



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Department of Revenue

Year Ended June 30, 2005



Debra K. Davenport
Auditor General

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

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

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

October 19, 2006

Gale Garriott, Director
State of Arizona
Department of Revenue
1600 West Monroe Street
Phoenix, AZ 85007

Dear Mr. Garriott:

In planning and conducting our audit of the State of Arizona for the year ended June 30, 2005, 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 cash receipts and distributions of individual, withholding, corporate, transaction privilege, use, excise, tobacco, and liquor taxes; unclaimed property; taxes receivable; tax refunds; tax refunds payable; due to local governments; payroll; transfers; and capital assets.

There are no audit findings that are required to be reported by *Government Auditing Standards*. However, our audit disclosed internal control weaknesses that do not meet the reporting criteria. Management should correct these deficiencies to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendations are described in the accompanying summary.

We are also performing a procedural review of the Department's internal controls over its information technology systems, including additional test work on the newly implemented Business Reengineering Integrated Tax System (BRITS), beyond what is included within this report. We will report the results of our procedural review to the Department's management in a separate letter to be issued at a future date.

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

TABLE OF CONTENTS



Introduction & Background	1
Recommendation 1: The Department should verify the accuracy of data recorded on BRITS in a timely manner	3
Recommendation 2: The Department should accurately report accounts receivable information	4
Recommendation 3: Computer access controls should be strengthened	5
Recommendation 4: The Department should improve controls over computer program changes	6
Recommendation 5: The Department needs to implement previously reported recommendations	7
Recommendation 6: The Department should properly safeguard and report capital assets	9
Department Response	

INTRODUCTION & BACKGROUND

In August 2002, the State contracted with a management consulting and technology services company to help improve the Department's tax collection processes and the effectiveness of its enforcement programs by developing an integrated tax information system. Beginning September 2002, the Department started implementing this new system, known as BRITS (Business Reengineering Integrated Tax System), and will continue to implement the system over the next several years. During fiscal year 2004, the Department implemented the first phase by converting transaction privilege tax (sales tax) information from the old (Legacy) system to BRITS. In fiscal year 2005, the Department implemented major components of the project by converting individual income tax withholdings (withholding) data from the Legacy system to BRITS. The Department also began preparing for the conversion of corporate income tax, which is scheduled for fiscal year 2007.

During our audit of the State's financial statements, we reviewed the BRITS system to evaluate whether the Department had established adequate controls and monitoring procedures to process, record, and safeguard sensitive electronic information. As a result of our audit work, we noted the following areas where the Department can improve its controls over BRITS:

- Data conversion and processing controls
- Reporting accurate accounts receivable information
- Computer access controls
- Program change controls

In addition to the information provided in this report, certain information came to our attention that has not been included in this report because of its sensitive nature. However, this information has been provided to the Department's Director.

The Department should verify the accuracy of data recorded on BRITS in a timely manner

The Department uses computerized information systems to process tax collections and to store critical taxpayer information. Therefore, it is vital that the Department has appropriate policies and procedures in place to help ensure that BRITS accurately processes, records, and reports tax collections and that taxpayer information recorded on the system is accurate, complete, and secure. However, the Department did not ensure that employee income tax withholdings were reconciled to the employers' withholding tax returns in a timely manner. As a result, the Department did not always determine the accuracy of amounts received from employers for employee income tax withholdings. Specifically, when processing individual income tax withholdings, the system is designed to reconcile each taxpayer's account by comparing payments received to the withholding return, updating the taxpayer's account balance, and if applicable, establishing a receivable or payable. Due to the nature of withholding transactions, the reconciliation cannot be completed until the quarterly return is filed with the Department and entered into the system. The Department should complete this process within 30 days of receipt of the quarterly return. However, because of continued problems processing withholding returns, the Department had not performed these reconciliations for returns received during the period of July 2004 through April 2005 until January 2006. As such, more than 16 percent of the withholding tax returns selected for testwork had not been compared to the payments received. As a result, the Department was unable to identify or record receivables or payables attributable to those returns. Further, the Department had to convert critical taxpayer information, including receivables from its existing Legacy system to BRITS. However, not all transactions were converted or not accurately converted to BRITS.

