Legislative Audit Division

State of Montana

Report to the Legislature

October 2004

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2004

Department of Revenue

This report contains six recommendations to the department. Issues addressed in the report include:

- **Constitutionality of IRIS Funding**
- **Liquor Receivables**
- **Unrecorded Expenditures**
- **Reporting Actual or Suspected Theft**

Direct comments/inquiries to:
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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
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Helena MT 59620
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October 2004

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Revenue for the two fiscal years ended June 30, 2004. Included in this report are six recommendations related to IRIS funding, liquor receivables, unrecorded expenditures, and compliance with state laws. The department's response begins on page B-3.

We thank the director and staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

(Signature on File)

Scott A. Seacat
Legislative Auditor

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Legislative Audit Division

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 2004

Department of Revenue

Members of the audit staff involved in this audit were Jeane Carstensen-Garrett, Laurie H. Evans, Melissa Heinert, Brenda Kedish, Paul J. O'Loughlin, and Vickie Rauser.

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	Dave Ohler, Chief Legal Counsel
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	Larry Finch, Tax Policy and Research
	Steve Austin, Resource Management (Financial & Asset Management)
	Shauna Bingham, Resource Management (Human Resources and Liquor)
	Neil Peterson, Customer Service
	Don Hoffman, Business and Income Tax
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Department of Revenue

This report documents issues noted during our financial-compliance audit of the Department of Revenue for the two fiscal years ended June 30, 2004. The six recommendations in this report include IRIS funding, liquor receivables, unrecorded expenditures, and state compliance.

We issued an unqualified opinion on the department's financial schedules presented in this report. This means the reader may rely on the presented financial information and the supporting detailed information on the primary accounting records.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

A. We recommend the Montana Legislature resolve the constitutional issues of state debt, repayment appropriation, and delegation of authority related to Chapter 597, Laws of 2003.

Department Response: Do not concur. See page B-3.

B. We recommend the department discontinue drawing funds from its BOI loan. 11

Department Response: Do not concur. See page B-3.

Recommendation #2

We recommend the department seek legislation to require payments from agency liquor stores within 30 days, or to allow payment to liquor suppliers in 60 days. 12

Department Response: Concur. See page B-4.

Recommendation #3

We recommend the department record contracted collection expenditures on the state's accounting records in accordance with state law. 13

Department Response: Concur. See page B-4.

Recommendation #4	We recommend the department develop written policy for the reporting of actual or suspected theft to ensure compliance with state law. 14
	Department Response: Concur. See page B-5.
Recommendation #5	We recommend the department:
	A. Seek legislation to amend section 15-36-311, MCA, to be consistent with the rest of Title 15, chapter 36, part 3, MCA.
	Department Response: Concur. See page B-5.
	B. Seek legislation to resolve the conflict between sections 15-1-113 and 15-1-121, MCA.
	Department Response: Concur. See page B-5.
	C. Seek legislation to amend section 15-1-201, MCA, to reflect current information needs. 16
	Department Response: Concur. See page B-5.
Recommendation #6	We recommend the department:
	A. Work with the Department of Administration's Accounting Bureau to revise the guidance for recording deferred revenue transactions on the entitywide ledger.
	Department Response: Partially concur. See page B-6.
	B. Record the proper deferred revenue transactions in the entitywide ledger to facilitate preparation of the state's government-wide financial statements. 17
	Department Response: Concur. See page B-6.

Introduction

Introduction

We performed a financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2004. The objectives of our audit were to:

1. Determine if the department complied with applicable state and federal laws and regulations.
2. Obtain an understanding of and, if appropriate, make recommendations for improvement in the internal and management controls of the department.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the department's financial schedules present fairly the results of its operations for each of the two fiscal years ended June 30, 2004.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing the recommendations contained in this report. Issues deemed not to have significant effect on department operations have been discussed with management, but are not included in this report.

As required by section 17-8-101(6), MCA, we analyzed the rates charged and the fund equity of the department's Internal Service Fund, which is used to provide bad debt collection services to state agencies. We found the rates were commensurate with costs for the activity in the Internal Service Fund for fiscal years 2002-03 and 2003-04 and the fund equity was reasonable at June 30, 2003, and June 30, 2004.

Department Organization and Functions

The department collects revenue and enforces regulations for over 30 state taxes and fees. Taxes collected include individual income, corporation, natural resource, accommodation, unemployment insurance, and inheritance. The department also regulates the sale and distribution of alcoholic beverages in the state. The department is organized into the following six divisions:

Director's Office (28 FTE) is composed of four primary sections providing communication and administrative support services as noted below:

Legal Services supervises the overall legal efforts of the department and development of policy and administrative rules, supervises the legal staff and maintains liaison with retained attorneys. It further oversees the office of dispute resolution, which reviews, facilitates, and resolves taxpayer disputes internally through a variety of means, including mediation.

The Business Plan/Performance Management Office provides the department's business planning and performance management.

The Tax Policy and Research Office is responsible for all state revenue legislation, all legislative proposals affecting the department, and department economic data analysis.

The Budget Analyst is responsible for monitoring the department's budget development and expenditures to ensure they are in compliance with the law.

Business and Income Taxes Division (120 FTE) is responsible for the administration and collection of Montana corporation license, natural resource, withholding, personal income, miscellaneous, industrial property, and centrally assessed property taxes. The income and withholding bureau and the business tax and valuation bureau handle these functions for the department. This division also serves as the department's federal tax liaison.

Customer Service Division (120 FTE) combines the processing and retention operations bureau, accounts receivable and collections bureau, and customer intake bureau into a single business unit designed to collect revenue and process documents for the department and agency partners.

Information Technology Division (32 FTE) is responsible for the data support, applications support, technology support, and user assistance that enable the department to meet its business objectives. The division maintains legacy tax systems including Individual Income Tax, Corporation Tax, Liquor, POINTS, Abandoned

Property, Solid Minerals, Utility Assessment, Livestock, and Hail. It also maintains property tax appraisal assessment systems. Further, the division provides support to the department's implementation of the Integrated Revenue Information System (IRIS), which is replacing POINTS. The division's responsibilities are accomplished through its technology resource, security and information support, and application resource bureaus.

Property Assessment Division (301 FTE) is responsible for administering the property tax laws, including annual appraisal and cyclical reappraisal. Two districts with six field sites (regions) perform the functions of this division.

Resource Management Division (37 FTE) integrates human resources, accounting, facilities, internal and external customer education, and liquor distribution through the human resources bureau, the financial management bureau, and the liquor distribution bureau. The division focuses on service and support to the department.

Advisory Councils, Boards, Commissions

The Advisory Council for Multi-State Tax Compact was created to act in an advisory capacity to the multi-state tax commission member for Montana. That member is the department director or the director's designee. This council has no rulemaking or rule adjudicating authority.

The Department of Revenue Stakeholder Advisory Council was created to advise the department concerning ongoing efforts for more efficient, modern business processing and customer service. This council meets semiannually or more often if needed and is made up of legislators, agency directors, association executives, and individual taxpayers. This advisory council is not a policymaking body and has no rulemaking authority.

Board of Review oversees the one-stop licensing program, as established in section 30-16-302, MCA, and is attached to the department for administrative purposes only. The board has separate rulemaking authority under section 30-16-104, MCA.

The department is a member of the Federation of Tax Administrators, the National Alcohol and Beverage Control Association, and the National Association of Unclaimed Property Administrators. The department also participates in the following state government organizations: the Information Technology Board, the Electronic Government Advisory Council, the Information Technology Managers Council, the SABHRS Enterprise Solutions Council, and the Montana Geographic Information Council.

