A Report
to the
Montana
Legislature

Financial-Compliance Audit

Department of Revenue

For the Two Fiscal Years Ended June 30, 2012

October 2012

Legislative Audit Division

12-14

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Financial-Compliance Audits

Financial-compliance audits are conducted by the Legislative Audit Division to determine whether 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, 2011, was issued March 29, 2012. The Single Audit Report for the two fiscal years ended June 30, 2013, will be issued by March 31, 2014. Copies of the Single Audit Report can be obtained by contacting:

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LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors
Cindy Jorgenson
Angie Grove

October 2012

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, 2012. During the course of the audit we analyzed the financial schedules, reviewed the financial records, and tested compliance with selected state laws and regulations. Included in this report are four recommendations related to unclaimed property, an advance from the liquor fund, the inflation adjustment for personal exemptions and the standard deduction, and compliance with the adoption of administrative rules. The department's response begins on page B-1.

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

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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Appointed and Administrative Officials

Administrative Officials

Dan Bucks, Director

Alan Peura, Deputy Director

C.A. Daw, Chief Legal Counsel

Rich Bechtel, Director, Taxpayer Assistance and Public Outreach

JeanAnn Scheuer, Director, Human Resources

Ed Caplis, Director, Tax Policy and Research

Gene Walborn, Administrator, Business and Income Tax

Steve Austin, Administrator, Citizen Services and Resource Management

Margaret Kauska, Administrator, Information Technology and Processing

Shauna Helfert, Administrator, Liquor Control

Cynthia Moore, Administrator, Property Assessment

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Montana Legislative Audit Division

Financial-Compliance Audit
Department of Revenue
For the Two Fiscal Years Ended June 30, 2012

October 2012 12-14 Report Summary

The Montana Department of Revenue (department) administers state tax laws, enforcing regulations for more than 30 state taxes and fees. In fiscal year 2011-12, the department collected approximately $1.7 billion in taxes. Of this, over $211 million was distributed to local governments. Our recent audit identified potential overpayments by payers of individual income tax.

Context

In addition to tax administration, the department oversees liquor distribution and licensing operations in the state and administers the one-stop licensing program and bad debt collections on behalf of state agencies. The department also manages unclaimed property, returning property to its rightful owners. For fiscal year 2011-12, the department had 661 authorized full-time equivalent employees.

Results

State law allows for an inflation factor to be applied to personal tax exemptions and the standard deduction each year. We found the factor was not accurately calculated resulting in an approximate $700,000 overpayment by individual income tax payers to the department.

State law also prescribes procedures for administering unclaimed property. An auction should be held for property unclaimed after three years, if prudent to do so. We found the last auction was held over ten years ago.

Accounting policy requires funds to have positive cash balance at the end of a fiscal year. One of the department's federal funds does not sustain a positive cash balance at fiscal year-end without a loan or advance from another fund. Rather than obtain a short-term loan each year, the department obtained a long-term loan from the liquor fund. The liquor fund should not be used for this purpose.

Recommendation Concurrence	
Concur	3
Partially Concur	1
Do Not Concur	0

Source: Agency audit response included in final report.

For a complete copy of the report (12-14) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at http://leg.mt.gov/audit
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Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2012. The objectives of our audit were to:

1. Obtain an understanding of the department's control systems to the extent necessary to support our audit of the department's financial schedules and, if appropriate, make recommendations for improvements in management and internal controls of the department.
2. Determine whether the department complied with selected state laws and regulations during the audit period.
3. Determine the implementation status of prior audit recommendations.
4. Determine whether the department's financial schedules fairly present the results of its operations for each of the fiscal years ended June 30, 2012, and 2011.

To address objectives #1 and #4, we focused our audit effort primarily on tax revenues, distributions to local governments, and liquor and coal tax activities. This included understanding the department's internal control policies and procedures and reviewing accounting transactions. We addressed objective #2 by reviewing and testing compliance with 150 state laws. We addressed objective #3 by determining whether notification is sent to the Secretary of State for nonfilers and delinquent filers and by reviewing the coal tax allocations.

In accordance with §5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing the recommendations contained in this report.

