

LEGISLATIVE AUDIT COMMISSION



Review of
Department of Revenue
Two Years Ended June 30, 2012
622 Stratton Office Building
Springfield, Illinois 62706
217/782-7097

REVIEW: 4418
ILLINOIS DEPARTMENT OF REVENUE
TWO YEARS ENDED JUNE 30, 2012

FINDINGS/RECOMMENDATIONS - 21

ACCEPTED - 8
IMPLEMENTED - 12
NOT ACCEPTED - 1

REPEATED RECOMMENDATIONS - 14
PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 37

This review summarizes the auditors' reports on the Illinois Department of Revenue, filed with the Legislative Audit Commission July 24, 2013. The auditors conducted a compliance examination for the two years ended June 30, 2012 and a financial audit for the year ended June 30, 2012 in accordance with *Government Auditing Standards* and State law. Auditors stated the financial statements were fairly presented.

The Department of Revenue is organized to provide for administering, collecting, enforcing and determining distribution of the taxes imposed by the State's major tax acts. The Department also administers and oversees the operations of the Liquor Control Commission. Effective July 1, 2009, the Department of Revenue transferred all functions of the Gaming Board and the Racing Board to their respective agencies. As of July 1, 2011, Lottery operations transitioned to a private manager, Northstar Lottery Group, and on October 15, 2011 all remaining Lottery functions were transferred from the Department of Revenue to the Department of the Lottery.

The Department collected approximately 80% and 62% of the receipts deposited into the General Revenue Fund in FY12 and FY11, respectively. A significant portion of the Department's total effort relates to the collection of the Retailers' Occupation Tax (ROT) and related taxes, income taxes, and personal property replacement taxes. The revenue collected from these sources approximates 87% and 83% of taxes collected by the Department for FY12 and FY11. The remaining 13% and 17% of the Department's revenue is derived from the collection of 25 other taxes. In addition to collecting State taxes, the Department collects some taxes on behalf of local governments, and administers the "Senior Citizens' and Disabled Persons' Property Tax Relief Act" and the "Additional Tax Relief Act."

The Director of the Department currently and since February 2003 is Mr. Brian Hamer. Director Hamer had no previous association with the Department. The average number of employees at June 30 was:

	FY12	FY11
Tax Operations	1,592	1,703
Liquor Control Commission	42	41
Lottery	-	173
Shared Services	26	34
TOTAL	1,660	1,951

Service Efforts and Accomplishments

Appendix A contains service efforts and accomplishments of the Department of Revenue as well as the Liquor Control Commission.

Expenditures From Appropriations

The General Assembly appropriated \$933,591,883 to the Department in FY12. The Department had expenditures of \$694,363,384 in FY12 compared to \$944,234,281 in FY11, a decrease of almost \$250 million, or 26.6%. However, once Lottery expenditures are deducted, Department expenditures on other items increased about \$77 million in FY12 over FY11. Significant changes in fund expenditures were as follows:

- \$326.5 million decrease in Lottery expenditures due to the separation of the Lottery from the Department of Revenue;
- \$10 million decrease in GRF due to the loss of Governor's Discretionary funding;
- \$11.8 million increase in Affordable Housing Trust Fund due to the removal of the contingency reserve;
- \$10.1 million increase in Federal HOME Investment Trust was due to funds returning to DOR from IHDA after clarification of federal regulation;
- \$14.6 million increase in Personal Property Tax Replacement Fund for grants to pay the State's share of salaries for certain county officials;
- \$5 million in first time funding of the Foreclosure Prevention Program;
- \$34.2 million for Build Illinois Bond Fund projects.

Appendix B summarizes the appropriations and expenditures for the period under review. Lapse period expenditures in FY12 were about \$48.4 million, or 7% of total expenditures.

Cash Receipts

Appendix C summarizes cash receipts of the Department for the year under review. Cash receipts were \$38.5 billion in FY12 compared to \$33.9 billion in FY11, an increase of \$4.6 billion, or 13.7%, despite a transfer of more than \$1.1 billion in funds to the Department of the Lottery and the end of the tax amnesty program that brought in \$711 million in FY11. Most of the increase in FY12 is due to collecting the increase in the income tax for a full year. Sales tax receipts were up \$445 million while taxes collected on public utilities and motor fuel decreased \$74 million and \$24 million, respectively.

Taxes Receivable Balances

Appendix D is a summary of taxes receivable balances. Net taxes receivable increased from \$973.7 million at June 30, 2011 to \$985.9 million at June 30, 2012. These taxes are due from individuals, corporations, and businesses. In FY12, approximately \$722 million of \$1.7 billion in total taxes receivable was considered uncollectible.

Property Report

Appendix E is a summary of changes in State property for FY12 and FY11. Total property decreased from \$16,038,920 at July 1, 2011 to \$13,026,705 at June 30, 2012. Equipment comprised \$13 million of total property in FY12.

Accountants' Findings and Recommendations

Condensed below are the 21 findings and recommendations presented in the reports. There were 14 repeated recommendations. Responses to the recommendations are classified based on updated information provided by Ryan McCoy, Chief Internal Auditor, via electronic mail on March 27, 2014.

Not Accepted

21. Strengthen procedures to ensure all records necessary to document transactions are preserved.

Finding: The Department of Revenue's (Department) former Division of the Lottery, now the Illinois Department of the Lottery, could not provide all FY11 information requested by the auditors.

Effective October 15, 2011, the Division of the Lottery under the Department of Revenue became a separate Department. As a result of the Department of the Lottery still being a Division within the Department during FY11, certain compliance testing associated with its operations were performed while it was a Division of the Department. Auditors requested reconciliations pertaining to the payment of winning prize payments valued at less than \$600 through retailers. The auditors were told the requested information could not be provided because it could not be located.

Department of Revenue personnel stated they could not provide the requested documents because the Department has no authority or responsibility for the Department of Lottery operations or records and the documents requested by the auditors are clearly the records of the Department of Lottery.

Response: DEPARTMENT OF LOTTERY: As noted in the finding auditors requested FY11 reconciliations pertaining to the payment of winning prize payments valued at less than \$600 through retailers and were told that the requested information could not be provided because it could not be located. It was not a matter of 'locating' the desired information; rather it was a matter of locating it in the format desired by the auditors. FY11 and FY12 reconciliations were performed differently because the systems used to provide the information changed in FY12 when Northstar Lottery Group took over as the private management agent. Fiscal year 2011's reconciliations were at the account level (cash, accounts receivable, prize expense etc.) with each account having separate detailed reports supporting the general ledger balances. These reconciliations were prepared by the Shared

REVIEW: 4418

Not Accepted – concluded

Services Center, properly preserved, and were always available to the Illinois Department of the Lottery (Lottery) or Department auditors. For FY12, Northstar Lottery Group used a new computer system and began providing a new report on retailer transactions that tied several general ledger accounts together (cash, accounts receivable, prize expense etc.). These reports became known as 'sweep' reports. For the Lottery audit, a FY11 year-to-date 'sweep' report was compiled to satisfy Lottery auditor requests in addition to providing them access to the monthly account reconciliation reports.