Department Reorganization and System Replacement

Chapter 597, Laws of 2003, provided that the state's Chief Information Officer and the Department of Administration work in conjunction with the Departments of Revenue and Labor & Industry to replace the POINTS computer system. The unemployment insurance tax collection and transactions processed under POINTS transferred to the Department of Labor & Industry as of July 1, 2004.

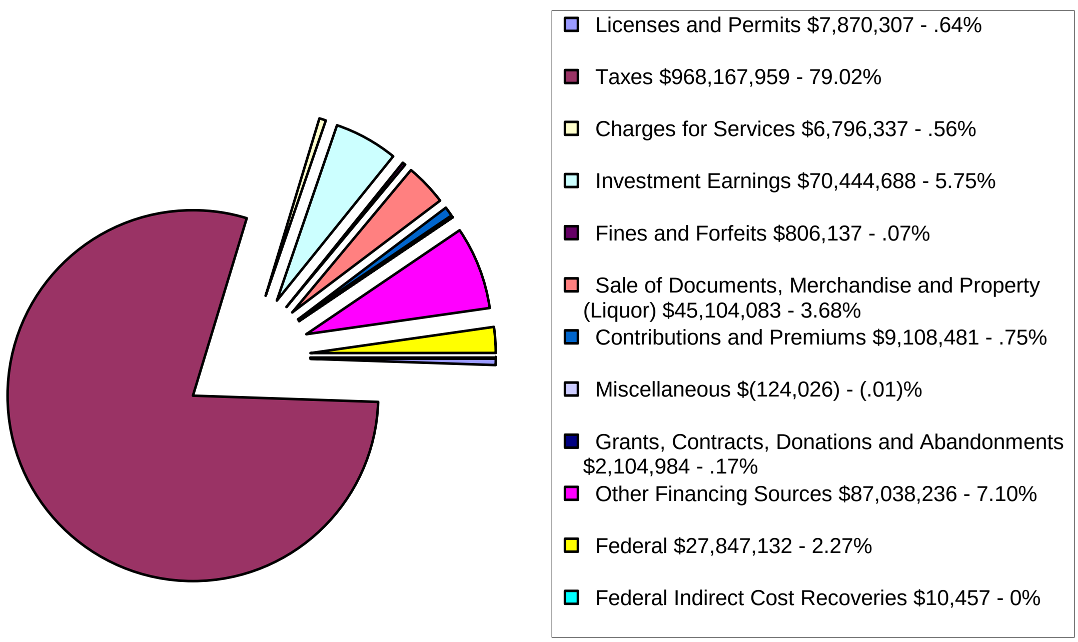
As of July 2004, the department uses IRIS to process four tax types: rental vehicle, lodging facility, cigarette, and withholding. The Combined Oil and Gas program is scheduled to begin processing through IRIS in August 2004.

Total Revenue

Total revenues by class, as recorded by the department on SABHRS, for fiscal years 2002-03 and 2003-04 are illustrated in the following charts.

Chart 1

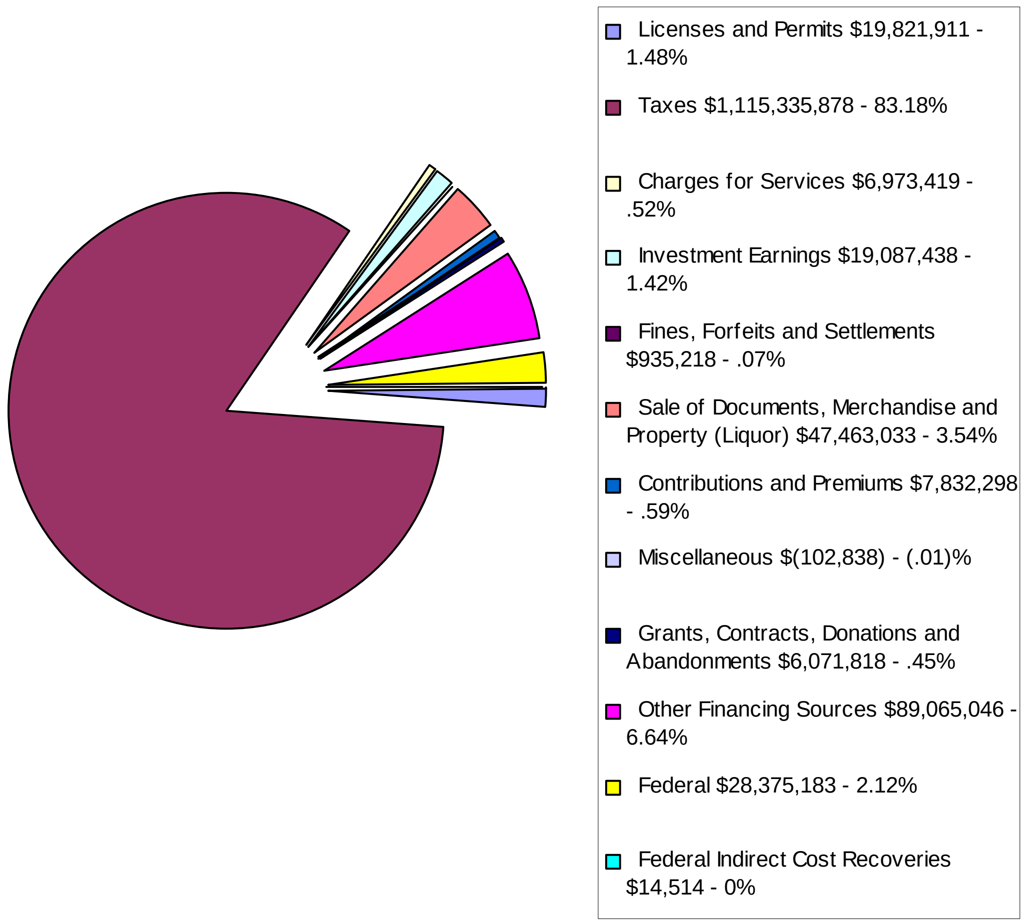
Total Revenue by Account Class
Fiscal Year 2002-03



Source: Compiled by the Legislative Audit Division from the department's financial schedules.

Chart 2

Total Revenue by Account Class
Fiscal Year 2003-04



Source: Compiled by the Legislative Audit Division from the department's financial schedules.

Prior Audit Recommendations

The previous financial-compliance audit report of the department for the two fiscal years ended June 30, 2002, contained eight recommendations. Of those, the department implemented six, partially implemented one, and did not implement one recommendation. The recommendation not implemented is related to liquor distribution receivables and is discussed on Page 12. Issues related to the partially implemented recommendation are discussed below.

Coal Tax Bond Fund

Section 17-5-703, MCA, requires the state treasurer to determine, on July 1 of each year, the amount necessary to meet all principal and interest payments on bonds payable from the coal severance tax bond fund during the next 12 months and retain that amount in the coal severance tax bond fund. Moneys in excess of this reserve amount are transferred to various funds according to state law.

The department relies on the Department of Natural Resources and Conservation (DNRC) to notify it of this reserve amount each year. The reserve requirements for the last 3 fiscal years were as follows:

2001-02	$5,815,475
2002-03	5,840,119
2003-04	6,706,444

For fiscal years 2002-03 and 2003-04, DNRC did not provide the reserve amounts until October 5, 2002, and December 3, 2003, respectively. The department needs to know the required reserve amount so it can determine if excess moneys should be transferred.

The department invests the required reserve in the Short-Term Investment Pool (STIP). According to department personnel, the department maintains the STIP investment at the previous year's reserve level until it receives notification from DNRC as to the current year reserve requirement. The only exception to this is when a bond payment must be made. Therefore, the risk that resources are not available to make payments of bond principal and interest as they come due is mitigated. However, during fiscal year 2003-04, transfers of current year severance tax receipts took place as the funds were received and this caused the department to transfer coal tax before it should have.