A similar recommendation was previously reported in our Management Letter to the Department dated September 6, 2005. In the Department's response to the recommendation, the Department planned to implement a process, which involved identifying unusual transactions for review and resolution to help ensure the accuracy of data recorded on BRITS. However, because of continued processing and data conversion problems with both withholdings and sales taxes, the Department had a significant increase in review items that were not resolved in a timely manner. As a result, more than 28,000 transactions had been identified for review and remained unresolved at fiscal year-end, including one account that resulted in a \$3.7 million understatement of the June 30, 2005 taxes-receivable balance.

As the Department will continue to implement BRITS for additional tax areas, the Department needs to ensure that all critical processes are operating effectively and that all taxpayer data converted to BRITS is accurate and complete. To help ensure that critical processes are functioning as intended, the Department should have reconciliation procedures in place to ensure the integrity of transactions processed on BRITS. Also, the Department needs to ensure the accuracy and completeness of taxpayer information converted from the Department's Legacy tax system to BRITS. The following procedures can help the Department ensure that the data processed on BRITS is complete and accurate:

- Reconcile taxes due, as reported on the withholding quarterly returns, to the withholding payments received and classify underpayments and overpayments as receivables or payables, as applicable. All reconciling differences should be investigated and corrected in a timely manner. This reconciliation will help to determine whether all tax returns were processed and all tax amounts owed to the State or due back to taxpayers were appropriately recorded as receivables or payables.
- Ensure the accuracy and completeness of taxpayer information recorded on the Department's Legacy system prior to converting this information to BRITS. Once the data is converted to BRITS, reconcile control amounts, such as accounts receivable balances, from the Legacy tax system to BRITS. Investigate and correct all reconciling differences.
- Examine and resolve transactions identified for review in a timely manner to prevent the misstatement of taxpayer accounts as well as the State's financial statements. In addition, due to the high volume of review items, the Department should evaluate the propriety of these items, investigate the reasons for so many items, and streamline the process to prevent an unmanageable backlog of review items.

The Department should accurately report accounts receivable information

The Department is responsible for recording and collecting outstanding receivable balances from taxpayers as well as reporting those balances at June 30 to the Department of Administration's General Accounting Office (GAO) for inclusion in the State's financial statements. Therefore, it is essential that the Department ensure that the accounting records provide complete and accurate information. However, the Department's BRITS system was not designed to generate accounts receivable reports, thereby preventing management from reporting, monitoring, and helping to further identify unusual accounts receivable transactions within its system. As a result, the Department was unable to obtain accurate accounts receivable

information from the BRITS system. Such information had to be obtained manually from the system and was incomplete or inconsistently recorded, and did not identify accounts receivable by type or list all pertinent and necessary information to accurately report the accounts receivable balance. Also, for financial statement presentation, the Department should only present accounts receivable balances that are not under dispute with the taxpayer and less than 2 years old. However, the accounts receivable balance was incorrectly reported because the Department could not identify each type of receivable balance and properly exclude receivables that were under dispute or more than 2 years old. In addition, the accounts receivable balance was overstated because the Department did not have adequate support for uncollectible taxes receivable that were written off and did not adjust data obtained from BRITS for credit balances. Further, the Department's audit division did not always properly classify or record audit adjustments from audits onto the BRITS system, resulting in the potential misstatement of receivables. GAO made appropriate adjustments to correct the misstatements.

To help enhance the collection of taxes due from taxpayers and help to ensure taxes receivable are accurately reported to the GAO and recorded on the State's financial statements, the Department should:

- Program the BRITS system to generate a detailed accounts receivable report by type of accounts receivable transactions. Prior to implementation, the report should be tested for completeness and accuracy. Upon approval, the report should be generated monthly, and management should review accounts receivable to determine collectability.
- Ensure amounts presented on the receivable reports are supported by detailed taxpayer records and documentation.
- Implement and monitor policies and procedures to ensure that all applicable adjustments proposed by the Department's audit division are accurately recorded on BRITS.