AUDITORS' COMMENT: *Auditors met with Lottery staff on April 4, 2013 to discuss support that could be provided in regard to testing reconciliations. At the meeting auditors were told the Shared Services Center was responsible for the reconciliations. The Department's audit liaison followed up with the Shared Services Center and responded back to the auditors that the Shared Services Center indicated the reconciliations were a Lottery responsibility. At another meeting with Lottery staff on April 25, 2013, auditors were informed that after a system conversion the Lottery is not able to go back in the system in order to provide the fiscal year 2011 information. Reconciliation information referenced within the Lottery's response was prepared for the Lottery's auditors for their testing of the Lottery's financial statement audit for the year ended June 30, 2012. Department auditors were not provided the reconciliation information referenced in the Lottery response during the engagement fieldwork to determine if it would be relevant to their testing.*

Updated Response: Not Accepted. The Department disagreed with this finding as we have no authority or responsibility for the Lottery or their operations as of October 15, 2011. As stated in 20 ILCS 1605/28, the records requested by the auditors are clearly the records of the Department of Lottery. This issue should have been addressed to the Department of Lottery. The Department has no possession of detail Lottery records.

Accepted or Implemented

- 1. Take steps to improve the review process of the underlying data that helps compile the financial statements. Also, perform a reasonableness test, as part of the financial statement preparation process, on the application of the accounting policy to eliminate certain accounts from the Credit Carry Forward calculation. Further, take action to improve timeliness in processing taxpayer information to ensure taxpayer's records and financial statement information reflect accurate information. Finally, ensure all information necessary for the preparation of financial statements be produced as of June 30 of each fiscal year end and retained to support the balances included therein.**

Finding: The Department of Revenue's (Department) year-end financial reporting to the Illinois Office of the Comptroller contained inaccuracies. The issues associated with the inaccuracies, if not detected and corrected, could materially misstate the Department's financial statements and impact the statewide financial statements prepared by the Illinois Office of the Comptroller. Some of the errors in the FY12 financial statements follow:

REVIEW: 4418

- Auditors noted a number was typed incorrectly on the spreadsheet utilized to record the statutory transfer between the County and Mass Transit Fund (Fund 0188) and RTA Sales Tax Fund (Fund 0812). As a result, the Due to Other Funds in Fund 0188 and the Due From Other Funds in Fund 0812 were understated by \$9.4 million.
- A formula error was discovered by the auditors in the spreadsheet utilized by the Department to calculate the estimated future refunds payable for the individual and business income taxes relating to the current fiscal year. As a result, the refunds payable balance in the Income Tax Refund Fund (Fund 0278) was overstated by \$70.4 million in the Department's GAAP packages. The Department notified the Illinois Office of the Comptroller and requested a journal entry be made to correct the Department's closed GAAP Reporting packages.
- During audit testing of deferred revenue, the Department determined its original calculation for deferred revenue related to taxpayer refunds carried forward for credit on future returns contained errors. The program to generate the data the Department utilized to calculate the deferred revenue for its financial statements contained errors. Upon reanalyzing the data, the Department determined deferred revenue was understated by \$19.4 million.

Department personnel stated that the Financial Control Bureau (FCB) modified a GenTax credit carry forward datamart. This change inadvertently cause the datamart to not calculate fields correctly.

- Auditors noted the report utilized by the Department to determine the total refunds and credit memoranda amount to be included in the accounts payable balances for the following funds was calculated as of July 9, 2012 rather than June 30, 2012. In addition, the detail information for the refunds and credit memoranda totals included in the report was not produced and saved as of June 30, 2012 and could not be reproduced for the revenue sources in those funds.

Department personnel stated this was an oversight of running the report and maintaining supporting documentation as of June 30, 2012. The report erroneously ran on July 9, 2012.

- During testing of the Department's accounts receivable from income tax accounts, Business, Withholding, and Individual, auditors noted exceptions with certain Business Income Tax and Individual Income Tax accounts. Auditors identified a number of exceptions related to accounts receivable from income tax accounts. A summary of some of the exceptions identified are as follows:
 - Three Business Income Tax accounts tested had information "in-house" at June 30, 2012 that was not processed by the fiscal year end, resulting in potential unadjusted receivables, totaling \$1,012,054 being reported.

REVIEW: 4418

Accepted or Implemented - continued

- Eighteen Business Income Tax accounts, one Withholding Tax account, and twelve Individual Income Tax accounts tested had incorrect interest, totaling \$4,621 being applied at June 30, 2012.
- One Business Income Tax account tested had improper late estimated payment penalty applied on the same day the Department issued a refund, which resulted in accounts receivable being overstated by \$1,952,729.

The errors noted above and other errors associated with this testing were projected to the entire billed income tax receivable populations, and the projected estimated overstatement for the populations as a whole is \$6.2 million.

Department personnel stated most of the errors noted by the auditors are not errors in the taxpayer accounts, but are merely timing differences for accrual accounting purposes. The true errors that have occurred are the result of human errors due to entering data into the system and manual calculations being performed by Department personnel.

Updated Response: Partially Implemented. The Department agrees that it should always be taking steps to improve the financial reporting process and the underlying data used to compile the financial statements. The Department recognized that some human errors occurred during the process of preparing the financial statements. There are a number of complex calculations and adjustments that require manual intervention or changes to properly process data. Enhancements continue to be made to reduce manual processes and improve upon the review process.

The Credit Carry Forward finding was not repeated in fiscal year 2013. The timeliness of processing taxpayer information is addressed in Finding #12-02.

The Department takes great pride in the high level of system testing, reviews, and year-end financial reporting work that it performs in order to produce materially correct financial statements for GAAP reporting purposes during a short window of time. Materiality is considered not only in relation to the nearly \$41 billion in total taxes collected and \$1.5 billion in net taxes receivable, but also at the individual fund level. For FY13, any corrections deemed material at the individual fund level were appropriately adjusted.

2. Seek sufficient resources to process taxpayer information in a timely manner to ensure taxpayer records and financial statement information reflect appropriate information and expedite the ability of the Department to collect all taxes due to the State. (Repeated-2011)

Finding: During testing, auditors noted the Department has sustained a significant level of inventory of Business Income Tax (BIT) and Withholding Income Tax (WIT) taxpayer information to be processed and finalized. Taxpayer information to be processed and

REVIEW: 4418

finalized consists of returns that are data entered but need further manual review and taxpayer correspondence that has been received but yet to be processed.

Auditors noted the inventory of taxpayer information to be processed and finalized at June 30, 2012 remained at sustained high levels and continued to take longer to be completed. One segment of the Department's inventory consists of original tax returns to be processed and finalized. When taxpayer information is entered into the Department's tax processing system (GenTax), certain returns are automatically flagged by GenTax that require additional manual processing to finalize, which creates this category of inventory. These flags are attached for various reasons including mathematical errors, missing tax forms, etc. This segment has increased significantly over the past few years and is predominantly business income tax returns.

It is the Department's policy to exclude the indicated balances due on these returns from the financial statements, because the true balances are unknown until the returns are manually worked by the Department's tax specialists.

At June 30, 2012, the Department identified \$5.5 billion of items related to taxpayer information to be processed and finalized (representing 217,822 returns). Although it is generally agreed the vast majority of the \$5.5 billion is invalid and will be reduced upon the tax information being finalized, there is no reasonable methodology or process for estimating the valid receivable amount of these partially processed returns. The number and amount of these returns has been increasing steadily from 41,517 returns at the end of FY09 to 217,822 at the end of FY12.

Department personnel stated the increase in taxpayer information to be processed and finalized was due to less staff available to process returns and other assigned tasks required of the processing staff such as performing "tests" of GenTax updates and revisions including the implementation of new tax laws.