DNRC notified the department of the fiscal year 2004-05 reserve amount on June 18, 2004. The department should work with DNRC to ensure the required reserve amount is determined by July 1 every year, as required by state law. We make no further recommendation at this time.

Introduction

Research and Development Tax Credit

The department has not yet adopted rules for the implementation of the state's research and development tax credit as recommended in our prior audit report. Section 15-31-150(7), MCA, requires these rules. According to department personnel, the rules are being developed and we make no further recommendation at this time.

Constitutionality of IRIS Funding

The 2003 Legislature authorized state debt without the constitutionally mandated 2/3 vote, indirectly put the Coal Tax Trust Fund corpus at risk, and inappropriately delegated its authority to allocate state tax resources.

Chapter 597, Laws of 2003, authorized funding not to exceed $17 million for the department to replace the Process Oriented Integrated System (POINTS) computer system. The replacement system is called Integrated Revenue Information System (IRIS). The department entered into a loan agreement with the Montana Board of Investments (BOI) to borrow money from the Permanent Coal Tax Trust Fund. As of June 30, 2004, the department had drawn $5,886,467 and repaid $188,025. The department has also incurred $79,031 of interest on the loan. The department has transferred $233,889 of income tax revenues to make the required principal and interest payments. There are issues regarding the constitutionality of this legislation. The following sections discuss our concerns.

Creation of State Debt

Article VIII, Section 8 of the Montana Constitution states, "No state debt shall be created unless authorized by a two-thirds vote of the members of each house of the legislature or a majority of the electors voting thereon." State debt is the incurring of an obligation for which repayment extends beyond the existing budgeting and reporting period and for which the source of repayment is revenue derived from the state's taxing power. That is, the Legislature obligates future legislatures to a particular course of action and limits their ability to appropriate state tax revenues until such time as that course of action is complete.

Chapter 597, Section 4 (4) (a), states in part, "If bonds are not issued for the project authorized in [section 1], the department of revenue is authorized to enter into contracts, loan agreements, or other forms of indebtedness with the board of investments." This language indicates the Legislature was aware that some form of debt instrument would be necessary to accomplish the replacement of POINTS. Further, Chapter 597 provided a debt service mechanism by requiring the department to establish an assessment against selected taxes, sufficient to cover the annual principal and interest payments of the loan, over a period not to exceed seven years.

The assets related to IRIS and POINTS are similar and the funding authorized for IRIS is similar to that for POINTS. The 1997 and 1999 Legislatures authorized a total of $32 million in bonding authority for the department to develop and complete POINTS and to realign the department's business processes, thus obligating future legislatures and limiting their ability to appropriate state tax revenues. Each of these legislative acts had the two-thirds vote of each house as required by the Constitution.

Chapter 597, Laws of 2003, was not approved by a two-thirds vote of each house and therefore the loan, which will be repaid by general tax revenues of the state, is an unconstitutional creation of state debt.

Coal Tax Trust Fund Corpus At Risk

Chapter 597, Section 4 (4) (d) states, "The loan is subject to the risk of nonappropriation." Since the Legislature created state debt, every succeeding legislative assembly has an obligation to provide continued funding for the repayment of that debt, making this provision irrelevant. Failure to appropriate funds for the repayment of the IRIS loan could result in default by the department and violation of the Coal Tax Trust Fund corpus. Article IX, Section 5 of the Montana Constitution states, in part, "The principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature." It is unlikely the Legislature will not appropriate funds for repayment of the IRIS loan.

Delegation of Legislative Authority

Chapter 597, Section 5, states, "(1) The department shall establish a fee of up to 0.45 percent of selected taxes collected by the department in order to recover costs and expenses associated with the POINTS replacement system described in [section 1]." This language appears to be an unconstitutionally vague delegation of legislative authority prohibited by Article III, Section 1, of the Montana Constitution which states, "The power of the government of this state is divided into three distinct branches--legislative, executive, and judicial. No person or persons charged with the exercise of power properly belonging to one branch shall exercise any power properly belonging to either of the others, except as in this constitution expressly directed or permitted."

The legislation does not identify the selected taxes or the precise percent of the tax transfers. Thus, the department has broad latitude in determining the source(s) it will use to repay the loan. It is the Legislature's, not the Executive's, responsibility to allocate the state's general tax revenues.

Resolution

The Legislature has several options available to resolve the issues presented above.

- Retroactively authorize the creation of debt by obtaining the constitutionally required two-thirds vote from each house and identifying a specific revenue source and amount for repayment.
- Appropriate General Fund monies to pay off the loan immediately and to complete IRIS implementation.
- Repeal the "subject to the risk of nonappropriation" provision in Chapter 597 to remove the risk to the Coal Tax Trust Fund Corpus.

We recognize that the department plans to move forward with its IRIS implementation. However, continuing to incur debt in light of the legal issues raised may not be a prudent course of action. We believe the department should discontinue drawing funds against its BOI loan until the Legislature resolves the issues discussed above.

<u>Recommendation #1</u>

A. We recommend the Montana Legislature resolve the constitutional issues of state debt, repayment appropriation, and delegation of authority related to Chapter 597, Laws of 2003.

B. We recommend the department discontinue drawing funds from its BOI loan.

Liquor Receivables

By statute, the state, in effect, provides 30-day interest free loans to privately owned agency liquor stores at an annual cost to the General Fund of $100,000.

The department's liquor distribution operation serves as the central purchasing facility for privately owned agency liquor stores in the state. Agency stores purchase inventory from the distribution operation. The purchase of liquor from vendors and the sale of the liquor to the agency stores are done simultaneously by the state.

Section 16-2-101(2)(b)(ii)(C), MCA, requires agency stores to pay for liquor they have purchased within 60 days from the date of purchase. However, the state's agreement with liquor suppliers and section 17-8-242(2), MCA, require the department to pay the liquor suppliers for the liquor in 30 days or less from the invoice date. In our prior audit we recommended the department take necessary action to ensure payments received from agency stores coincided with payments made to the state's liquor suppliers.

The department partially concurred with our recommendation. Legislation to amend the above-mentioned law was introduced in the 2003 Legislative Session and died in committee. Department management cited potential adverse impacts to agency stores as a contributing factor.

We determined the state's General Fund lost interest in excess of $100,000 per year because of the discrepancy in these payment requirements. Allowing the agency stores to pay the state for these liquor purchases in 60 days when the state must pay its obligations to liquor suppliers in 30 days is not sound cash management and constitutes a 30-day interest free loan to agency liquor stores.

Recommendation #2
We recommend the department seek legislation to require payments from agency liquor stores within 30 days, or to allow payment to liquor suppliers in 60 days.

Unrecorded Expenditures

The department did not record expenditures incurred under its contract with a collection agency.

In fiscal year 2003-04, the department contracted with a collection agency to assist in recovering past due individual income taxes. The collection agency retains its fee and forwards the remainder of the taxes collected to the department. The department accounts for the transaction by recognizing cash received and net revenue. Recording the transaction in this manner fails to recognize an expenditure on the accounting records of the department. Employees of the department also perform collection services and the expenditures associated with that activity are recorded on the accounting records. This results in inconsistent financial reporting for the same type of activity.

Section 17-1-102(4), MCA, provides that state agencies shall input all necessary transactions to the state's accounting system before the accounts are closed at the end of the fiscal year in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with generally accepted accounting principles (GAAP). Financial reporting standards under GAAP require consistency in reporting financial information.