Computer access controls should be strengthened

System access controls help ensure that only authorized users have access to the Department's computer systems. These controls are critical in preventing or detecting unauthorized use, damage, loss, or modification of programs and equipment, and misuse of sensitive information. System access controls restrict not only physical access to the Department's systems, but also logical access to those systems. Access to the Department's computer systems should be limited to those individuals authorized to process transactions or maintain a particular system. However, the Department did not adequately limit logical or physical access to its computer systems. For example, during busy hours, supervisors from the license

and registration unit may assist cashiers to help reduce taxpayer wait times. However, supervisors have the computer access rights to process applications, approve applications, and waive application fees, which resulted in improper separation of responsibilities, as well as increased risk of theft. Additionally, logical access was granted to one user who did not need access to BRITS to fulfill his daily responsibilities. Further, access to the on-site computer room was not restricted to essential employees only.

The Department should strengthen its policies and procedures over system access to help prevent or detect unauthorized use, damage, loss, or modification of programs and equipment, and misuse of sensitive information. Only authorized users should have physical or logical access to the Department's computer systems. Also, physical and logical access should be limited to essential employees only. The Department's written policies and procedures over access controls should include, at a minimum, the following:

- Require supervisors to review and approve access levels granted to users to help prevent employees from having incompatible or unnecessary access rights.
- Eliminate access to BRITS when it is not compatible with the employee's job responsibilities.
- Restrict physical access to computer room facilities to only those authorized individuals who need access to perform their job responsibilities.

A similar recommendation was previously provided in our Management Letter to the Department dated September 6, 2005.

The Department should improve controls over computer program changes

To help ensure that an information system functions as designed, it is essential that modifications to the application software be properly authorized, tested, reviewed, and approved before modifications are implemented. The Department used system investigation requests to track computer program changes on the BRITS system. However, the Department did not enforce existing policies and procedures to ensure that program changes were properly tested, reviewed, and approved by users and management prior to implementation. For example, several system investigation requests were prepared to correct problems with simple interest calculations, applied credits, and the classification of taxpayer account receivable balances as canceled or satisfied. The Department's program change status report indicated that these requests were tested, approved, and changed within the system. However, based on

audit testwork, it does not appear that the appropriate users were involved with testing as the program changes did not address the problems in the system. As such, end users were not aware that these requests had been satisfied even though the errors were not corrected. Additionally, a system investigation request was prepared which would permit users to designate delinquent accounts as uncollectible, and add time limits to track delinquent accounts and forward them to the collections department. However, this program change and other related changes have not been implemented by the Department in a timely manner. As a result, the Department reported inaccurate receivable balances to GAO at June 30, 2005. GAO made adjustments as necessary to correct the misstatements.

To help ensure that the BRITS system reports complete and accurate information, the Department should include the following policies and procedures for system investigation requests:

- Ensure that users and management authorize, review, and approve all program changes to information systems prior to implementation.
- Require management and users to review and approve the testing methodology.
- Monitor all system investigation requests with a log or report tracking system to ensure that all requests have been authorized, assigned resources, tested, and approved. In addition, give first priority to requests affecting security, taxpayer accounts, and financial reports and assign timelines for all critical steps.
- Provide updates to management and users with the status of each system investigation request, thereby allowing users to track the status of their requests.

A similar recommendation was previously provided in our Management Letter to the Department dated September 6, 2005.