According to the original response, the Department has reduced the inventory level in the past year. The BIT inventory levels at December 31, 2012 were at the lowest level in the past 20 months. The Department has filled 36 positions in BIT processing during the past year and, subject to sufficient resources, will continue to acquire staff to process tax returns in an expeditious manner.

Updated Response: Partially Implemented. We agree with the auditors that the Department should seek sufficient resources to process taxpayer information in a timely manner and that effort continues.

As stated in the finding, the establishment of edit checks, which creates the inventories, is a critical part of the operations of the Department and is critical to combating fraud and identity theft. The inventories represent the accounts on which the Department is performing additional due diligence in order to ensure the taxpayer is in compliance with tax laws and to validate refunds due or amounts owed. June 30 inventory levels will always be the highest of the year, due to the tax filing deadline of April 15.

REVIEW: 4418

Accepted or Implemented - continued

To put the inventories in perspective, the Department receives approximately eight million individual income tax, business income tax and withholding income tax returns covering an annual tax period. On June 30, 2013, the 101,172 returns in inventory noted by the auditors amounts to less than 1.3% of the returns received.

While it would be preferable for financial reporting purposes to process all inventory and have more precise balances, our highest volume of tax returns are received just prior to our fiscal year-end. GASB 33 points out that states are likely to recognize amounts based on practical considerations. While we agree that inventories should be minimized as much as possible, we also believe that our reporting of such inventory awaiting finalization is in compliance with GAAP.

- 3. Obtain or perform an independent internal control review of externally controlled service providers. Perform reviews using the Internal Audit division or a qualified external firm. Obtain and review copies of independent reviews performed by external firms. Ensure the internal control reviews address all applicable policies, practices, controls, and safeguards utilized or needed by the service providers to safeguard the taxpayer data entered into the tax returns. Identify areas to include in the reviews based upon the specific services provided by the vendor and its environment.**

Implement and monitor user controls delineated within the reports. Take corrective action promptly on findings and other weaknesses noted as a result of the independent reviews. Document any Service Organization Internal Control (SOC) reports, reviews, and corrective action taken and maintain documentation for review by the external auditors. (Repeated-2009)

Finding: The Department did not obtain independent internal control reviews of the two externally controlled service providers used to data enter tax returns. The Department also utilizes two other vendors to process mail for the Department. The Department performs periodic site visits of the service providers to monitor certain compliance requirements. The Department did not obtain Service Organization Internal Control (SOC) Reports or independent internal control reviews from any of these service providers. The Department also did not perform independent internal control reviews of these service providers. Of the total returns received by the Department, 11% of the volume is processed and 32% of the mail is handled by these four external service providers.

Department personnel stated they continuously monitor the data entered returns from the vendors in the same manner as returns that go through data entry internally in the Department. In addition, there is no procurement or other statutory requirement for the vendors to have SOC Reports completed.

Updated Response: Implemented. We agree that the Department should periodically obtain or perform such reviews of external service providers that we retain to enter tax

REVIEW: 4418

returns and process mail, and in fact, Internal Affairs and Processing perform periodic on-site compliance reviews, as well as routinely review work received from the vendors. In addition, Internal Audit has completed internal control reviews of the externally controlled service providers noted in the finding.

4. Review the current sales and use taxes (ROT) cash allocation process and develop a process to account for unperfected cash receipts due to various State and local government funds. (Repeated-2010)

Finding: The auditors noted weaknesses in the Department's controls over the fund allocation process for sales and use taxes (ROT).

The Department is mandated by various State laws to collect and allocate ROT receipts to various State and local government funds based upon amounts or percentages designated by State statute. During fiscal year 2012, the Department deposited approximately \$12.5 billion in ROT receipts into the State Treasury. As cash is collected daily, the Department allocates 98% of receipts to various State and local government funds based upon a biannual estimate. For the remaining 2% of receipts, the Department sets aside these collections (2% reserve) in order to have sufficient funds to "true-up" the various local government funds once the ROT returns are perfected and the correct/final local government allocations are known. The process is necessary due to a delay in typically two months to both "perfect" (process and approve) the ROT returns and present vouchers to the State Comptroller for distribution of ROT collections from the date a return is received by the Department.

The monthly cash information associated with the perfected returns is used by the Department to determine the amount of ROT receipts to distribute to local governments. This distribution is compared to the 98% deposits made in the second preceding month. Any shortage is allocated from the 2% reserve, which the Department set aside for this purpose. Any overage is retained in the local government fund and is added to the next month's receipt collections for consideration as part of the "true-up" process in the subsequent month. Any amounts remaining after this "true-up" are then allocated to the various State funds.

At the conclusion of this process, the Department has deposited and recorded all cash receipts received during the second preceding month; however, the "true-up" process does not ensure an adequate amount of cash receipts is retained in each local government fund for cash receipts associated with returns awaiting "perfection" by the Department.

Further, for financial reporting purposes, the Department reports each fund's cash balance in the Department's financial statements based upon the results of the process described above at June 30; however, these balances may not be individually representative of cash for "unperfected" returns. Due to this limitation, the auditors noted the following weaknesses:

- For local government funds showing a cash overage during the "true-up" process, the cash overage retained within the fund does not reflect an estimation by the Department for unperfected cash receipts due to that local government fund.

REVIEW: 4418

Accepted or Implemented - continued

- While the local government funds showing a cash shortage during the “true-up” process receive additional deposits from the 2% reserve, the ending cash overages do not reflect an estimation by the Department for unperfected cash receipts due to that local government fund.
- The deposit of the remaining cash from the 2% reserve after performing the “true-up” process into State ROT funds does not reflect an estimation by the Department for cash receipts due to the State for unperfected cash receipts due to the State funds.

At the conclusion of each month, the cash balance for ROT receipts deposited into each local government fund and the State’s ROT funds as a whole should reflect:

- The total amount of 98% daily deposits paid into the fund during the previous month and current month;
- Interest deposited by the State Treasurer during the current month; and,
- The total amount of cash receipts estimated by the Department to reflect unperfected ROT batches due to the fund collected during any month preceding the previous month.

As a result of these limitations, the cash receipts and revenue associated with the unperfected returns from the 2% reserve are generally recorded in the State’s General Fund. Upon perfecting the returns, cash allocations to other governmental and fiduciary funds will be required and are expected to be material. Further, due to the current cash allocation process limiting the accuracy of each individual fund’s cash balance at a point in time, it also limits the State Treasurer’s ability to accurately allocate interest due to various local government funds.

Department personnel stated that on June 30, with respect to unperfected returns, it lacks the information and appropriate system capabilities to accurately allocate cash receipts into the proper local government and State funds until those returns are “perfected.” Unperfected returns mean that the Department is unable to finalize processing due to various reasons, most usually errors by the taxpayer in providing appropriate distribution information. The Department’s current estimation process ensures that each fund is allocated at least as much receipts (percentage wise) as the previous fiscal year actual receipts. Department personnel indicated the true up of funds is merely a timing issue and is deemed immaterial.

Updated Response: Implemented. We agreed with the recommendation and reviewed the current process. Using historical averages and the monthly true-up process described in this finding is the best available means to allocate receipts until returns are perfected. It is important to note that this longstanding methodology has resulted in accurate distributions to local governments as returns are perfected and the needed cash being available in all funds to support these distributions. The Department is planning enhancements to GenTax, which include rewriting the Consolidated Accounting System and developing a general ledger system for reconciling detail return information with deposit information.