For the fiscal year ended June 30, 2004, the amount of unrecorded expenditures in the General Fund related to this collection activity is approximately $377,000. Management noted that the former director did not want to have invoices and checks being exchanged between the collection agency and the department and did not want to pursue obtaining appropriation authority.

Recommendation #3
We recommend the department record contracted collection expenditures on the state's accounting records in accordance with state law.

State Compliance

During our audit we noted the following instances where the department can improve compliance with state law.

Reporting Actual or Suspected Theft

The department has no policy in place to ensure its employees report actual or suspected theft in accordance with state law.

Section 5-13-309 (3), MCA, states, "The head of each state agency shall immediately notify both the attorney general and the legislative auditor in writing upon the discovery of any theft, actual or suspected, involving state moneys or property under his control or for which he is responsible."

Department administrators noted two incidents occurring in fiscal year 2002-03 that were not reported as required by law. A digital camera was taken from a department vehicle in the fall of 2003 and $35 was found to be missing from a change fund. We did receive notice that a projector was stolen sometime between July 3, and July 8, 2002. This suspected theft was not reported until September 18, 2002, which is a two-month lag between identification and reporting.

There is no written department policy that instructs employees on what to do if they become aware of actual or suspected theft. The department's legal counsel was not aware of any of the above-mentioned thefts and indicated the department should have a written policy. The policy needs to be clear as to what procedures are followed and who is responsible for ensuring timely reporting of actual or suspected theft, regardless of dollar amount.

<u>Recommendation #4</u>
We recommend the department develop written policy for the reporting of actual or suspected theft to ensure compliance with state law.

Statutory Housekeeping

Statutes affecting the department's operations are out of date.

Oil and Gas Production

During the 1999 Legislative Session the references in state law to pre- and post-1985 gas and oil production were changed to pre- and post-1999 production for certain oil and gas production statues. Section 15-36-311, MCA, however still contains language about pre- and post-1985 gas and oil wells. The definitions in section 15-36-303, MCA, and the production tax rates imposed on oil and natural gas in section 15-36-304, MCA, were modified but now conflict with section 15-36-311, MCA.

Distributions to Local Governments

Section 15-1-113, MCA, requires the department to determine the amount of fee in lieu of property tax lost by each local government as the result of amendments to section 61-3-529, MCA, contained in Chapter 500, Laws of 2001. Section 61-3-529, MCA, pertains to a schedule of fees for buses, motor vehicles having rated capacity greater than one ton, and truck tractors. Section 15-1-113, MCA, also provides guidance for determining reimbursement amounts to be distributed via quarterly payments to local governments. Department personnel indicated that there is no need to comply with this statute because section 15-1-121, MCA, requires the department to calculate each local government's base entitlement share of the state General Fund. This statute includes fee revenue in section 61-3-529, MCA, as part of the entitlement calculation.

There appears to be a conflict between the statutes as both involve calculation of reimbursements to local governments for lost property taxes. The department believes that section 15-1-121, MCA, supercedes section 15-1-113, MCA, regarding payments made to local governments. We determined the department is in substantial compliance with section 15-1-121, MCA. However, the department should seek legislation to resolve the conflicts in these statutes.

Municipal Corporations

Section 15-1-201(3), MCA, requires the department to collect certain information from municipal corporations to assist the department in its work. Department personnel noted that certain types of information required to be collected by the law are no longer collected because the information is not needed. We determined the department is in substantial compliance with section 15-1-201, MCA, but should seek legislation to amend this statute to reflect the current information needs of the department.

Recommendation #5
We recommend the department:

A. Seek legislation to amend section 15-36-311, MCA, to be consistent with the rest of Title 15, chapter 36, part 3, MCA.

B. Seek legislation to resolve the conflict between sections 15-1-113 and 15-1-121, MCA.

C. Seek legislation to amend section 15-1-201, MCA, to reflect current information needs.

Deferred Revenue – Entitywide Ledger

The department did not process transactions needed to convert its modified accrual deferred revenue account to full accrual for presentation in the state's government-wide financial statements.

The Governmental Accounting Standards Board issued financial reporting requirements, effective for the state of Montana on July 1, 2001, that require financial statements similar to those issued by a private-sector business. These statements are referred to as government-wide statements and present a broad view of the state's operations. These statements provide both short-term and long-term information about the state's financial position and are prepared using the full accrual basis of accounting. This means they consider all revenues and expenses associated with the fiscal year, regardless of when any cash involved is received or paid.

This is in contrast to fund financial statements, which focus on individual parts of the state's operation, and use different accounting approaches depending on the fund category. For example, governmental funds use the modified accrual basis of accounting, focusing on near-term inflows and outflows of spendable resources.

To accomplish the government-wide reporting requirements, the Department of Administration created an entitywide ledger to accumulate accounting transactions necessary to convert modified accrual basis accounts to full accrual. The department has not recorded the transactions needed to fully convert its modified accrual basis deferred revenue to the full accrual basis since implementation of the entitywide ledger. As of June 30, 2004, the following misstatements exist within the state's entitywide ledger records:

	Over(Under)Stated
Deferred Revenue	$ 23,455,609
Tax & Fee Revenues	10,596,252
Net Assets, June 30, 2004	(23,455,609)

Department personnel stated they followed the guidance provided by the Department of Administration's Accounting Bureau personnel in developing the procedures used for posting the deferred revenue transactions to the entitywide ledger. We reviewed the guidance provided and believe it to be incomplete. The department should work with the Accounting Bureau to ensure the appropriate deferred revenue transactions are posted to the entitywide ledger.

Recommendation #6

We recommend the department:

A. Work with the Department of Administration's Accounting Bureau to revise the guidance for recording deferred revenue transactions on the entitywide ledger.

B. Record the proper deferred revenue transactions in the entitywide ledger to facilitate preparation of the state's government-wide financial statements.

Independent Auditor's Report & Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

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John W. Northey, Legal Counsel

Deputy Legislative Auditors:
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Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Revenue for each of the fiscal years ended June 30, 2004, and June 30, 2003. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities, and cash flows.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Department of Revenue for each of the fiscal years ended June 30, 2004, and June 30, 2003, in conformity with the basis of accounting described in note l.

As discussed in note 7, during fiscal year 2003-04, the department obtained a loan from the Permanent Coal Tax Trust Fund to finance the acquisition of a new computer system. Legal issues related to the funding for this acquisition have been raised. These issues include unconstitutional creation of state debt and unconstitutionally vague delegation of legislative authority.

