



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Department of Revenue

Department of Revenue

Year Ended June 30, 2002



Debra K. Davenport
Auditor General

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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

February 5, 2003

J. Elliott Hibbs, Director
State of Arizona
Department of Revenue
1600 West Monroe Street
Phoenix, AZ 85007

Dear Mr. Hibbs:

In planning and conducting our audit of the State of Arizona for the year ended June 30, 2002, we considered the Department of Revenue's internal controls over financial reporting and tested its compliance with laws and regulations that could have a direct and material effect on the State's financial statements as required by *Government Auditing Standards*.

Specifically, we performed tests of the receipt and distribution of individual, withholding, corporate, transaction privilege, use, excise, tobacco, and liquor taxes; taxes receivable; tax refunds; tax refunds payable; due to local governments; payroll; transfers; and journal entries.

There are no audit findings that are required to be reported by *Government Auditing Standards*. However, our audit disclosed an internal control weakness that did not meet the reporting criteria. This internal control weakness was reported in prior years. Management should correct this deficiency to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendation is described below.

The Department should reconcile income tax receipts to income tax revenues recorded on the Arizona Financial Information System (AFIS)

Periodic reconciliation of information posted to separate accounting systems allows users to detect and resolve any differences. The reconciling process helps to ensure that potential problems will be detected and corrected. It also allows users to rely on the information in those systems.

J. Elliott Hibbs, Director
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Amounts recorded on the Department's income tax processing system and amounts recorded as income tax revenues on the AFIS differ because of timing differences and/or input errors. The Department should reconcile total income tax collections recorded on its system to the amount of income tax revenues recorded on AFIS at least quarterly. Any discrepancies should be investigated and resolved immediately.

Performing timely reconciliations will also help ensure that accurate and complete financial information is provided to the Department of Administration and reported in the State's Annual Financial Statements.

This letter is intended solely for the information of the Department of Revenue, and is not intended to be and should not be used by anyone other than the specified party. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning its contents, please let us know.

Sincerely,

Debbie Davenport
Auditor General



Janet Napolitano
Governor

ARIZONA DEPARTMENT OF REVENUE

J. Elliott Hibbs
Director

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January 31, 2003

Ms. Debra Davenport, Auditor General
Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, AZ 85018-7243

Dear Ms. Davenport:

We have reviewed the Management Letter and accompanying audit finding resulting from your test work performed in conjunction with the audit of the State of Arizona for the year ended June 30, 2002. Our general comments about the finding and specific responses to the recommendation are as follows:

The Department should reconcile income tax receipts to income tax revenues recorded on the Arizona Financial Information System (AFIS)

Department Response: **Agree**

The department understands that a periodic reconciliation of our income tax systems to AFIS is necessary to ensure potential problems are detected and corrected. However, the design of our current systems does not allow for a comprehensive reconciliation. The department performs periodic reviews of different aspects of the income tax systems including:

- A daily reconciliation to ensure the accurate transmission of all deposit batches from our remittance processing and electronic funds transfer systems to the income systems.
- A daily reconciliation to ensure the accurate transmission of all receipts taken through our cashier system to the income systems.

The department is currently involved in reengineering how it conducts business for the purpose of integrating our tax systems. As part of the project scope, there is a requirement for a comprehensive reconciliation of the integrated tax systems to AFIS. The implementation for the withholding tax system is expected in 2004. The implementation of the corporate and individual income systems is expected in 2006. We are anticipating the successful integration of these tax systems will eliminate this management letter in the future.

Sincerely,

J. Elliott Hibbs
Director

JEH:TM:dbl

cc: Tom MacConnell, Comptroller
File