The Department needs to implement previously reported recommendations

We have reported to the Department certain deficiencies noted during our previous audits that should be corrected to strengthen operations. Two of the four recommendations identified below were first reported in our Management Letter for the fiscal year ended June 30, 2004, issued September 6, 2005 and the other two were reported last year and in prior fiscal year audits. The Department should implement the following recommendations to correct these deficiencies:

Billing taxpayers in a timely manner for amounts due—The Department bills taxpayers for underpayments and notifies taxpayers of delinquent filings of required tax returns. To help maximize tax collections, it is essential for the Department to send out tax bills in a timely manner and notify taxpayers in a timely manner of delinquent filings. However, due to data conversion and processing errors encountered during the implementation of sales and withholding taxes on BRITS, the system could not produce accurate taxpayer billing statements. Due to the volume of errors on the billing statements, the Department had to manually review and correct billing statements before sending them to taxpayers. As a result, more than 10,000 sales and withholding tax accounts totaling more than \$12.5 million in receivables, had not been billed as of June 30, 2005. Further, BRITS was not equipped to produce system-generated taxpayer notices to notify taxpayers of delinquent filings of required tax returns. Further, billing statements generated from the system should include applicable penalties and interest charges. Also, the Department should reconcile billings to the receivable accounts and review them prior to mailing to help ensure the completeness and accuracy of the amounts billed. In addition, the Department should generate monthly statements from the system to notify taxpayers of missing returns. Statements should be reviewed for accuracy and approved prior to mailing.

Controlling cash receipts—Since cash receipts are highly susceptible to potential theft or misuse, the Department should establish and enforce effective controls to safeguard cash receipts. However, the Department did not have adequate written policies and procedures or enforce existing procedures to properly control and safeguard receipts processed in the luxury tax division. For example, the employee responsible for receiving mail and recording receipts was also responsible for posting payments to taxpayer accounts and for preparing the necessary reconciliations, resulting in a lack of separation of responsibilities. To help strengthen controls over cash receipts in the luxury tax division, the Department should separate responsibilities among employees so that no one employee opens mail receipts, records and deposits cash receipts, and prepares reconciliations.

Computer backup and recovery procedures—The Department uses computerized information systems to process, record, and store information that is vital to its operations. Backup and recovery controls are designed to provide reasonable assurance that the Department would be able to continue processing or retrieve saved data should a major computer hardware or software failure occur. Since the Department's vendors are responsible for securing and maintaining the physical inventory of all backup files, the Department should prepare and maintain a current inventory listing of all back-up files and request periodic access to vendors' storage facilities to ensure adequate files are available in the event that backup and recovery procedures become necessary to restore the system.

Accuracy of revenues and expenditures recorded on Arizona Financial Information System—The Department's management and state officials depend on accurate financial information so they can fulfill their oversight responsibility, report accurate information to the public, and ensure that accurate information is reported in the State's annual financial report. Reconciling revenues and expenditures to the Arizona Financial Information System (AFIS) allows the Department to resolve any timing differences and detect errors in a timely manner. However, the Department did not prepare reconciliations for individual, corporate, and withholding income tax revenues recorded on its system. As a result, auditors noted that income tax collections recorded on the Department's income tax processing system differed from amounts recorded as income tax revenues on AFIS by more than \$9.7 million. To help ensure that accurate and complete information is recorded 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 differences noted.

The Department should properly safeguard and report capital assets

The Department has invested a significant amount of taxpayer money in its capital assets. Therefore, it is essential that the Department maintain effective stewardship over these assets. To accomplish this objective, the Department must maintain a reliable capital assets listing and follow its procedures to accurately identify, record, reconcile, control, and report its capital assets. However, the Department did not always follow its established internal control policies and procedures to ensure its capital assets were accurately recorded, controlled, and reported. For example, the Department did not effectively control its capital assets since the listing was incomplete and did not include some assets. Also, assets that were disposed of were still included on the listing, and some assets recorded on the listing could not be located. Further, the Department's policies and procedures did not address the acceptable use of state vehicles. For example, the Department had assigned an employee a specific state vehicle for travel to and from his home for after-hour calls. Use of this vehicle extends beyond the Department of Administration's guidance. As such, it is the Department's responsibility to ensure employees comply with the Department's established policies and procedures that prevent misuse of the vehicle and, indirectly, public monies.