REVIEW: 4418

5. Ensure taxpayer information is adequately protected during both business and non-business hours from potential unauthorized access as mandated by State statute and IRS Publication 1075. (Repeated-2010)

Finding: The Department has not completely implemented controls and safeguards over processing taxpayer information. During FY12, the Department processed 11.8 million tax receipt documents throughout its facilities, totaling \$34.6 billion.

The Department receives and uses federal tax information (FTI) to verify information contained on various State tax returns; therefore, under the Internal Revenue Service's definition of comingling, the information on the Department's tax processing system (GenTax) related to Business Income Tax (BIT) and Individual Income Tax (IIT) is considered FTI and should be handled as such.

During testing auditors noted the Department's internal controls and physical safeguards to protect taxpayer information contained weaknesses as follows:

- The Department has not implemented sufficient physical safeguards to control access to the tax processing areas throughout the Department from contractors, vendors and other State employees utilized by the Department.
- Auditors noted tax payer files were stored on open shelving units throughout the Department. This information is not secure from potential unauthorized access.

Department personnel stated they have made significant improvements over the area of protection of taxpayer records. Further, Department personnel stated this is a continuing effort and they are continually making improvements as recommendations from their Security Consultant are completed and funding is available to enact the recommendations.

According to the original response, the Department was allocated \$1 million in FY13 by the Capital Development Board for security initiatives and has requested an additional \$5 million in FY2014.

Updated Response: Partially Implemented. The Department agrees with the importance of safeguarding physical taxpayer information and continues to implement compensating controls that limit/restrict access to it in our buildings. The agency has relocated non-IDOR employees to public areas. As funding is available, IDOR continues to implement other physical controls that are consistent with the two-barrier security plan. As new threats to security emerge, the effort to make improvements evolves to meet them. It should be noted that no state meets all the requirements of publication 1075. The IRS expects to see continuous improvements and the Department has ongoing discussions with the IRS to ensure that we are meeting its expectations regarding safeguarding data.

Accepted or Implemented - continued

6. **Continue to seek legislative remedy to the conflicting provisions of the State Revenue Sharing Act and the Illinois Income Tax Act; implement systems and controls to capture sufficient information to properly allocate tax receipts among State funds and calculate statutory transfers; and, work with the Office of the State Comptroller to review and update receipt codes to ensure the receipt code information reported by the State Comptroller is accurate and fairly presented regarding the type of receipt collected. (Repeated-2011)**

Finding: The Department could not resolve conflicts with provisions of the State Revenue Sharing Act (30 ILCS 115) and the Illinois Income Tax Act (35 ILCS 5/901), as both of these Acts were impacted by the passage of Public Act 096-1496, the Taxpayer Accountability and Budget Stabilization Act.

During FY11, the General Assembly passed and the Governor signed Public Act 096-1496, which increased the State income rates on individuals, trusts, estates, and corporations and contained amendatory provisions to update existing State law. During testing, auditors noted the following:

- The Illinois Income Tax Act was not amended by Public Act 096-1496 to authorize deposits of a portion of income tax receipts by the Department into the Income Tax Refund Fund.
- Prior to Public Act 096-1496, the Illinois Income Tax Act and the State Revenue Sharing Act were harmonious statutes directing the Department to transfer 10% of the prior month's income tax receipts deposited into both the General Revenue Fund and the Education Assistance Fund from the General Revenue Fund to the Local Government Distributive Fund. Public Act 096-1496 amended the Illinois Income Tax Act to change the transfer percentage to 6.86% for receipts from corporate tax collections and 6% for receipts from individual, estate, and trust collections; however the State Revenue Sharing Act was not amended. From a review of the statutes, it does not appear a supremacy clause or other language directs which statute controls in this situation. As a result of the conflicting provisions between the two statutes if the Department had followed the State Revenue Sharing Act they would have transferred an additional \$759 million to the Local Government Distributive Fund during FY12.

Further, the auditors noted the Department's receipt deposit codes and receipt processing system do not provide sufficient information for the Department to allocate receipts among the various State funds or calculate statutory transfers pursuant to State law. Specifically, auditors identified the following:

- It was determined the deposits for estates, trusts, and certain individual income taxes are coded as corporate income tax receipts and transferred at 6.86%; however, the Illinois Income Tax Act transfer calculation includes estates, trusts, and individual income taxes under the 6% transfer calculation for individual income tax

REVIEW: 4418

receipts. The Department determined the transfers from the General Revenue Fund to the Local Government Distributive Fund may have been overstated by as much as \$257,639.

- The Illinois Income Tax Act specifies deposits into the Income Tax Refund Fund between corporate receipts and individual income tax receipts, including receipts from estates and trusts. As noted above, estates, trusts, and certain individual income taxes are coded as corporate income tax receipts. The Department determined the deposits into the Income Tax Refund Fund during FY12 may be overstated by as much as \$12.2 million, the General Revenue Fund may be understated by as much as \$11.3 million, and the Education Assistance Fund may be understated by as much as \$.9 million.

Department personnel stated that they believed they followed the intent of the General Assembly and that an oversight in Public Act 096-1496 created a conflict between statutes. It is the Department's legal opinion that the most recent Act of the General Assembly supersedes the older Act with which it conflicts; therefore, deposits into the Income Tax Refund Fund were properly made.

In response to this finding from the previous audit, the Department stated it would seek legislative changes to the Illinois Income Tax Act (35 ILCS 5/901(c)) and the State Revenue Sharing Act to reflect the new percentages established by Public Act 096-1496 amending the Illinois Income Tax Act (35 ILCS 5/901(b)). The Department stated, in its response to that finding, the corrective language had been written and it continued to work to get the legislation enacted. However, the desired legislative language changes were not obtained during the audit period. The Department also stated it would develop strategies to distinguish between corporate and non-corporate tax collections associated with trust and estate returns to more accurately calculate transfers and deposits of these particular tax receipts. The Department's efforts in that regard were ongoing during the current audit period, but auditors noted the Department was unable to resolve this issue, as noted above.

Response: The Department is seeking changes to Section 901 (c) of the Illinois Income Tax Act to authorize deposits of a portion of income tax receipts into the Income Tax Refund Fund and to the State Revenue Sharing Act (30 ILCS 115/1) to reflect the new percentages established by Public Act 096-1496 amending the Section 901 (b) of the Income Tax Act. The corrective language has been written and the Department is working to get the legislation enacted.

In addition, to correct the receipt allocation and statutory transfer discrepancies caused by tax returns that cover multiple entity types that are neither individuals nor corporations (trusts, estates, partnerships), the Department will do the following:

- With respect to individual and other non-corporate income tax receipts reported on the "mixed returns" that were originally deposited into the Refund Fund at the higher business income tax percentage, submit receipt transfers to the Illinois Office of the Comptroller annually or semi-annually to correct the over deposits into the Refund Fund and under deposits into the General Fund and Education Assistance Fund.

REVIEW: 4418

Accepted or Implemented - continued

- With respect to individual and other non-corporate income tax receipts reported on the “mixed returns” that should be transferred at the 6% rate (rather than the 6.86% rate), correct the statutory fund transfer from the General Revenue Fund and the Education Assistance Fund to the Local Government Distributive Fund (LGDF) either annually or semi-annually to address any over transfer that was made to LGDF.

Updated Response: Partially Implemented. The Department continues to seek the legislative changes described in the finding. The corrective language has been written and the Department is working to get the legislation enacted. Controls have been put in place to properly allocate receipts and calculate statutory transfers. The codes currently used are correct in identifying the types of receipts collected.

