claims processing system that support the amounts in the AFR are properly designed, and management has not ensured that its AFR was properly prepared and reviewed for errors."

LDR management accepts full responsibility for all errors reported in its financial reports. However, when unintentional errors occur (similar to those identified in the finding), they should be presented in the appropriate perspective. The inaccuracies noted in the finding are primarily the result of errors in calculation and/or oversight during compilation. As it relates to the overstatement of Net Refunds and Net Receivables, the net impact on the financial report is less than one percent. The impact of the understatement of Net Revenues on the financial report was approximately one-tenth-of-one-percent of the $8.8 billion dollars in cash deposits accounted for by the Department of Revenue. Rarely are miscalculations of this nature ever considered material enough to warrant any type of notification to the user of the financial data.

As a result of your finding, however, we have reviewed our compilation process as well as the compilation review process. Specifically, procedures have been added to reduce, and hopefully

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eliminate, errors like those noted in your finding. LDR management believes that reports from our claims system are accurately designed. Nevertheless, we recognize the benefits associated with continuously evaluating and improving our processes and systems and are committed to this principle.

As is customary, consideration will also be given to the findings' specific recommendations as we review the process for possible improvements. We invite and encourage your staff to offer any recommendations they may have for improving our procedures.

The staff member responsible for the improvements mentioned above is Joyce Anderson, Controller.

Sincerely,

Clarence J. Lymon, CPA
Undersecretary

CL/kb

c: Cynthia Bridges
Joyce Anderson
Dianne Morris
Phyllis Perry

LDR
Louisiana Department of Revenue

Kathleen Babineaux Blanco
Governor

Cynthia Bridges
Secretary

January 10, 2008

Mr. Steve J. Theriot, CPA
Legislative Auditor
Office of the Legislative Auditor
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Re: **Deficiency in Disaster Recovery/Business Continuity Plan**

Dear Mr. Theriot:

The Louisiana Department of Revenue (LDR) concurs in part with the noted deficiency regarding a lack of access to a remote facility in the agency's Disaster Recovery/Business Continuity Plan. Your finding continues by suggesting that without this functionality, there is a "risk that in the event of a disaster, there may be excessive delays in collecting taxes owed to the state and in processing critical data needed to ensure the accurate collection of taxes."

Our concurrence in part is due primarily to the fact that electronic services have been developed to assist us in the collection of tax revenues. In fact, approximately seventy-five percent of the taxes collected by the Department are through electronic means. In addition, LDR has planned for the potentiality of a total interruption in our manual payments and returns processing systems in our Continuation of Operations Plan (COOP). Our COOP provides the steps to ensure that the Department can perform the essential function of depositing state tax revenues into the State Treasury as soon as possible. Because of the availability of the electronic options and our plan for manual deposits, it is our position that a disaster will not materially impact the cash flow of the state, at least as it relates to tax collections. However, we do agree that delays in processing data will be a factor in the aftermath of a disaster.

As it relates to the "remote facility with the same operating system", the Department has taken steps to identify and evaluate available solutions. To that end, the Department is currently taking steps to rectify this situation and have taken the following actions:

1. ***Identify and evaluate potential remote facility solutions.***

   The research for this strategy has been completed. Included were consultations with state agencies (OIT, OTM, DNR, DHH, LDOL and Group Benefits) and equipment/recovery services vendors (Dell, EMC, Rentsys, Keta and Agility). The solution possibilities identified included: (1) commercial fixed-location (e.g. IBM or Sungard); (2) commercial mobile site (e.g. Rentsys or Agility); (3) non-commercial fixed location (e.g. OIT sponsored, multi-department); and (4) LDR Regional Office site (or other LDR-controlled remote site). It was determined that limitations and costs associated with solutions 1 and 2 make these the least desirable options. Solution number 3 is viable, but is dependent on possible future construction of such a site by state government. Timeliness is a potential issue with option 3. Solution number 4 was determined to be the best overall solution for LDR at this time and it is currently being implemented.

2. ***Coordinate with the State Office of Information Technology (OIT) to take advantage of anticipated enterprise agreements.***

   Relevant enterprise agreements have not been finalized. Coordination with OIT continues in the event such agreements become available and meet the needs of LDR.

3. ***Formulate Department specific requirements for a remote facility solution.***

   LDR has determined that the requirements for establishing a remote facility include: (1) selection and preparation of the physical facility - probably an LDR regional office; (2) mirroring of critical data between the primary data center and the remote site; (3) pre-staging of operational servers for critical applications and services; (4) establishment of communications facilities to accommodate connectivity to the remote facility; and (5) testing of the remote facility, in advance of a disaster, to validate the operational recovery efficiency of the plan. The objective is to restore operation of the Department's most critical applications and data access within minutes or hours rather than days or weeks.