To help ensure that its capital assets are adequately safeguarded and accurately reported, the Department should at a minimum:

- Maintain effective control over all capital assets, ensuring that all assets have been properly identified, accounted for, and included on the Department's assets listing. The Department's listing should include, at a minimum, the property identification number, description, and location of the asset, as well as the method of acquisition, funding source, acquisition date, disposal date, purchase document number, and cost.
- Record all capital asset acquisitions and disposals on the State's Fixed Asset System (FAS). Prepare a reconciliation of the Department's listing to FAS at least annually and make all necessary corrections.
- Adopt policies that clearly define acceptable use of state vehicles used for after-hour business calls. At a minimum, require authorized employees to maintain a log of all after-hour calls made with state vehicles; that is reviewed and approved by supervisors monthly. Park the vehicle at a local secure location when not in use, such as a local Department of Transportation facility, police department, or fire facility near the employee's residence, but not at the employee's home.

STATE OF ARIZONA

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



Janet Napolitano
Governor
Gale Garriott
Director

August 22, 2006

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

Dear Ms. Davenport:

The following is the Department of Revenues response to the Financial Audit for FY2005. The Department is particularly concerned about the FY2005 audit recommendations given their similarity to many of the FY2004 recommendations. The Department takes the Auditor General findings and recommendations very seriously and makes a concerted effort to implement necessary changes to address those recommendations. However, the FY2004 Financial Audit was not published until September 6, 2005. Given that FY2005 had already ended and the audit for that same period had begun, the Department had no opportunity to implement the agreed upon recommendations from the previous years audit.

Recommendation 1: The Department should ensure the accuracy of data recorded on BRITS in a timely manner

Department's Response: Agree

The Department understands the importance of having accurate data recorded in a timely manner on BRITS and as such, has established procedures to achieve that end.

Reconcile withholding tax payments and returns in a timely manner

The Department has had an effective reconciliation procedure in place for processing withholding tax returns for many years. However, as noted in the audit report, problems associated with the implementation of the BRITS withholding functionality led to processing delays and a backlog of returns to be processed.

Significant progress has been made in processing the backlogged returns. For withholding returns due in FY2005, 127,125 were stopped in suspense for review. Currently only 828 of those returns remain to be processed. In addition, the Department is on schedule for completing the processing and posting of the approximately 121,155 returns for the first quarter of 2006, due from employers on April 30th.

Going forward the recommendation advises that withholding tax returns be processed by the Department within 30 days. The Department is not opposed to this recommendation, however, without additional resources a 30 day processing goal cannot be met.

Ensure the accuracy of taxpayer data prior to conversion

The withholding income tax conversion required that 9,964 receivables be converted from the legacy system to BRITS. Of the 9,964 receivables, 304 did not properly convert. The Department will review these transactions for resolution in October 2006.

For the upcoming BRITS corporate income tax release the Department has implemented an improved approach for the conversion of data. The data to be converted and the data conversion approach were documented in a data conversion plan reviewed and approved by leadership. Automated conversion modules and a series of "mock" conversions were developed. The mock conversion results were then reconciled against DOR's legacy system, and any discrepancies were investigated. As of May 31, 2006 a total of five mock conversions had been executed and reconciled. The most recent mock conversion resulted in a 100% reconciliation rate (i.e., all data accounted for), with 99% of the data having converted properly. A DOR data purification team is correcting data in the legacy system in order to address the remaining 1% of data that did not convert properly. There will be a final mock conversion and reconciliation in August to validate the data purification activities since May 31. As a final checkpoint, during the implementation of the corporate income tax release, the results of the data conversion execution will be reviewed and reconciled by DOR staff before the system is made available to DOR users.

Resolve transactions identified for review in a timely manner

With the implementation of BRITS the Department established a series of automated evaluation criteria to help ensure the accuracy of billings and refunds prior to distribution to taxpayers. If a particular transaction met the established criteria, then Department staff manually review the resulting bill or refund from that transaction before it is mailed. The transactions being reviewed are referred to as Process Review Items (PRI). Having not utilized this process before, the Department underestimated the amount of resources necessary to review the resulting PRIs.