7. Implement controls to ensure the deposit, allocation, and distribution of receipts from sales and use taxes are performed in accordance with State law or seek modification to statutory language as needed. (Repeated-2011)

Finding: Auditors noted weaknesses in the Department’s internal control structure over the deposit, allocation, and distribution of receipts from sales and use taxes (ROT). The auditors also identified noncompliance within the Department’s “true-up” calculations, and noncompliance with State laws in managing certain local government funds. The weaknesses noted over ROT deposits included:

- The Department’s receipt allocation process is a manual paper process involving data amassed from several sources with complex calculations on multiple spreadsheets. It relies on interaction between various areas within the Department that are responsible for portions of the ROT tax deposit and allocation process. The structure creates additional risk of error and miscommunication.

Department personnel stated the current estimation process ensures that each fund is allocated at least as much receipts (percentage wise) as the previous fiscal year actual receipts. Without significant investments into system upgrades, the Department lacks the information and system capabilities to allow for precisely allocating all receipts when they are initially received.

The auditors noted noncompliance with the Department’s administration of local government ROT funds, as noted below:

- Distributions from the County Option Motor Fuel Tax Fund were not made in accordance with the Counties Code.
- During testing of distributions from the Home Rule Municipal Retailers’ Occupation Tax Fund, the auditors noted distributions to municipal governments were not reduced by an administration fee.

REVIEW: 4418

In both instances, Department personnel indicated that to operate in the most efficient and effective manner, it follows a standardized process knowing there are minor statutory language differences among some tax statutes, which have a de minimis or no impact on allocations.

- During the review of the ROT receipt deposits, the auditors noted the following errors in the allocation of State ROT receipts into various State funds:
 - The Department treated receipts paid into the McCormick Place Expansion Project Fund as a 100% reduction in receipts from the General Revenue Fund, rather than splitting the reduction between the General Revenue Fund and Special Account for the Common School Fund. As a result, the Department should have deposited an additional \$8.8 million into the General Revenue Fund, with a corresponding reduction in receipts for the Special Account for the Common School Fund.
 - The Department does not have a system in place to split remaining receipts from the Use Tax Act and Retailers' Occupation Tax Act and receipts from the Service Use Tax Act and Service Occupation Tax Act. As a result, the Department is unable to properly allocate receipts between the General Revenue Fund and Special Account for the Common School Fund.

Specific to the exceptions noted in the current audit, Department personnel stated receipts from Retailers' Occupation and Use Tax and Service Occupation and Use Tax receipts are collected from taxpayers on the same tax form and the same line. The Department does not have information sufficient to deposit Retailers' Occupation and Use Tax and Service Occupation and Use Tax separately from ROT or Use Tax. The Department has deposited these taxes in this manner since Sales Tax reform in 1990.

Updated Response: Partially Implemented. We agreed with the recommendation and reviewed the current process. Using historical averages and the monthly true-up process described in this finding is the best available means to allocate receipts until returns are perfected. It is important to note that this longstanding methodology has resulted in accurate distributions to local governments as returns are perfected and the needed cash being available in all funds to support these distributions. The Department is planning enhancements to GenTax, which include rewriting the Consolidated Accounting System and developing a general ledger system for reconciling detail return information with deposit information.

In order to operate in the most efficient and effective manner, the Department follows a standardized systemic process in GenTax to calculate administrative fees. We recognize there are minor language differences among some tax statutes; however the Department believes the differences in the calculations have a de minimis or no impact on allocations. The Department is proposing a legislative change that will codify the longstanding systemic process we have performed for the County Option Motor Fuel Tax Fund and the Home Rule Municipal Retailers' Occupation Tax Fund. Legislation was changed in August 2013 to correct the issues noted with the General Revenue Fund and the Common School Fund.

Accepted or Implemented - continued

8. **Implement procedures to ensure the amount allocated from each tax unit to the GAAP reporting packages are included and properly classified in the financial statements. (Repeated-2011)**

Finding: The Department misstated cash during the year-end reporting process. During testing of cash balances recorded in the Office of the State Comptroller's GAAP reporting packages, the auditors noted the following:

- The Department maintains 19 tax units, for which 13 contained discrepancies in the amount allocated to the funds per the GAAP reporting packages versus the amounts allocated in the bank reconciliations. In aggregate, the errors led to a misclassification of \$6.5 million between cash and accounts receivable on the GAAP reporting packages. Due to the accrual process developed by the Department, it records 7 days of July hotel operators' occupation tax receipts in cash instead of accounts receivable.
- The Department did not properly record \$2.8 million of cash from remittance clearing accounts leading to cash being understated as of June 30, 2012. The Department did not record \$2.8 million (13%) in the GAAP reporting packages.

Department personnel stated that the cash over (under) statements were included in suspense clearing accounts at June 30, 2012 pending final deposit to the appropriate tax units and were not included in the GAAP reporting packages since they were not deemed material. The majority of the cash over (under) statements is the result of consistently applying procedures that pick up certain cash receipts for a few days in July each year.

Updated Response: Implemented. The Department agreed with the recommendation and has changed its procedures to recognize these receipts as revenues and accounts receivable at year-end. As noted throughout the audit findings, the Department had recorded and reported materially correct GAAP packages and financial statements for GAAP reporting purposes.

9. **Expand existing policies and procedures to address instances when taxpayer information is identified as being undelivered/lost/mislaid, including notify the proper State and federal authorities, as applicable, regarding any potential disclosure of taxpayer information.**

Formally document and communicate policies and procedures associated with transporting taxpayer information between locations such that taxpayer information is packaged in a manner that if lost it would readily be identifiable as confidential information.

Communicate to employees that all auditor requests be timely complied with and any instances related to unlocatable/undelivered/lost/mislaid taxpayer information be identified to the auditors in a timely fashion.

REVIEW: 4418

Finding: The Department did not have a detailed process to follow up on lost files and failed to timely disclose information related to the lost files to the auditors.

As part of performing testing associated with the financial statement audit, the auditors requested certain account information for one taxpayer to support amounts being reported by the Department. From September 2012 through November 2012, Department management continued to represent to the auditors the requested taxpayer information was unavailable as it had been assigned to the Department's Legal Services Office in Chicago in order to finalize a settlement with the taxpayer. On November 13, 2012, the auditors made arrangements with the Department to test the requested taxpayer information in the Department's Chicago office. During testing, the auditors noted the documentation provided for the six audit files was lacking documents to support the Department's audit conclusions and some of the documents contained inaccuracies. During a meeting with Department officials on November 15, 2012, the Department disclosed the audit files, which had been in two banker boxes, had been lost in transit between the Department's Chicago and Springfield offices in May 2011, fourteen months prior to the Department receiving the auditors' request for these audit files. What the auditors had been provided to test were recreations from the Department's Continuing Audit File (CAF) system, which lacked the supporting information the auditors would use to agree to the amounts in the Department's audit reports.

The auditors noted the following deficiencies:

- The Department did not have a documented policy ensuring taxpayer information is packaged for shipping that would identify it as confidential information. The Department is responsible for ensuring the confidentiality of all tax information, including both Federal and State tax information, within its possession.
- Prior to this instance of audit files being lost the Department lacked detailed policies and procedures to address the protocol in searching for undelivered/lost/mislaid files which contain taxpayer information as well as the timely notification of the Department's Director, Internal Audit Division, and Internal Affairs Division. Further, the Department did not have procedures to timely determine the contents of lost or mislaid files.