4. ***Pursue remote facility access in conjunction with OIT, or independently in the event of OIT project delays.***

   LDR continues to work closely with OIT in the event options are offered which meet agency needs in this area. LDR will also move forward with its own recovery strategy – either as an interim or permanent solution.

5. ***Resolution estimated by end of fiscal year 2008-2009.***

   Estimated resolution is projected to be in the second half of fiscal year 2008-2009. A budget request for fiscal year 2008-2009 has been prepared for additional funding for this initiative.

As a result of the development of our Disaster Recovery/Business Continuity Plan and our Continuation of Operations Plan, we believe that we have provided adequate solutions to the issues identified in your finding, given the resources available to this Agency. We are committed to improving our ability to perform essential functions in the aftermath of a disaster as resources and technological solutions become available.

The contact person responsible for the corrective action specified is Greg Montagnino.

Sincerely,

Clarence J. Lymon, CPA
Undersecretary

CL/kb

c: Cynthia Bridges
Greg Montagnino
Phyllis Perry
Robert Manuel
James Greeson

BOBBY JINDAL
Governor

CYNTHIA BRIDGES
Secretary

State of Louisiana
Department of Revenue

February 26, 2008

Mr. Steve J. Theriot, CPA
Legislative Auditor
Office of the Legislative Auditor
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Re: Inadequate Controls Over Tax Allocations to the Sports Facility Assistance Fund

Dear Mr. Theriot:

The Louisiana Department of Revenue (LDR) concurs with the stated deficiency regarding "inadequate internal controls over the collection, allocation, and transfer of income tax revenues to the Sports Facility Assistance Fund (SFAF)." The failure to adequately identify, reconcile, and allocate revenues collected from nonresident professional athletes has resulted in an understatement of the amount due to the SFAF. The primary cause of this deficiency was due to our inability to assign adequate resources to this task. In response to this deficiency, LDR has committed a full-time Revenue Tax Specialist position to this task whose primary responsibility is to account for taxes attributable to the SFAF.

In response to the reconciliation issue noted in your finding, the Department has notified all visiting teams to send their withholding returns and remittances to a special post office box. This change will allow us to identify the nonresident athletes and the taxes withheld from their salaries. The information collected from the withholding returns will then be reconciled to the nonresident athlete returns filed by the athletes themselves. Performing this reconciliation will ultimately assist us in identifying a majority of revenues attributable to the SFAF.

We are in agreement with the amounts identified in your finding for tax dollars that have not been earmarked for transfer to the SFAF. As mentioned above, we have allocated the resource necessary to ensure that taxes paid by athletes are attributed and dispersed to the SFAF in a timely manner. The staff member assigned this responsibility has been adequately trained to account for the revenues payable to this fund. We expect that all issues related to this finding will be resolved as a result of this action.

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Mr. Steve J. Theriot
February 26, 2008
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As stated in your finding, you reviewed the 2005 calendar year withholding taxes paid (Form L-3, 2005 Employer's Annual Reconciliation of State Income Tax Withheld) by the professional sports franchises for nonresident athletes by the out-of-state teams and found that the taxes were not reconciled to the individual nonresident athlete income tax returns. You stated further that because LDR failed to reconcile the payments from the NFL and NBA teams to the income tax returns filed by the players, the total amount due to the SFAF has not been determined. We agree with your recommendation and do reconcile the Form L-3 detailed data to the nonresident athlete returns in cases where the information is available. However we disagree that performing this reconciliation alone will ensure that all nonresident athlete income taxes will be transferred to the SFAF. Performing the reconciliation will assist us in identifying the players and the amount of taxes withheld; however, the taxes are attributed to the SFAF only after a return has been filed by the athlete. The information on the L-3 provides confirmation of the taxes withheld from the players' income which is ultimately claimed as a credit on the nonresident athlete returns. In addition, the information obtained from this reconciliation process is also used to identify and locate those players who fail to file their returns. This reconciliation is a single task in a laundry list of procedures performed in order to ensure the accuracy of the SFAF. Exception is taken to the characterization of the primary issues stated in paragraphs one and three of your finding as being dissimilar points of contention.

As always, we are open to any ideas and/or suggestions you might have with respect to improving processes within the Louisiana Department of Revenue. We welcome the opportunity to discuss this as well as other tax administration matters.

The contact person for specified actions is Carl Reilly.

Sincerely,

Clarence J. Lymon, CPA
Undersecretary

CL/jjb

c: Cynthia Bridges
Phyllis Perry
Gwen Scott
Carl Reilly