



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Department of Revenue

Year Ended June 30, 2003



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 23, 2004

J. Elliot 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, 2003, 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 receipt and distribution of individual, withholding, corporate, transaction privilege, use, excise, tobacco, liquor, and unclaimed property taxes; taxes receivable; tax refunds; tax refunds payable; due to local governments; payroll; and transfers.

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. Management should correct this deficiency to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. This internal control weakness was reported in prior years. Our recommendation is described below.

**The Department should ensure the accuracy
of income tax revenues recorded on the
Arizona Financial Information System**

The Department's management and State officials depend on accurate information so they can fulfill their oversight responsibility, report accurate information to the public, and ensure accurate information is reported in the State's Annual Financial Statements. Periodically reconciling income tax collections posted to the Department's income tax processing system and the State's Arizona Financial Information System (AFIS) allows the Department to detect and resolve any timing differences or input errors in a timely manner. However, the Department did not perform such reconciliations. As a result, income tax collections recorded on the Department's income tax processing system differed from amounts recorded as income tax revenues on AFIS.

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February 23, 2004
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To help ensure accurate and complete information on AFIS, 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. The Department should promptly investigate and resolve any differences noted.

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,

Dennis L. Mattheisen, CPA
Financial Audit Director

STATE OF ARIZONA

Department of Revenue
Office of the Director
(602) 716-6090



February 10, 2004

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

Janet Napolitano
Governor

J. Elliott Hibbs
Director

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, 2003. The following is our general comments about the finding and specific response to the recommendation:

The Department should ensure the accuracy of 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 income tax 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 transmission of all deposit batches from our remittance processing, cashier, and electronic funds transfer systems to the income systems.

The department is currently implementing an integrated tax system (BRITS). Since January 2004 for withholding tax, BRITS is providing the Comptroller's Office with the appropriate revenue accounting transaction to accurately update AFIS for any receipts recorded or adjustments to receipts by Department personnel to taxpayer accounts. The same methodology will be utilized as part of the implementation of the corporate income system which is expected in September 2004 and for the individual income tax which is expected in 2006.

Sincerely,

J. Elliott Hibbs
Director

cc: File