Department personnel stated the tax audit files were lost in transport by the CMS Messenger service. The Audit Bureau recreated the audit files from internal records and these were relied upon by Legal Counsel and the taxpayer to reach a final legal settlement. Department personnel indicated the Audit Bureau creates over 70,000 audit cases a year and this is the only known instance of a lost tax audit file in the past 5 years. Department personnel noted it was never the Department's intention to withhold information from the auditors.

Updated Response: Implemented. The Department agreed and improved policies and procedures to protect all taxpayer records and data. Additional procedures have been put in place regarding potentially lost files. Potential unauthorized disclosure procedures are also addressed in the Department's Annual Safeguard Training completed by all employees. It was expressed to senior staff that any lost files should be promptly communicated to the auditors.

Accepted or Implemented - continued

10. Ensure the development process of the enterprise-wide tax system (GenTax) is adequately controlled and documented. Specifically:

- **Ensure a high-level management review, evaluation, resolution, and approval of significant milestones is performed and documented.**
- **Ensure all required documentation and critical deliverables are developed, reviewed, and approved prior to system implementation and final vendor payment.**
- **Ensure all artifacts outlined in the development methodology are developed, reviewed and approved prior to implementation of each phase.**
- **Ensure all system testing is properly documented, reviewed and approved and data reconciliations are properly completed.**

In addition, ensure all major upgrades are properly documented and tested prior to implementation. Finally, ensure all developments conducted by staff adhere to development standards and documentation requirements. (Repeated-2008)

Finding: The Department continued to have problems with the controls over the development and project management of the multi-million dollar enterprise-wide tax system (GenTax). Since October 2006, the Department has expended over \$49 million in a multi-phase development of the tax system which replaced over 70 legacy tax systems.

As first reported in fiscal year 2008, auditors identified problems with the controls over the functions, development, and project management of GenTax. In the current audit problems were identified with project management that contributed to:

- A lack of high-level documentation supporting the review, evaluation, resolution, and approval of significant milestones and contractual requirements.
- Internal control deficiencies which included incomplete reconciliation of data.
- A lack of compliance with the vendor supplied development methodology. Auditors found that 11 of 23 artifacts required to be delivered by the vendor during this phase had not been developed or lacked compliance with the methodology.
- Required deliverables were not provided by the vendor. The contract outlined 14 deliverables to be provided by the vendor; however, auditors noted two deliverables had not been provided and one other deliverable (Operations Manual) was in "Draft" form.

In addition, Department staff conducted the development of the module related to Real Estate, Rental and Single Trip Permit Taxes. Per Department staff, they intended to follow the GenTax Implementation Methodology; however, the Methodology was not followed. As a result, the Department was unable to provide certain documentation related to the development, user testing, conversion, reconciliation of converted data, and training.

Department personnel stated that throughout the development process efforts were made to ensure that all required documentation and deliverables were provided. However, the primary focus of the Department's efforts was on ensuring that the system functioned as required to support Departmental operational processes.

REVIEW: 4418

Updated Response: Implemented. The Department agrees that the GenTax development process should be adequately controlled and documented, and should adhere to the prescribed implementation methodologies. The Department has created a procedure that outlines the steps required to initiate, assign, test, implement and close changes to the GenTax system. All changes receive prior approval from management before system implementation. Each project is placed into a tracking system used to store all communication related to the project. It should be noted that the use of GenTax has been a great success in many ways, such as streamlining operations, allowing more automated processes, and providing data analysis capabilities with greater visibility across multiple tax types.

- 11. Establish a documented process over the administration of GenTax access rights. Additionally, the Department should adhere to its process and periodically review the access rights of GenTax users, document such reviews, and timely deactivate separated employee accounts.**

In addition, the Department should ensure required background checks are properly and timely completed, and documentation maintained, including those for applicable DCMS employees. The Department should consider developing a formal process to ensure all current and future DCMS employees with administrative access rights to servers with Department data have required background checks. (Repeated-2010)

Finding: The Department continued to have inadequate security controls over the GenTax (enterprise wide tax system) system and data. During the auditors review, some of the issues noted were as follows:

- The Department did not have a documented process for the administration of access rights to GenTax.
- The deactivation of 3 of 36 separated employees' accounts ranged from 15 to 33 days after separation.
- Seven of 15 Department of Central Management Services (DCMS) employees with administrative access rights to servers with Department data did not have documentation to support that required background checks had been performed.
- The Department had a process in place for the review of access rights to GenTax; however, a review had not been completed during the audit period.

Department personnel stated a process is in place for the administration of access rights and the process for reviewing access rights on a periodic basis began during the audit period.

Updated Response: Implemented. The Department agrees and has established the Information Security Office. A Chief Information Security Officer (CISO) was hired and has implemented a comprehensive information security policy specifically addressing the administration of GenTax access rights. The CISO periodically reviews all access accounts and necessary action is taken on inappropriate access or anomalies. The Department has completed all required background checks on employees with administrative access rights and is properly maintaining these documents in accordance with Department policy.

Accepted or Implemented - continued

- 12. Ensure the change management process is effectively controlled and documented for GenTax. In particular, ensure all changes adhere to established standards, processes and procedures. In addition, restrict programmer access to production programs and data. (Repeated-2008)**

Finding: The Department continued to lack adequate controls over the change management process. During the auditor's detailed review of 30 completed GenTax change requests, it was noted:

- Documentation required by the established standards, processes, and procedures had not been developed or maintained;
- Meeting minutes of the weekly SQR meetings were not maintained from October 2011 to September 2012.

In addition, the auditors noted the Department had not developed a formal change management process to control modifications to the Consolidated Accounting System. In the event a change was required, an email would be sent to the applicable programmer requesting the change to be made. The programmer would complete the change; however, documentation was not always maintained.

Additionally, due to the limitations of Consolidated Accounting System, programmers had access to the production environment and implemented changes.

Department personnel stated that internal processes have changed to improve change management; however the final written procedures were not completed during the audit period.

Updated Response: Partially Implemented. The Department agrees and has improved the change management processes by finalizing written procedures requiring all changes to be properly documented, tested and approved prior to implementation. The Department's pre-migration review process has been strengthened to ensure that all required information is present prior to any changes being migrated to the production environment. Due to the limitations of restricting access in the Consolidated Accounting System, programmers have access to production programs and data on an as needed basis.

- 13. Upgrade the contingency plans to address the current environment, including the enterprise-wide tax system (GenTax). Also, ensure the contingency plans include details specific to the recovery applications and data. In addition, the test the contingency plans on an annual basis and continually update contingency plans to reflect environmental changes and improvements identified from tests. (Repeated-2006)**

Finding: The Department had not provided adequate planning or testing for the recovery of its applications or data.

REVIEW: 4418

In 2006, the Department contracted with a vendor for the development of the enterprise wide tax system (GenTax). As part of the contract, the vendor was to develop a disaster contingency plan to coincide with GenTax. However, such a plan has not been developed.

Department personnel stated that after several years of working with the Department of Central Management Services (CMS) on a disaster recovery solution, the Department opened a formal implementation charter with CMS in December 2011. Since 2011, Department personnel indicated they have continued to reach out to CMS, as the Department's infrastructure service provider, to obtain the necessary recovery capabilities to establish the disaster recovery plan.