To address the backlog of PRIs the Department is tracking the inventory daily and has assigned staff to process those transactions as quickly as possible. To ensure timely and accurate processing in the future the Department began an analysis in June of the PRI criteria and the value each review item added toward ensuring accurate billings and refunds. The analysis and associated recommendations are expected to be complete by the end of September. Once the recommendations are approved and the corporate income tax implementation complete, the programming for the necessary system changes will be prioritized and implemented accordingly.

Recommendation 2: The Department should accurately report accounts receivable information

Department's Response: Agree

The development of an accurate accounts receivable report within the BRITS system has been and remains one of the Department's highest priorities. As noted in the audit report, the BRITS system was not designed to generate an accounts receivable report. This factor combined with the complexity of the report have made its programming and testing a very difficult project.

Program the BRITS system to generate a detailed accounts receivable report

Earlier attempts to create the accounts receivable report underestimated the complexity of the programming effort required in the BRITS system. The root cause of the previous failed attempts was analyzed, and an approach was created based upon an improved understanding of the complexity. The users and the developers have met continually since December 2005. A thorough and methodical approach was used to design and develop the required software components, and to validate results through testing. Some of the activities required to create the report were the gathering of 103 user requirements, the creation of 2 functional design documents and 73 technical design documents, the creation and/or modification of 73 software modules, and the execution of 103 separate test cases for each tax type (TPT, withholding tax, corporate income tax). The Department is currently performing user acceptance testing on the accounts receivable report to ensure its completeness and accuracy. After the report is successfully tested, it will be generated monthly to facilitate the Department's review of accounts receivable balances.

Ensure amounts presented in the report are supported with detailed records

A receivable effective date will be associated with every transaction in BRITS to present a more accurate accounts receivable statement. In addition to the main detail file that provides information regarding underpayments and overpayments for taxpayer accounts, the Department will be providing a separate transaction file for credit audits past protest, soft audits (debit audits still in the protest period), uncollectible debits, and hard audits (debit audits past protest). These files, in particular the credit and soft audit files, provide the detailed support that will tie back to the numbers presented on the BRITS Accounts Receivable Summary Report.

Implement and monitor policies and procedures to ensure audit division adjustments are accurately recorded on BRITS

The current manual processes for recording audit adjustments will become electronic with the implementation of ESKORT. The Field Audit migration of the ESKORT Audit Support and Case Management & Tracking software occurred in late July. This software release effects only the work associated with the TPT, corporate income tax and Pass Through Entity Field Audit programs. It is anticipated that the electronic

posting of adjustment data for the Field Audit release will occur by July 2007. Until ESKORT is fully implemented the Department will conduct a review of audit receivables prior to billing the taxpayer.

Recommendation 3: Computer access controls should be strengthened

Department Response: Agree

The Department understands the importance of properly controlling access to computer resources. In October 2004, the Department established a Security Officer position to centralize the data security role. The Department is continuing to improve its control and protection of information by creating an Information Security Section within the Information Technology Division. This group will build upon the centralized procedures established to date and provide additional expertise, policies and procedures, enforcement, and on-going assessment of information security for the Department. This Information Security group is planned to be in place by October 31, 2006.

In addition, the Department has taken immediate action to ensure that proper separation of duties exist in the cashiering area. As noted in the report, in an effort to reduce taxpayers wait times Supervisors in the Licensing and Registration unit were assisting cashiers. This effort to improve customer service inadvertently resulted in an inappropriate span of control over transactions. To address the issue the Department will require an additional verification of a taxpayer's documents by another employee prior to completing the processing of the transaction. As a more efficient long term solution a system investigation request (SIR) will be submitted requesting a modification to BRITS to require a second employee (if in cash handling operations) to provide online approval of any transactions in which fees are waived. Additionally, we will request regular weekly/monthly reporting of all transactions showing the initiator and approver, in order to identify any suspicious trends.

Require Supervisors to review and approve access levels granted to users

Currently, Department supervisors are required to approve access granted to system users. Those requests are made via an access form. System access is established through security "roles" that define specific types of access that will be granted to a user to perform a specific job. Any change in a security role must be approved by the appropriate Assistant Director. For the corporate income tax release of BRITS, the Assistant Directors will review and approve the security access for all impacted system users within their division.