Respectfully yours,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

August 31, 2004

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DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND BALANCE: July 1, 2003	$ (3,736,822)	$ 10,866,377	$ 967,256	$ 64,071	$ 1,859,169	$ 7,212,794	$ 102,594	$ 0	$ 258,805	$ 837,957,434
PROPERTY HELD IN TRUST: July 1, 2003								$ 3,589,583		
ADDITIONS										
Budgeted Revenues & Transfers-In	1,009,795,552	137,275,340	2,737,406		5,552,801	69,219,033	170,907			46,705,081
NonBudgeted Revenues & Transfers-In	734,026	1,030,129		299,674		11,063,623			1,465,053	6,889,529
Prior Year Revenues & Transfers-In Adjustments	66,170,053	(1,458,768)	(1,610,610)	1,087	10,573	(15,860,212)			2,001,945	(1,319,304)
Direct Entries to Fund Balance	(946,125,378)	(84,104,991)	2,358,907	(298,002)	(5,383,524)	(839,145)		693,990	94,827	(483,313)
Additions to Property Held in Trust								2,941,513		
Total Additions	130,574,253	52,741,710	3,485,703	2,759	179,850	63,583,299	170,907	3,635,503	3,561,825	51,791,993
REDUCTIONS										
Budgeted Expenditures & Transfers-Out	118,230,651	48,700,382	2,392,803		993,674	63,796,064	141,454			
NonBudgeted Expenditures & Transfers-Out	356	5,919,631				109,136	3,812		1,449,376	64,466,538
Prior Year Expenditures & Transfers-Out Adjustments	62,607	(1,100,666)				(37,374)	(1,086)		2,007,413	
Reductions in Property Held in Trust								5,585,184		
Total Reductions	118,293,614	53,519,347	2,392,803		993,674	63,867,826	144,180	5,585,184	3,456,789	64,466,538
FUND BALANCE: June 30, 2004	$ 8,543,817	$ 10,088,740	$ 2,060,156	$ 66,830	$ 1,045,345	$ 6,928,267	$ 129,321	$ 693,990	$ 363,841	$ 825,282,889
PROPERTY HELD IN TRUST: June 30, 2004								$ 945,912		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND BALANCE: July 1, 2002	$ (4,986,717)	$ 8,748,809	$ 219,417	$ 70,821	$ 5,023,078	$ 4,737,945	$ 485,848	$ 249	$ 430,942	$ 798,152,153
PROPERTY HELD IN TRUST: July 1, 2002								$ 2,220,634		
ADDITIONS										
Budgeted Revenues & Transfers-In	879,836,944	106,920,480	1,559,100	279,524	4,618,740	65,113,375	111,605			97,494,600
NonBudgeted Revenues & Transfers-In	912,324	1,954,286				11,474,001		(2,753)	10,578	19,928,689
Prior Year Revenues & Transfers-In Adjustments	62,561,504	(646,203)	(614,226)	145	41,900	(13,822,424)	12,392	2,753	(55,369)	(12,517,190)
Direct Entries to Fund Balance	(825,535,669)	(62,497,435)	2,289,672	(286,419)	(4,967,114)	(703,322)		(249)	(109,723)	(93,941)
Additions to Property Held in Trust								30,115,673		
Total Additions	117,775,103	45,731,128	3,234,546	(6,750)	(306,474)	62,061,630	123,997	30,115,424	(154,514)	104,812,158
REDUCTIONS										
Budgeted Expenditures & Transfers-Out	116,520,604	45,657,064	2,486,637		2,851,517	59,518,643	108,537			
NonBudgeted Expenditures & Transfers-Out	3,732				5,918	87,751	401,142		17,623	65,146,557
Prior Year Expenditures & Transfers-Out Adjustments	872	(2,043,504)	70			(19,613)	(2,428)			(139,680)
Reductions in Property Held in Trust								28,746,724		
Total Reductions	116,525,208	43,613,560	2,486,707		2,857,435	59,586,781	507,251	28,746,724	17,623	65,006,877
FUND BALANCE: June 30, 2003	$ (3,736,822)	$ 10,866,377	$ 967,256	$ 64,071	$ 1,859,169	$ 7,212,794	$ 102,594		$ 258,805	$ 837,957,434
PROPERTY HELD IN TRUST: June 30, 2003								$ 3,589,583		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS										
Licenses and Permits	$ 6,311,732	$ 11,561,678				$ 1,948,501				$ 19,821,911
Taxes	986,066,343	92,355,502		$ 300,761	$ 5,563,374	14,619,585			$ 16,430,313	1,115,335,878
Charges for Services	204,830	6,500,634	$ 92,400			4,648	$ 170,907			6,973,419
Investment Earnings								$ 3,049	19,084,389	19,087,438
Fines, Forfeits and Settlements			825,721			109,497				935,218
Sale of Documents, Merchandise and Property						47,463,033				47,463,033
Contributions and Premiums		7,558,239				274,059				7,832,298
Miscellaneous	(105,959)					3,121				(102,838)
Grants, Contracts, Donations and Abandonments	2,375,754	232,115						3,463,949		6,071,818
Other Financing Sources	53,665,909	18,638,533							16,760,604	89,065,046
Federal	28,166,508		208,675							28,375,183
Federal Indirect Cost Recoveries	14,514									14,514
Total Revenues & Transfers-In	1,076,699,631	136,846,701	1,126,796	300,761	5,563,374	64,422,444	170,907	3,466,998	52,275,306	1,340,872,918
Less: Nonbudgeted Revenues & Transfers-In	734,026	1,030,129		299,674		11,063,623		1,465,053	6,889,529	21,482,034
Prior Year Revenues & Transfers-In Adjustments	66,170,053	(1,458,768)	(1,610,610)	1,087	10,573	(15,860,212)		2,001,945	(1,319,304)	47,934,764
Actual Budgeted Revenues & Transfers-In	1,009,795,552	137,275,340	2,737,406	0	5,552,801	69,219,033	170,907	0	46,705,081	1,271,456,120
Estimated Revenues & Transfers-In	1,024,858,575	95,303,234	667,731	290,681	5,393,374	65,285,134	145,000		53,783,006	1,245,726,735
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (15,063,023)	$ 41,972,106	$ 2,069,675	$ (290,681)	$ 159,427	$ 3,933,899	$ 25,907	$ 0	$ (7,077,925)	$ 25,729,385
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS										
Licenses and Permits	$ 359,889	$ 10,801,416				$ (182,805)				$ 10,978,500
Taxes	(5,588,236)	29,121,548		$ (290,681)	$ 159,427	946,803			$ 4,273,113	28,621,974
Charges for Services	(5,673,146)	401,850	$ 640			(1,352)	$ 25,907			(5,246,101)
Investment Earnings									(21,359,774)	(21,359,774)
Fines, Forfeits and Settlements	(100)		2,168,331			18,369				2,186,600
Sale of Documents, Merchandise and Property						(868,351)				(868,351)
Contributions and Premiums		1,540,587				4,021,235				5,561,822
Miscellaneous	(1,162,340)									(1,162,340)
Grants, Contracts, Donations and Abandonments	781,828	6,614								788,442
Other Financing Sources	(9,042,116)	100,091							10,008,736	1,066,711
Federal	5,267,303		(99,296)							5,168,007
Federal Indirect Cost Recoveries	(6,105)							$		(6,105)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (15,063,023)	$ 41,972,106	$ 2,069,675	$ (290,681)	$ 159,427	$ 3,933,899	$ 25,907	$ 0	$ (7,077,925)	$ 25,729,385

