

DEPARTMENT OF REVENUE  
STATE OF LOUISIANA



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MANAGEMENT LETTER  
ISSUED JULY 25, 2007

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**LEGISLATIVE AUDITOR  
1600 NORTH THIRD STREET  
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BATON ROUGE, LOUISIANA 70804-9397**

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

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STEVE J. THERIOT, CPA  
LEGISLATIVE AUDITOR

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July 6, 2007

**DEPARTMENT OF REVENUE**  
**STATE OF LOUISIANA**  
Baton Rouge, Louisiana

As part of our audit of the State of Louisiana's financial statements for the year ended June 30, 2006, we considered the Department of Revenue's internal control over financial reporting; we examined evidence supporting certain accounts and balances material to the State of Louisiana's financial statements; and we tested the department's compliance with laws and regulations that could have a direct and material effect on the State of Louisiana's financial statements as required by *Government Auditing Standards*.

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

In our prior management letter on the Department of Revenue for the year ended June 30, 2005, we reported findings relating to weaknesses in the Gen Tax system, information system control weaknesses, untimely bank reconciliations, inadequate controls over reporting claims and litigation, weaknesses in controls over payroll expenditures, and the lack of a disaster recovery/business continuity plan. The finding on the lack of a disaster recovery/business continuity plan has not been resolved by management and is addressed again in this letter. The remaining findings have been resolved.

Based on the application of the procedures referred to previously, all significant findings are included in this letter for management's consideration. All findings included in this management letter that are required to be reported by *Government Auditing Standards* will also be included in the State of Louisiana's Single Audit Report for the year ended June 30, 2006.

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

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

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

Management of LDR should take the necessary measures to include access to a remote processing facility in its comprehensive disaster recovery/business continuity plan to allow critical operations to be reestablished within an acceptable time frame should a disaster or other event occur. Management concurred in part with the finding and recommendation and outlined a plan of corrective action (see Appendix A, pages 1-2).

**Inadequate Controls Over Tax Allocations  
to the Sports Facility Assistance Fund**

LDR does not have adequate internal controls over the collection, allocation, and transfer of income tax revenues to the Sports Facility Assistance Fund (SFAF). Louisiana Revised Statute (R.S.) 39:100.1 requires that the State Treasurer's Office pay to the SFAF an amount equal to the income taxes collected from the income earned in Louisiana by nonresident professional athletes and professional sports franchises. In addition, the statute authorizes LDR to establish regulations to identify and provide for the proper allocation of income taxes to the SFAF and to require income tax returns, schedules, and payments to carry out the purposes of the statute. In accordance with the statute, LDR requires that nonresident athletes use form IT-540B-NRA to file their returns, which enables LDR to identify those income taxes attributable to the SFAF.

LDR prepares a listing of taxpayers who file nonresident athlete income tax returns and periodically transfers, at its discretion, the tax revenues to the SFAF. However, LDR does not reconcile this listing to withholding taxes paid by professional athletic teams to ensure all nonresident athlete income taxes are transferred to the SFAF.

Our tests were limited to nonresident athlete income tax returns filed for the 2004 calendar year, regardless of the year in which the taxes were paid. Through February 2007, LDR collected nonresident athlete income taxes totaling \$1,143,006 (net of film tax credits totaling \$126,378) of which \$870,704 has been transferred to the SFAF. The difference of \$270,302 represents 2004 calendar year taxes collected in fiscal year 2007 that have yet to be transferred to the SFAF.

Our review of selected nonresident athletes' 2004 calendar year income tax returns disclosed that 139 nonresident athletes filed regular nonresident returns (form IT-540B) instead of nonresident athlete returns (form IT-540B-NRA), which results in income taxes totaling \$443,066 (net of film tax credits totaling \$269,413) that have not been earmarked for transfer to the SFAF.

Our review of 2004 calendar year withholding taxes paid for nonresident athletes by out-of-state National Football League (NFL) and National Basketball Association (NBA) teams disclosed that these teams paid withholding taxes totaling \$601,931 for nonresident athletes, but these withholding taxes were not reconciled to individual nonresident athlete income tax returns. Because LDR has not reconciled the payments from NFL and NBA teams to income tax returns filed, the total amount due to the SFAF has not been determined.

In all of these tests, we did not apply statistical sampling; therefore, we did not make a projection of the total potential error. In addition, we have not estimated the total amount of uncollected income taxes due to the SFAF.

Failure to maintain adequate controls over the collection, allocation, and transfer of revenues due to the SFAF results in an understatement of the SFAF's revenues. LDR should establish controls over the collection, allocation, and transfer of revenues to the SFAS to ensure compliance with R.S. 39:100.1. Management concurred in part with the finding and recommendation (see Appendix A, pages 3-4).

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

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

Respectfully submitted,



Steve J. Theriot, CPA  
Legislative Auditor

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

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**Kathleen Babineaux Blanco**  
Governor

**Cynthia Bridges**  
Secretary

February 26, 2007

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

Re: Deficiency in Disaster Recovery/Business Continuity Plan

Dear Mr. Theriot:

The Louisiana Department of Revenue (LDR) concurs in part with the stated deficiency regarding a lack of access "to a remote facility with the same operating system . . . ." Your finding continues by suggesting that without this functionality, there is an increased "risk that in the event of a disaster, there may be excessive delays in collecting taxes owed to the state and in processing critical data needed to ensure the accurate collection of taxes."

Our concurrence in part is due primarily to the fact that electronic services have been developed to assist us in the collection of tax revenues. In fact, approximately seventy-five percent of the taxes collected by the Department are through electronic means. Because of the availability of the electronic options for making tax payments, a disaster will not materially impact the cash flow of the state, at least as it relates to tax collections. However, we do agree that delays in processing data will be a factor in the aftermath of a disaster.