Updated Response: Partially Implemented. The Department continues to work with DCMS, its managed service provider, to obtain the necessary infrastructure recovery capabilities to establish its disaster recovery plan. The Department has defined and communicated its critical applications and data to CMS. However, to date CMS has not provided infrastructure recovery capabilities or the needed support for the Department to complete or exercise recovery plans. The Department does have a detailed Continuity of Operations Plan (COOP) that would allow the Department to commence and continue operations following a prolonged impairment to our systems.

14. Devote sufficient resources to develop an effective internal audit program such that all planned audits are performed within the designated time period in accordance with the Statute.

Direct the Office of Internal Audit (OIA) to reevaluate its risk assessment program to document the risks identified and the planned responses to those risks as well as all additional risks which could have a greater impact on the transaction/event cycles as a whole.

Direct OIA to document any change in the risk assessment process as well on a change form.

Finding: The Department's Office of Internal Audit did not comply with the Fiscal Control and Internal Auditing Act. During FY11 and FY12, OIA could not demonstrate that internal audits of all major systems were being planned or completed once every two years of all the Department's major systems of internal accounting and administrative control. Auditors noted:

- The OIA audit plan in effect for FY11 did not include a risk assessment which defined all auditable entities within the Department due to the recent re-establishment of OIA within the Department.
- The initial OIA audit plan for FY12 identified 13 high risk audits to be performed during the fiscal year. Three additional internal audits were added to the plan during the year for a total of 16. OIA postponed 6 and cancelled 2 of the 16 high risk internal audits scheduled to be performed during fiscal year 2012. OIA spent a significant

REVIEW: 4418

Accepted or Implemented - continued

number of hours coordinating external audits and reviews, Office of the Auditor General (OAG) finding follow up, and special requests within the Department.

Three internal audits associated with the FY12 audit plan were issued and completed subsequent to June 30, 2012.

- Internal audits performed were completed within the guidelines; however, the extent of testing performed did not provide coverage commensurate with assessed risk on a Department-wide basis. The Chief Internal Auditor indicated the decision to perform internal audits within various areas of the Department is influenced, in part, to avoid duplicating efforts when those areas are subject to testing by the external audit performed by the OAG.

Department personnel stated that some internal audits were not conducted due to extenuating circumstances such as management's judgment, and the allocation of scarce resources. A major factor in FY12 was the development and implementation of the Taxpayer Access Portal (TAP). OIA devoted substantial resources to this project as it was deemed high risk and of high importance by Department management.

Department personnel noted the OIA is also responsible for carrying out many of the tasks associated with administering external audits and the related follow up. The original staffing plan for OIA included 8 positions, however during the majority of the audit period, only 4 positions were filled.

Updated Response: Partially Implemented. The Department agrees with the recommendation and understands the importance of the Internal Audit function and compliance with the Fiscal Control and Internal Auditing Act. Turnover within the Internal Audit Department will impact the timing to develop an effective program. The risk assessment process will continue to evolve and improve. Additional staff will be added as resources are available.

- 15. Send a formal notice to those employees whose jobs involve travel to remind them of the requirement and importance of filing accident reports in a timely manner. Also monitor the submission of accident reports to ensure the requirements are being met as required by the DCMS and Department policy. Further, enforce vehicle maintenance schedules to reduce future year expenditures for repairs and to extend the useful lives of vehicles. Finally, monitor personnel in charge of receiving the required annual Certification of License and Auto Liability Coverage to ensure signatures are dated.**

Finding: The Department had several weaknesses regarding the reporting of vehicle accidents, vehicle maintenance, and personal use of State vehicles and annual certifications of license and vehicle liability coverage.

REVIEW: 4418

Auditors noted that four of 25 accidents involving State/Department vehicles were not reported in a timely manner, and the Department was not ensuring personally assigned and pool vehicles were adequately maintained. In addition, exceptions were noted concerning the dated signature on the annual certification of license and insurance form.

Department personnel stated they stress to all drivers that maintaining the vehicles in the fleet is a priority and is the responsibility of the driver.

Updated Response: Implemented. The Department agrees with the importance of filing accident reports in a timely manner. A formal reminder was sent to all employees assigned State vehicles that outlined the requirements for submitting accident reports as required by DCMS and Department policy. The Department has continued to work with DCMS to update and clarify recommended maintenance schedules. The Department has added a reminder to the monthly report completed by drivers to assist them in maintaining accurate maintenance records. A new employee assigned to monitor the annual Certification of License and Auto Liability Coverage process was hired.

16. Take the following actions to improve the administration of its cash accounts:

- **Implement adequate segregation of duties in the Evidence Fund.**
- **Investigate and correct unreconciled differences.**
- **Ensure all transactions are accounted for and recorded on the books to ensure completeness of the Evidence Fund.**
- **Once the above three actions are implemented, ensure the Form C-17 is properly completed.**
- **Implement a policy for preparer and supervisor sign-offs for bank reconciliations in cash clearing accounts.**

Finding: Internal controls used to administer two of the Department's cash accounts were inadequate. During testing of the Evidence Fund, auditors noted the following exceptions:

- The custodian of the locally held fund had incompatible responsibilities including recordkeeping, depositing, and disbursing funds. This lack of segregation of duties compromises the security of the funds.
- The FY11 beginning balance had an unreconciled difference of \$265 between the bank and book balance which was carried throughout the remainder of the audit period and a \$116 deposit was recorded on the bank statement but was not reflected in the book balance during the audit period.
- In FY12, a bank fee was assessed on the bank statement but was not reflected on the books during the audit period. In addition, a duplicate deposit was recorded on the books and was not corrected in the audit period.

During testing of Tax Unit 14 clearing account reconciliations for FY11, auditors noted the reconciliation included documentation of the individual preparing the reconciliation, but did not include the documentation of the supervisor's review. For FY12, auditors noted the reconciliations did not include documentation of the individual preparing the reconciliation or

REVIEW: 4418

Accepted or Implemented - continued

documentation of the supervisor's review. The monthly reconciliations appeared to be otherwise accurate.

Department personnel stated the Evidence Fund was not accurately reconciled to the bank statement due to employee oversight along with the other issues noted by the auditors. Department personnel also noted the Tax Unit 14 clearing account reconciliations were accurate and the supervisor stated he performed the review, the lack of documentation of the supervisor's review was due to employee oversight.

Updated Response: Implemented. The Department agrees and has assessed the internal control structure over the Evidence Fund to implement additional controls including a clearer segregation of duties. The Department has finalized written procedures for the administration of the Evidence Fund which will be published in the BCI Administrative and Operations Manual. These procedures formalize the Department's policy for making requests for funds. The name of the Tax Enforcement Program Administrator has been updated on the checking account.

In addition, the Department continues to ensure the Tax Unit 14 clearing account reconciliations are maintained with the appropriate documentation. All unreconciled differences have been resolved.

17. Ensure employee performance evaluations are performed in a timely manner; maintain accurate and approved overtime records for all employees; and maintain accurate and approved leave records for all employees. (Repeated-2007)

Finding: The Department did not ensure all required processes were followed and that required forms and documents were completed and/or retained in the administration of their payroll and timekeeping functions. During testing, auditors noted:

- The Department did not perform employee performance evaluations as required.
 - Thirty-eight of 100 evaluations tested were not completed within 30 days, ranging from 35 to 829 days late.
 - Eight of 100 evaluations selected for testing were not on file and available for review.
- Department personnel did not complete required overtime approval forms correctly.
 - During testing of 25 RPS-43 forms, auditors noted exceptions pertaining to 15 of 25 (60%) forms tested, with multiple exceptions noted regarding some forms.