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DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS											
Licenses and Permits	$ 5,793,888	$ 334,735				$ 1,741,684					$ 7,870,307
Taxes	855,771,362	79,114,842	$ 13	$ 279,669	$ 4,660,640	13,626,416				$ 14,715,017	968,167,959
Charges for Services	205,093	6,370,052	92,400			4,795	$ 123,997				6,796,337
Investment Earnings	(54,227)								$ 4,026	70,494,889	70,444,688
Fines and Forfeits			694,642			111,495					806,137
Sale of Documents, Merchandise and Property						45,104,083					45,104,083
Contributions and Premiums		6,933,254				2,175,227					9,108,481
Miscellaneous	(125,278)					1,252					(124,026)
Grants, Contracts, Donations and Abandonments	1,954,458	199,343							(48,817)		2,104,984
Other Financing Sources	52,065,706	15,276,337								19,696,193	87,038,236
Federal	27,689,313		157,819								27,847,132
Federal Indirect Cost Recoveries	10,457										10,457
Total Revenues & Transfers-In	943,310,772	108,228,563	944,874	279,669	4,660,640	62,764,952	123,997	$	(44,791)	104,906,099	1,225,174,775
Less: Nonbudgeted Revenues & Transfers-In	912,324	1,954,286				11,474,001		(2,753)	10,578	19,928,689	34,277,125
Prior Year Revenues & Transfers-In Adjustments	62,561,504	(646,203)	(614,226)	145	41,900	(13,822,424)	12,392	2,753	(55,369)	(12,517,190)	34,963,282
Actual Budgeted Revenues & Transfers-In	879,836,944	106,920,480	1,559,100	279,524	4,618,740	65,113,375	111,605	0	0	97,494,600	1,155,934,368
Estimated Revenues & Transfers-In	1,068,699,768	110,773,152	1,118,194		5,769,000	64,821,938	7,194,357			61,668,000	1,320,044,409
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (188,862,824)	$ (3,852,672)	$ 440,906	$ 279,524	$ (1,150,260)	$ 291,437	$ (7,082,752)	$ 0	$ 0	$ 35,826,600	$ (164,110,041)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS											
Licenses and Permits	$ 284,709	$ 149,225				$ 216,260					$ 650,194
Taxes	(189,459,264)	263,195		$ 279,524	$ (1,150,260)	(272,975)				$ 1,526,773	(188,813,007)
Charges for Services	16,354	411,339				(205)	$ (7,082,752)				(6,655,264)
Investment Earnings		(50,000)								34,299,827	34,249,827
Fines and Forfeits	(100)		$ 1,388,746			36,496					1,425,142
Sale of Documents, Merchandise and Property	(1,000)					(3,868,699)					(3,869,699)
Rentals, Leases and Royalties						(500)					(500)
Contributions and Premiums		940,835				4,196,060					5,136,895
Miscellaneous	(1,000)		(879,865)			(15,000)					(895,865)
Grants, Contracts, Donations and Abandonments	(438,636)	164,401									(274,235)
Other Financing Sources	(4,764,715)	(5,731,667)									(10,496,382)
Federal	5,515,828		(67,975)								5,447,853
Federal Indirect Cost Recoveries	(15,000)										(15,000)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (188,862,824)	$ (3,852,672)	$ 440,906	$ 279,524	$ (1,150,260)	$ 291,437	$ (7,082,752)	$ 0	$ 0	$ 35,826,600	$ (164,110,041)

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DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	BUSINESS & INCOME TAXES DIVISION	CUSTOMER SERVICE CENTER	DIRECTORS OFFICE	INFORMATION TECHNOLOGY	PROPERTY ASSESSMENT DIVISION	RESOURCE MANAGEMENT	TOTAL
Personal Services							
Salaries	$ 3,362,740	$ 2,993,280	$ 1,332,005	$ 1,103,712	$ 8,132,647	$ 1,212,682	$ 18,137,066
Other Compensation		44,000	36		26,018		70,054
Employee Benefits	1,128,579	1,002,388	341,227	307,904	3,525,153	370,203	6,675,454
Personal Services-Other		2,671				(7,104)	(4,433)
Total	4,491,319	4,042,339	1,673,268	1,411,616	11,683,818	1,575,781	24,878,141
Operating Expenses							
Other Services	275,604	1,266,062	1,434,262	1,450,593	1,215,061	142,317	5,783,899
Supplies & Materials	280,656	119,102	83,405	37,996	658,933	133,284	1,313,376
Communications	94,804	742,053	25,930	19,524	254,485	39,768	1,176,564
Travel	147,602	38,275	51,489	34,573	226,595	1,135	499,669
Rent	53,382	124,838	40,870	117,865	1,096,927	21,409	1,455,291
Utilities	1,793	2,505			1,359	63,332	68,989
Repair & Maintenance	8,601	87,533	5,053	15,240	66,583	49,798	232,808
Other Expenses	149,762	21,363	18,487	18,295	60,856	153,797	422,560
Goods Purchased For Resale						39,937,629	39,937,629
Total	1,012,204	2,401,731	1,659,496	1,694,086	3,580,799	40,542,469	50,890,785
Equipment & Intangible Assets							
Equipment		18,162		5,688		7,535	31,385
Intangible Assets	13,000		35,150		15		48,165
Total	13,000	18,162	35,150	5,688	15	7,535	79,550
Local Assistance							
From State Sources			82,458,751		52,790,639	304,929	135,554,319
Total			82,458,751		52,790,639	304,929	135,554,319
Benefits & Claims							
STIP Distrib to Local Govts		3,446,510					3,446,510
Total		3,446,510					3,446,510
Transfers							
Accounting Entity Transfers					70,354,066	21,849,917	92,203,983
Total					70,354,066	21,849,917	92,203,983
Debt Service							
Loans			79,031				79,031
Installment Purchases					2,452		2,452
Total			79,031		2,452		81,483
Total Expenditures & Transfers-Out	$ 5,516,523	$ 9,908,742	$ 85,905,696	$ 3,111,390	$ 138,411,789	$ 64,280,631	$ 307,134,771
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	$ 4,091,880	$ 4,523,620	$ 84,681,544	$ 2,831,426	$ 21,301,782	$ 863,362	$ 118,293,614
State Special Revenue Fund	142,802	359,397	79,031		52,633,190	304,927	53,519,347
Federal Special Revenue Fund	1,281,841	667,515	121,280	215,490		106,677	2,392,803
Capital Projects Fund			993,674				993,674
Enterprise Fund		767,520	30,167	64,474		63,005,665	63,867,826
Internal Service Fund		144,180					144,180
Private Purpose Trust Fund		3,446,510			10,279		3,456,789
Permanent Fund					64,466,538		64,466,538
Total Expenditures & Transfers-Out	5,516,523	9,908,742	85,905,696	3,111,390	138,411,789	64,280,631	307,134,771
Less: Nonbudgeted Expenditures & Transfers-Out		1,442,909	33,167		70,363,641	109,132	71,948,849
Prior Year Expenditures & Transfers-Out Adjustments		2,018,765	(364)	872	(1,051,561)	(36,818)	930,894
Actual Budgeted Expenditures & Transfers-Out	5,516,523	6,447,068	85,872,893	3,110,518	69,099,709	64,208,317	234,255,028
Budget Authority	6,507,524	6,731,259	88,022,582	4,190,529	69,210,389	70,150,529	244,812,812
Unspent Budget Authority	$ 991,001	$ 284,191	$ 2,149,689	$ 1,080,011	$ 110,680	$ 5,942,212	$ 10,557,784
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	$ 897,277	$ 264,793	$ 137,260	$ 1,080,009	$ 10,855	$ 100,400	$ 2,490,594
State Special Revenue Fund			1,854,136		99,825	15,288	1,969,249
Federal Special Revenue Fund	93,724	18,936	1	2		3	112,666
Capital Projects Fund			158,292				158,292
Enterprise Fund						5,826,521	5,826,521
Internal Service Fund		462					462
Unspent Budget Authority	$ 991,001	$ 284,191	$ 2,149,689	$ 1,080,011	$ 110,680	$ 5,942,212	$ 10,557,784

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DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2003