As it relates to the "remote facility with same operating system", the Department is currently taking steps to identify available solutions. Consequently, we are coordinating with the State Office of Information Technology (OIT) to do so. It is our understanding that OIT is currently engaged in the evaluation of multiple, "hot site" vendors with the intent of establishing enterprise agreements for the offerings that best meet state requirements. These agreements could be available as early as July 2007. LDR plans to use these agreements to fulfill its need for a remote facility.

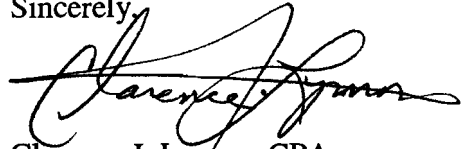
In preparation, LDR will be completing the documentation of its specific requirements for such a service. This exercise is expected to be completed over the next four months. This information

Mr. Steve J. Theriot  
February 26, 2007  
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will then be used to pursue the needed facility in conjunction with the OIT initiative; or possibly as an independent effort in the event the OIT project was to be unexpectedly delayed. LDR hopes to resolve this issue no later than the end of fiscal year 2007-2008.

The contact person for specified actions is Greg Montagnino.

Sincerely,

A handwritten signature in black ink, appearing to read "Clarence J. Lymon". The signature is fluid and cursive, with a long horizontal stroke extending to the left.

Clarence J. Lymon, CPA  
Undersecretary

CL/GM/jjb

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



Kathleen Babineaux Blanco  
Governor

Cynthia Bridges  
Secretary

July 3, 2007

Mr. Steve J. Theriot, CPA  
Legislative Auditor  
Office of the Legislative Auditor  
Post Office Box 94397  
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Re: Inadequate Controls Over Tax Allocations to the Sports Facility Assistance Fund

Dear Mr. Theriot:

The Louisiana Department of Revenue (LDR) concurs in part with the stated deficiency regarding "inadequate internal controls over the collection, allocation, and transfer of income tax revenues to the Sports Facility Assistance Fund (SFAF)." Your finding concludes that failure to maintain control over this process results in an understatement of the SFAF's revenues and is not in compliance with R.S. 39:100.1.

In your finding, you partially stated the procedures established by LDR to encourage compliance by the nonresident professional athletes and professional sports franchises that earn income in Louisiana. Our procedures are designed to allow for payment of the taxes owed by this taxpayer group via one or a combination of three methods: (1) Louisiana Nonresident Professional Athlete Return (Form IT-540B-NRA); (2) Louisiana Nonresident Professional Athlete Team Composite Income Tax Return (Form IT-540B-NRA/Composite); and/or, (3) the Louisiana Withholding Tax Return (Form L-1). There is also a vast amount of information, primarily brochures and other instructional documents, available to assist taxpayers with complying with the relevant filing and payment requirements.

We disagree with your description of the procedures we use to correctly account for taxes that should be attributable to the SFAF. Contrary to your finding, LDR does verify the accuracy of the nonresident athlete income tax returns including reconciliation of the W-2 withholdings as well as quarterly estimated payments. We agree with your finding of \$270,302 of "2004 calendar year taxes collected in fiscal year 2007 that have yet to be transferred to the SFAF." However, our normal procedure calls for authorizing a distribution after a majority of the current year returns have been processed. Therefore, the distribution authorized as of June 19, 2007, included all 2004 taxes collected in fiscal year 2007.

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Mr. Steve J. Theriot

July 3, 2007

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As stated in the finding, you reconciled the detail W-2 information attached to the 2004 Employer's Annual Reconciliation of State Income Tax Withheld (Form L-3 filed by the professional sports franchises) to the tax return data located in our integrated tax system (DELTA). In addition, other 2004 returns of interest were found on listings used to account for tax dollars to be paid to the SFAF by LDR staff members. We are in agreement with the amount identified in your finding for tax dollars that have not been earmarked for transfer to the SFAF. These returns were not accounted for through normal means because the taxpayers incorrectly filed the regular Nonresident Returns instead of the Nonresident Professional Athlete Returns. Our procedures for ensuring the accuracy of tax dollars attributable to the fund includes reconciling L-3 detail information to our tax system which helps us identify this type of incorrect filing. However, due to a shortage in resources and the fact that Hurricanes Katrina and Rita placed an enormous burden on our Taxpayer Services Division during fiscal year 2005/2006, we were not able to perform all of the usual reconciliation functions. As resources become available, the reconciliation procedures discussed are scheduled to be performed.

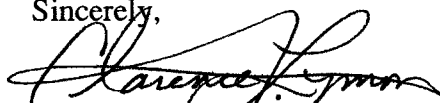
We disagree with your contention that inadequate controls exist with the transfer of dollars accumulated in the SFAF. As mentioned earlier, funds are scheduled to be transferred at least once each fiscal year. It is our position that the timing of the distribution should coincide with the processing of a majority of the returns filed, including all extensions allowed by statute.

It is our opinion that, given the resources available, we have diligently pursued the collection of and accounting for tax dollars attributable to the SFAF. As with other taxpayer groups, we have dedicated resources to encourage voluntary compliance through enforcement and educational efforts. The Department is charged with allocating its resources in a manner that encourages the highest level of voluntary compliance across all taxpayer groups. Therefore, we must manage and utilize allocated resources in order to achieve the highest level of compliance possible. Often times this means that a higher priority and greater number of resources must be devoted to other areas of tax administration.

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

The contact person for specified actions is Carl Reilly.

Sincerely,



Clarence J. Lyman, CPA  
Undersecretary

CL/GM/jjb

c: Cynthia Bridges  
Phyllis Perry  
Gwen Scott  
Carl Reilly