REVIEW: 4418

- Auditors noted exceptions in testing the Department's timekeeping records, exceptions were noted with 12 of 25 employees tested, with multiple exceptions noted regarding some employees.

Updated Response: Partially Implemented. The Department agrees that timely completion of evaluations, accurate leave records and overtime records are important. The Department continues to inform managers and supervisors of evaluations due and requires evaluations to be completed before it will effectuate changes in positions, promotions or transfers. The Department requires all employees to maintain time sheets in compliance with the State Officials and Employees Ethics Act and maintain accurate accumulated leave records for all employees.

In FY13, the Department transitioned to a paperless system (Etime) for tracking time balances, submitting and approving leave and overtime requests. The Department also implemented new time policies. E-time tracks available benefit time and its use and accruals based on the initial submissions from employees. This system removes the prior manual processes. This new system also is used for submitting overtime requests. Employees cannot receive overtime now without having an approved overtime use request in Etime. The new system mitigates the issues noted by the auditors as all records are now electronically maintained.

18. Make the advance payment to the Sports Facilities Fund required by statute or seek a legislative change to the Hotel Operators' Occupation Tax Act. (Repeated-2010)

Finding: The Department did not comply with specific provisions of the Hotel Operators' Occupation Tax Act. During testing, auditors noted the Department did not deposit the entire statutorily required "Advance Amount" into the Illinois Sports Facilities Fund from the State's share of Hotel Operators' Occupation Tax receipts. During FY12, the Department deposited \$33,100,000; however, the Department should have deposited \$38,307,000.

Department personnel stated they have worked with the Illinois Sports Facility Authority (ISFA) for years to ensure that the Department deposited the advance payment based on the "certified amount" received from the ISFA's Chief Financial Officer and then required repayment to the General Revenue Fund throughout the fiscal year until the advance payment was satisfied. The "certified amount" is equal to the amount appropriated to the ISFA for the advance amount. The Department received confirmation from the ISFA documenting their agreement with the Department's process and handling of the advance payment.

Updated Response: Implemented. The Department agreed, but decided not to pursue a legislative change to the Act. Beginning FY14, the Department made the deposit according to current statute.

REVIEW: 4418

Accepted or Implemented - concluded

19. Implement internal controls to ensure compliance with statutory transfer limitations.

Finding: The Department exceeded statutory limitations for transfers into the Tourism Promotion Fund. Auditors noted the Department transferred \$30,394,645 in FY12, thus exceeding the statutory limitation by \$4,094,645.

Department personnel stated this was an employee oversight, which resulted in a duplicate transfer.

Updated Response: Implemented. The Department agreed and implemented a formal procedure to review the fund transfer report on a monthly basis.

20. Implement internal controls to ensure: (1) all system corrections implemented since June 30, 2012 are tested to verify their accuracy and compliance with the Environmental Protection Act; (2) GenTax correctly grants tire retailers a discount of \$0.10 per tire sold to the amount that is timely paid with a timely return; (3) Taxpayers are required to file a final return within one month of ceasing to sell tires; and, (4) Receipts collected are properly allocated among the Used Tire Management Fund and Emergency Public Health Fund. (Repeated-2010)

Finding: The Department failed to comply with the requirements of the Environmental Protection Act (Act) regarding the tire user fee, resulting in errors on taxpayer accounts and inaccurate fund deposits and statutory transfers, and related financial reporting. Auditor testing noted the following noncompliance:

- In 17 out of 25 returns tested, the Department's GenTax system did not correctly calculate the discount allowed on tires that were timely paid by the taxpayer which also timely filed their return. The differences between the correct discount and GenTax calculated discount were from \$0.10 to \$1.40.
- The Department did not exercise adequate controls over allocating tire user fee receipts. The Department's daily deposit process assumed all taxpayers filed returns and paid moneys due to the State in a timely manner. Then, after the end of the fiscal year, the Department calculated a transfer to account for untimely returns that had been received during the fiscal year. These transfers were not performed timely, as the transfer for FY11 was performed in April 2012, and the transfer for FY12 was performed in December 2012.
- The Department's statutory transfers of \$0.10 per tire sold from the Used Tire Management Fund to the General Revenue Fund does not appear reasonable and resulted in an excess transfer of \$1,020,313 for FY12 and \$880,864 for FY11. The Department's transfer process assumed all taxpayers filed returns and paid all moneys

REVIEW: 4418

due to the State in a timely manner.

In addition, the auditors noted the following internal control deficiencies during testing:

- For all five final returns tested, the Department's GenTax system did not require a taxpayer filing a final return to file the return within one month of the cease date of the business. Further, the instructions for the Department's Form ST-8, *Tire User Fee*, does not notify taxpayers of this requirement.

In response to this finding from the previous audit, the Department implemented several changes to GenTax. One of the changes was to correct the issue for retailers reporting an odd number of tire sales which caused GenTax to round the total tire fees due to the next dollar. This system change was effective with the returns due on October 20, 2011, which was during the first quarter of fiscal year 2012 and during current audit period. The Department also implemented additional system changes to GenTax after June 30, 2012 which were after the auditors' testing period. Specific to the exceptions noted during the current audit period, Department personnel stated that form changes and system changes were implemented into GenTax as resources were available.

Updated Response: Implemented. The Department agreed and has tested all system corrections implemented since June 30, 2012, to verify their accuracy and compliance with the Act. GenTax has been modified to grant tire retailers the appropriate discount for timely filed and paid returns. The Department has published the additional statutory requirements for discontinued businesses that sell tires at retail. The Department has ensured that receipts collected have been properly allocated among the Used Tire Management Fund and the Emergency Public Health Fund. The Department generates a quarterly report noting the number of tires reported to make the required transfer to General Revenue Fund.

Emergency Purchases

The Illinois Procurement Code (30 ILCS 500/) states, "It is declared to be the policy of the State that the principles of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts..." The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption when there exists a threat to public health or public safety, or when immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage to State Property, to prevent or minimize serious disruption in critical State services that affect health, safety, or collection of substantial State revenues, or to ensure the integrity of State records; provided, however that the term of the emergency purchase shall not exceed 90 days. A contract may be extended beyond 90 days if the chief procurement officer determines additional time is necessary and that the contract scope and duration are limited to the emergency. Prior to the execution of the extension, the chief procurement officer must hold a public hearing and provide written justification for all emergency contracts. Members of the public may present testimony.

REVIEW: 4418

Notice of all emergency procurement shall be provided to the Procurement Policy Board and published in the online electronic Bulletin no later than 3 business days after the contract is awarded. Notice of intent to extend an emergency contract shall be provided to the Procurement Policy Board and published in the online electronic Bulletin at least 14 days before the public hearing.

A chief procurement officer making such emergency purchases is required to file an affidavit with the Procurement Policy Board and the Auditor General. The affidavit is to set forth the circumstance requiring the emergency purchase. The Legislative Audit Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

The Department filed six affidavits for emergency purchases in FY11 and FY12 totaling \$3,630,065.22 as follows:

- \$ 3,515,001.63 for Lottery ticket printing and delivery;
- \$ 100,000.00 for Tax Amnesty Plan publication; and
- \$ 15,063.59 for scanning and imaging for archival purpose.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission. Each State agency is required to file reports of all its officers and employees for whom official headquarters have been designated at any location other than that at which official duties require them to spend the largest part of their working time.

In July of 2012, the Department indicated it had 405 employees who spent at least 50% of their time working at locations other than their official headquarters.