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	COMPLIANCE VALUATION AND RESOLUTION	CUSTOMER SERVICE CENTER	DIRECTORS OFFICE	INFORMATION TECHNOLOGY	RESOURCE MANAGEMENT	TOTAL
Personal Services						
Salaries	$ 12,156,959	$ 3,109,338	$ 1,629,735	$ 1,422,154	$ 1,380,640	$ 19,698,826
Other Compensation			134			134
Employee Benefits	3,724,980	857,789	419,821	373,731	391,373	5,767,694
Personal Services-Other		(1,287)			(5,376)	(6,663)
Total	15,881,939	3,965,840	2,049,690	1,795,885	1,766,637	25,459,991
Operating Expenses						
Other Services	1,542,657	1,255,476	3,152,933	462,083	153,457	6,566,606
Supplies & Materials	350,067	122,701	119,181	195,194	72,223	859,366
Communications	830,613	331,815	18,417	111,679	52,884	1,345,408
Travel	260,915	19,525	12,915	13,903	2,652	309,910
Rent	1,134,908	115,636	38,818	36,925	32,432	1,358,719
Utilities	2,661	256			48,368	51,285
Repair & Maintenance	90,361	82,639	14,843	20,462	16,411	224,716
Other Expenses	211,645	58,321	23,445	12,064	126,724	432,199
Goods Purchased For Resale					37,308,397	37,308,397
Total	4,423,827	1,986,369	3,380,552	852,310	37,813,548	48,456,606
Equipment & Intangible Assets						
Equipment	22,039	17,102		18,158		57,299
Total	22,039	17,102		18,158		57,299
Local Assistance						
From State Sources	51,792,038		80,618,029		242,535	132,652,602
Total	51,792,038		80,618,029		242,535	132,652,602
Transfers						
Accounting Entity Transfers	63,343,535	400,000	5,918		20,219,877	83,969,330
Total	63,343,535	400,000	5,918		20,219,877	83,969,330
Debt Service						
Installment Purchases	5,614					5,614
Total	5,614					5,614
Total Expenditures & Transfers-Out	$ 135,468,992	$ 6,369,311	$ 86,054,189	$ 2,666,353	$ 60,042,597	$ 290,601,442
EXPENDITURES & TRANSFERS-OUT BY FUND						
General Fund	$ 26,257,120	$ 3,955,687	$ 83,056,259	$ 2,269,856	$ 986,286	$ 116,525,208
State Special Revenue Fund	43,050,776	320,249			242,535	43,613,560
Federal Special Revenue Fund	1,136,596	808,993	108,500	321,118	111,500	2,486,707
Capital Projects Fund			2,857,435			2,857,435
Enterprise Fund		777,131	31,995	75,379	58,702,276	59,586,781
Internal Service Fund		507,251				507,251
Private Purpose Trust Fund	17,623					17,623
Permanent Fund	65,006,877					65,006,877
Total Expenditures & Transfers-Out	135,468,992	6,369,311	86,054,189	2,666,353	60,042,597	290,601,442
Less: Nonbudgeted Expenditures & Transfers-Out	65,167,912	401,141	5,918		87,752	65,662,723
Prior Year Expenditures & Transfers-Out Adjustments	(2,176,878)	(3,067)	(765)		(23,573)	(2,204,283)
Actual Budgeted Expenditures & Transfers-Out	72,477,958	5,971,237	86,049,036	2,666,353	59,978,418	227,143,002
Budget Authority	82,998,399	6,189,043	87,728,481	2,737,827	70,375,006	250,028,756
Unspent Budget Authority	$ 10,520,441	$ 217,806	$ 1,679,445	$ 71,474	$ 10,396,588	$ 22,885,754
UNSPENT BUDGET AUTHORITY BY FUND						
General Fund	$ 924,525	$ 175,415	$ 527,481	$ 71,474	$ 35,762	$ 1,734,657
State Special Revenue Fund	9,594,951	10,927			12,194	9,618,072
Federal Special Revenue Fund	965	1				966
Capital Projects Fund			1,151,964			1,151,964
Enterprise Fund					10,348,632	10,348,632
Internal Service Fund		31,463				31,463
Unspent Budget Authority	$ 10,520,441	$ 217,806	$ 1,679,445	$ 71,474	$ 10,396,588	$ 22,885,754

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1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Capital Projects, Debt Service, and Permanent Funds). In applying the modified accrual basis, the department records:

> Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.
>
> Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Enterprise and Internal Service) and Fiduciary (Agency and Private-Purpose Trust) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period earned, when measurable, and records expenses in the period incurred, when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

Department accounts are organized in funds according to state law applicable at the time transactions were recorded. The department uses the following funds.

Governmental Fund Category

General Fund – to account for all financial resources except those required to be accounted for in another fund.

State Special Revenue Fund – to account for proceeds of specific non-federal resources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific purposes. Department State Special Revenue funds include various earmarked tax accounts.

Federal Special Revenue Fund – to account for proceeds of specific federal revenue sources that are legally restricted to expenditures for specific purposes. The department's Federal Special Revenue funds relate to Unemployment Insurance and Mineral Royalty audits.

Debt Service Fund – to account for accumulated resources for the payment of general long-term debt principal and interest. The department's Debt Service funds relate to Renewable Resource Bonds.

Capital Projects Fund – to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds. The department collects coal severance tax revenues in support of the Long-Range Building Program, as well as funding for its tax processing systems.

Permanent Fund – to account for financial resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support state programs. The Permanent funds reported in the accompanying schedules include the Permanent Coal Trust Fund, the Cultural Trust Fund, the Coal Severance Tax Income and Bond Funds, the Resource Indemnity Trust Fund, Common

School Trust Fund, and the Treasure State Endowment and Income Funds.

Proprietary Fund Category

Internal Service Fund – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The department's Internal Service fund accounts for bad debt collection activity.

Enterprise Fund – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; or (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. Department Enterprise funds include the Liquor Distribution and Unemployment Insurance (UI) Tax Funds.

Fiduciary Fund Category

Private-Purpose Trust Fund – to account for activity of all other trust arrangements under which principal and income benefit individuals, private organizations, or other governments. Department Private-Purpose Trust funds are used to account for unclaimed property, escheat property, and unlocated mineral owners.

Agency Fund – to account for resources held by the state in a purely custodial capacity. The department uses the Agency Fund as a clearing account to facilitate the distribution of gas and oil taxes, one-stop licensing, county collections, and bad debt collections.

2. General Fund Balance

The negative fund balance in the General Fund at June 30, 2003, does not indicate overspent appropriation authority. The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets it has placed in the fund, resulting in the negative ending General Fund balance for the fiscal year ended June 30, 2003.

The department's total assets placed in the fund at June 30, 2004, exceeded its liabilities, resulting in a positive General Fund balance at that date. The balance reflects activity at the department and not the fund balance of the statewide General Fund.

3. Direct Entries to Fund Balance

Most of the direct entries to fund balances as shown on the Schedules of Changes in Fund Balances & Property Held in Trust for the fiscal years ended June 30, 2004, and 2003, relate to entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies. Examples of these entries include transfers of the accommodations tax, employment security accounts, cigarette tax, treasure state endowment, public service commission, university mills, reclamation and development, alcohol funds, orphan share, and renewable resources.

4. Prior Year Activity

Prior Year Revenues & Transfers-In Adjustments in the General Fund on the Schedules of Changes in Fund Balances & Property Held in Trust for the fiscal years ended June 30, 2004, and 2003, are related to tax accruals and subsequent adjustments for the differences between actual and estimated collections and for refunds.

5. NonBudgeted Activity

NonBudgeted activity in the Permanent Fund on the Schedules of Changes in Fund Balances & Property Held in Trust for the fiscal years ended June 30, 2004, and 2003, is related to coal tax transfers made in accordance with state law.

6. Program Change

During fiscal year 2003-04, the department restructured its Compliance Valuation and Resolution expenditure program. The expenditure activities reported in this program for fiscal year 2002-03 are reported in two programs for fiscal year 2003-04, the Business and Income Tax Division program and the Property Assessment Division program.

7. Integrated Revenue Information System (IRIS) Funding

Chapter 597, Laws of 2003, required the department to begin replacement of its Process Oriented Integrated System (POINTS). The legislation authorized funding for IRIS not to exceed $17 million.