Eliminate access to BRITS when not compatible with employee's job responsibilities

To address this recommendation the Department's IT Division Security Officer will immediately increase its reviews of the employee Vacancy Tracking System (VTS). The report identifies employees that have transferred or terminated from the Department.

As previously mentioned, the Assistant Directors will also be reviewing BRITS Security before the corporate implementation in September. In addition, the Department conducts an annual review of security which gives the Divisions the opportunity to limit access to BRITS.

Restrict physical access to computer room facilities to authorized individuals

The Department recognizes there are employees outside of DOR that are given access to the building. However, the Department and/or Department of Administration (DOA) must specifically grant access privileges to an individual for him/her to gain access to the computer room. Currently, vendors accessing the computer room are escorted by an authorized Department employee. To strengthen current policies and procedures the Department will begin completing a quarterly review of those having access to the computer room and eliminate access if it is no longer needed.

Recommendation 4: The Department should improve controls over computer program changes

Department Response: Agree

Currently, the BRITS Steering Committee, which is comprised of the Director, Deputy Director, and Assistant Directors from each of the Divisions, meets to discuss and agree on the priorities for BRITS program changes. Once SIRs are prioritized, the requested changes are estimated and completed based on the complexity of the request and availability of staff. Due to the magnitude and severe nature of SIRs generated immediately following the implementation of BRITS Release 1, and limited programming resources, the Department has been unable to complete SIRs in a timely manner.

Ensure users and management authorizes, reviews, and approves program changes

All program changes are performed via software releases. Users and management prioritize the changes (SIRs) to be included in the releases, and are responsible for defining requirements, testing and approval of the changes before they can be migrated to production. This process needs to be enhanced to ensure appropriate controls are in place and all changes to production environments are appropriately tracked and approved. A formal change management process has been implemented within Information Technology as of 7/1/2006. In addition, a release management process will be implemented that ensures appropriate prioritization, testing, and approval are monitored and formally managed. The release management approach will be introduced in October of 2006.

Require users and management to review and approve testing methodology

In addition to testing performed by the Information Technology Division for each change, appropriate users are required to perform User Acceptance Testing and must approve changes before they are released to production.

Monitor SIRs to ensure all requests have been authorized, assigned resources, tested, and approved. Give first priority to requests affecting security, taxpayer accounts, and financial reports

With limited resources, there are typically more demands than can be addressed at any one time. The Department's prioritization process ensures that the most critical items are assigned resources and addressed first. Prioritization is controlled by the Department's executive management and is based upon multiple factors. The Department does not assign priority to SIRs based solely upon the category of the SIR (e.g. financial reports) without factoring in the impact of the SIR, and how the SIR compares to other open SIRs.

Provide updates to management and users with the status of each SIR.

The status of SIRs that have been prioritized and assigned to a software release are discussed at weekly Production Support meetings attended by the Deputy Director and Assistant Directors. In addition, a written status report for each release is prepared weekly and available through the Department's Intranet. Information on all SIRs is also available through the web-based SIR tracking database. An enhanced demand management process with appropriate prioritization and feedback to the agency regarding information technology capacity and resource availability will be implemented starting October 2006. This approach will more appropriately identify, define, and communicate the level of status of all Information Technology demands (SIR, ITR, etc.)

Recommendation 5: The Department needs to implement previously reported recommendations

Department's Response: Agree

As previously noted, the FY2004 Financial Audit was not published until September 6, 2005. Given that FY2005 had already ended and the audit for that same period had begun, the Department had no opportunity to implement the agreed upon recommendations from the previous year's audit.

The Department should bill taxpayers in a timely manner for amounts due

Department Response: Agree

The Department currently issues billings for transaction privilege and withholding tax on a weekly basis. A manual review of the billings prior to their mailing is no longer conducted on every run of billings. However, if a major programming change is made to BRITS that affects the billings, a manual review will be conducted of the first run completed after the change is made. Also, all billing notices include applicable penalty and interest. The Department also issues delinquency notices to those taxpayers who have not filed the applicable tax return. The notices are generated on a monthly basis for transaction privilege tax and a quarterly basis for withholding tax. A delinquency

notice explains to the taxpayer that they have not filed a return for a specific period. The notice does not include information on tax, penalty, or interest that may or may not be due as the Department has not received a return which establishes the taxpayer's liability.