Under the provisions of this legislation, the department entered into a loan agreement with the Montana Board of Investments to borrow money from the Permanent Coal Tax Trust Fund. The loan activities are accounted for in the State Special Revenue Fund, as required by Chapter 597, Laws of 2003.

As of June 30, 2004, the department has drawn $5,886,467 on the loan and repaid $188,025 of principle. The department incurred $79,031 of interest and has transferred $233,889 of income tax revenues from the General Fund to the State Special Revenue Fund to make the required interest and principal payments.

8. Tax Revenues over (under) Estimate

The Schedule of Revenues and Transfers-In for the fiscal year ended June 30, 2003, reports actual tax revenues under the estimate by $189,459,264. This amount is primarily attributable to three individual revenue estimates: Individual Income Taxes were $123,128,949 less than the recorded estimate; Corporation Taxes were $40,501,452 less than the recorded estimate; and a Video Gaming Tax estimate of $45,321,000 had no revenues associated with it because those revenues are recorded on the Department of Justice records.

9. Licenses and Permits

Licenses and permit revenues increased by $11.95 million between fiscal year 2002-03 and 2003-04. The increase is due to the effects of Chapters 390 and 531, Laws of 2003. These chapters established utilization fees for (1) hospitals and (2) intermediate care facilities for the developmentally disabled.

10. Contingent Liabilities

The department is involved in several lawsuits concerning property values, corporation taxes, and non-business income. Department legal counsel believes unfavorable outcomes are reasonably possible. As of June 30, 2004, the amounts in dispute total $8,950,000.

Department Response

Montana Department of Revenue

Don Hoffman
Acting Director

Judy Martz
Governor

October 26, 2004

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LEGISLATIVE AUDIT DIV.

Scott A. Seacat, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

We appreciate the opportunity to respond to the recommendations raised in the Financial Compliance Audit Report of the Montana Department of Revenue for the fiscal years ended June 30, 2003 and 2004. Our responses to the six recommendations included in the report are as follows:

Recommendation #1

A. We recommend the Montana Legislature resolve the constitutional issues of state debt, repayment appropriation, and delegation of authority related to Chapter 597, Laws of 2003.

Do not concur. The department has followed the statutory authority granted to it during the last legislative session to proceed with replacing the agency's POINTS system. The department has no basis to concur with whether legislation passed during the last session is unconstitutional. Should the legislature pass into law a different course of action as a result of the legislative audit recommendation, the department will comply with changes to state law.

B. We recommend the department discontinue drawing funds from its BOI loan.

Do not concur. The department recently entered into a contract to proceed with the next phase of the IRIS Project. During the June 2004 meeting of the Legislative Finance Committee, it was reported that the project was ahead of schedule and under budget. The committee, as noted in the minutes of the June meeting, encouraged the Budget Director to utilize current authorization to add additional tax types. With funding saved in the initial phase, the department is presently working to add individual income tax and corporation license tax to the integrated tax system. During the 2003 Legislative Session, the department was authorized to enter into indebtedness not to exceed $17 million for the replacement of the POINTS computer system.

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By February 1, 2005, the department was required to have a base component and at least one tax-processing component of the replacement system in place. To date, five tax types are being processed on the IRIS system, and as previously mentioned, this has been completed ahead of schedule and under budget.

In light of the issues raised in the audit report, the department is currently in negotiations with the Office of Budget and Program Planning to address continued funding through the Executive Planning Process.

Recommendation #2

We recommend the department seek legislation to require payments from agency liquor stores within 30 days, or to allow payment to liquor suppliers in 60 days.

Concur. During the privatization of agency liquor stores in the 1995 Legislative Session, an agreement was reached allowing agency liquor stores 60 days to remit payment for liquor purchases. These payment terms were put into state law and represent what is allowed today. Since that time, there have been several attempts to reduce the payment terms from 60 days to 30 days. Most recently the department requested a legislative change during the 2003 Session. This piece of legislation failed in committee. The department will again seek legislation to change the payment terms from 60 days to 30 days. This would make the payment terms of liquor stores consistent with terms the state is required to follow for purchases of liquor from liquor suppliers. Although the department recognizes the general fund loses interest, this is due to differences in payment terms between state statutes. Montana state law, however, does not provide for interest free loans to privately owned agency liquor stores.

Recommendation #3

We recommend the department record contracted collection expenditures on the state's accounting records in accordance with the state law.

Concur. Although there is not an impact to the overall general fund balance on how the transactions with the collection agency were recorded, the department agrees the expenditures associated with the commission expense should be recorded on the financial records. This would require gross revenues and the related commission expense to be recorded versus net revenues that have been recorded to date. During fiscal year 2004, over $2 million in gross revenues were realized as a result of contracting for the collection of delinquent individual income taxes. As noted in the audit report, the commission expense associated with this effort was approximately $377,000. It is estimated gross revenues from the collection activities during fiscal year 2005 will exceed $2.3 million. The department is currently under contract with the collection agency through September 2005. In order to record the associated commission expense on the financial records for future contracts with the collection agency, the department will seek spending authority through the budgeting process and the Office of Budget and Program Planning during the 2005 Legislative Session.

Recommendation #4

We recommend the department develop written policy for the reporting of actual or suspected theft to ensure compliance with state law.

Concur. The department has prepared written procedures for employees to follow when they are aware of theft or suspected theft of state property. These procedures have been communicated to department employees and are now incorporated in the department's procedures.

Recommendation #5

We recommend the department:

A. Seek legislation to amend section 15-36-311, MCA, to be consistent with the rest of Title 15, chapter 36, part 3, MCA.

Concur. The department will seek legislation to resolve the discrepancies between existing statutes and make state law consistent with the current distribution of oil and gas revenues. The department is putting forth a bill to amend Section 15-36-311, MCA, to be consistent with the rest of Title 15, Chapter 36, Part 3 of the Oil and Gas Production Tax Act.

B. Seek legislation to resolve the conflict between sections 15-1-113 and 15-1-121, MCA.

Concur. The department has coordinated the effort with the Legislative Fiscal Division to resolve the conflicts between existing statues 15-1-113, MCA, and 15-1-121, MCA, through a tax clean-up bill. The legislation will seek to repeal 15-1-113, MCA, since counties receive full reimbursement of the fees, in lieu of property tax, imposed in 61-3-529, MCA, through the entitlement share payments provided for in 15-1-121, MCA.

C. Seek legislation to amend section 15-1-201, MCA, to reflect current information needs.

Concur. The department will assess its current information needs from municipal corporations and seek legislation to amend 15-1-201, MCA, to match these needs.

Recommendation #6

We recommend the department:

A. Work with the Department of Administration's Accounting Bureau to revise the guidance for recording deferred revenue transactions on the entitywide ledger.

Partially concur. The department concurs it should work with the Department of Administration's Accounting Bureau to ensure deferred revenue collections are properly recorded on the entitywide ledger. To date, the department has recorded the entitywide ledger transactions based on its understanding of guidance provided by the Accounting Bureau and believes these transactions are recorded properly. The department will work with the Accounting Bureau to ensure our understanding is correct and the transactions are recorded in accordance with financial reporting requirements issued by the Governmental Accounting Standards Board.

B. Record the proper deferred revenue transactions in the entitywide ledger to facilitate preparation of the state's government-wide financial statements.

Concur. The department concurs that deferred revenue transactions should be recorded properly on the entitywide ledger. The department will work with the Department of Administration's Accounting Bureau on the issues raised in this recommendation and will make any accounting entries deemed necessary.

We appreciate the professionalism demonstrated by your staff that participated in the audit. Thank you again for the opportunity to review the audit report and respond to the recommendations raised.

Sincerely,

Don Hoffman, Acting Director
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