The audit noted that the Department should reconcile billings to the accounts receivable report. Although the Department does not reconcile billings to receivable accounts, we currently track the number of account periods that have been staged and eligible for billing, track the number of periods excluded and the total periods that have been billed. Additionally, we track the number that are cancelled due to offset and the total number of correspondence sent. Finally, once the accounts receivable report is completed, we will identify any additional reports that may be needed to reconcile the billings to the accounts receivable. The applicable SIRs will be written and prioritized according to the Department's process.

Controlling cash receipts

Department Response: Agree

When the Department received the FY2004 findings, the response identified procedures that were based on having 3 staff members assigned to the cash receipts process in order to safeguard cash receipts. Unfortunately, due to staff turnover, the Luxury Tax Section was only able to devote two staff members to this process. A new procedure has been drafted and is in the process of being implemented so that adequate separation of duties occurs.

Computer backup and recovery procedures

Department Response: Agree

The Department understands the critical nature of securing the information vital to its on-going operations. As the Department's vendors, AT&T and ATIS are responsible for securing and maintaining the physical inventory of backup files. The Department has reviewed the vendors' procedures and determined they meet or exceed the approved statewide standards. Since the BRITS system went into production in January 2004, all requested file restores from backup tapes have been completed without any data loss. As an additional safeguard, the Department will develop an inventory listing of all backup files, and will request access to the vendor's storage facilities on an annual basis in order to validate availability of backup files.

Accuracy of revenues and expenditures recorded on Arizona Financial Information System (AFIS)

Department Response: Agree

The Department understands the importance of reconciling the income tax revenues from the applicable tax system to AFIS. It is the Department's goal to do so. The legacy tax systems do not provide the ability for the Department to accomplish this task. One of the main revenue accounting requirements of BRITS is to provide the ability to reconcile between the two systems. Currently, the Department is testing the requirements in the corporate release of BRITS to reconcile both corporate and withholding tax revenue. The ability to reconcile individual income tax revenue will be available when that tax type is converted and implemented in BRITS.

Recommendation 6: The Department should properly safeguard and report capital assets

Department Response: Agree

The Department understands the importance of following established policies and procedures for recording, tracking, and disposal of capital and non-capital assets. The Department will begin implementing a new asset tracking system in FY2007. The new system will utilize bar scanning technology to record and track all capital and non-capital assets. Training on the operation of this system was completed in June 2006.

Maintain effective control over capital assets

The Department is committed to identifying and listing all fixed assets in the Bar Scan system and all capital assets in the AFIS system. Additionally, the Department will continue to conduct an annual agency wide inventory of all capital and non-capital assets.

Record all capital asset acquisitions and disposals on the State's Fixed Asset System (FAS)

The Department understands the importance of properly recording the acquisition of all capital and non-capital assets. The Department is currently reviewing all assets acquired through the BRITS program and is accordingly updating the new asset tracking system. All FY2007 BRITS purchases will be entered into FAS. Starting with FY2007, the Department will be reconciling all acquisitions and disposals of fixed assets to FAS on a quarterly basis.

Adopt policies that clearly define acceptable use of state vehicles

The Department will expand existing overnight vehicle usage policies to require employees to use and supervisors to review a logbook for any vehicle used in overnight

Ms. Debra K. Davenport
August 22, 2006
Page 9

and call-out situations. The policy will also recommend that any vehicles held overnight be stationed at a secure local location.

Thank you for the opportunity to respond to the report. I would like to thank your audit staff for their professionalism during this audit.

Sincerely,

Gale Garriott,
Director

GG:dbl

cc: Taryn Stangle
Kristine Ward
Lynette Nowlan
Susan Silberisen
Vince Perez
Reed Spangler
File