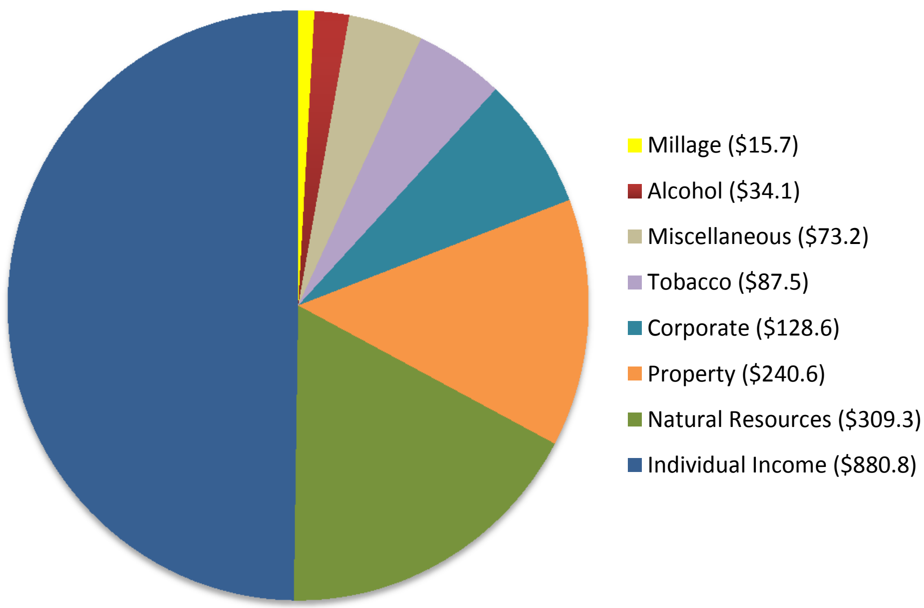
As required by §17-8-101(6), MCA, we analyzed the fees and charges for services and the fund equity of the department's Internal Service Fund, which is used to provide bad debt collection services to state agencies. Bad debt collections primarily occur during the months of January through June when the department is able to offset the debts against requested tax refunds. Due to the timing of the collections, our review noted that at June 30, there is a large fund balance. The fund balance is spent down from July through December when collections lag. Our review further noted that revenues approximate expenditures indicating the fees charged are commensurate with costs and the fund balances are reasonable.

Department Organization and Functions

The department is responsible for the administration of state tax laws and enforcing regulations for numerous state taxes and fees. Revenues collected by the department include, but are not limited to, individual income, corporate income, natural resource, accommodation, property, alcohol and tobacco taxes. Department tax revenues are recorded primarily in the General, State Special Revenue, and Permanent Funds. The department also regulates the sale and distribution of alcoholic beverages in the state; associated revenue collections are recorded in the Enterprise Fund. The following chart shows the total taxes collected by the department in fiscal year 2011-12 by type.

Figure 1

Fiscal Year 2012 Tax Revenues by Type (in millions)



Source: Compiled by the Legislative Audit Division.

For fiscal year 2011-12, the legislature authorized 661.28 full-time equivalent (FTE) employees for the department in five divisions. The department uses an additional 3.50 FTE to operate the Collection Services Program, which collects bad debts on behalf of all state agencies. This program is funded through collection service charges and operates in the Internal Service Fund.

Director's Office (51.48 FTE) provides overall department direction and management. It also supports the agency's director and is composed of five work units. The basic function for each unit is:

- **Legal Services** supervises the overall legal efforts of the department, which includes legal representation, legislative development and review, administrative rules, policies, the disclosure officer, and the Office of Dispute Resolution.

- **Tax Policy and Research** is responsible for the preparation of legislative fiscal notes that affect revenue, the analysis of legislative proposals affecting the department, and analysis of department economic and tax compliance data.
- **Human Resources** manages the personnel activities of the department. The office includes three units: Human Resources, Payroll and Benefits, and Education and Training.
- **Executive Office** includes budget analysis, public information, and administrative support.
- **Office of Taxpayer Assistance** is authorized by §15-1-223, MCA. The office assists taxpayers by providing understandable information on department audit, correction and review, and appeal procedures. The office answers questions on preparation and filing of returns and reports and locates documents or payments filed with or submitted to the department. The office also handles taxpayer complaints, monitors the department's compliance with the Taxpayer Bill of Rights, monitors collection activities, and performs any other function necessary to assist taxpayers in complying with Montana's tax laws.

Business and Income Taxes Division (158.95 FTE) administers and collects 38 Montana taxes and fees, oversees tax audits and verifies compliance with Montana tax law for all state taxes, oversees state revenue collection activity, and completes appraisals and assessments of industrial and centrally assessed property.

Citizen Services and Resource Management Division (28.00 FTE) provides service to Montana citizens, businesses, and nonresident taxpayers through a call center, one-stop licensing, forms design, and other taxpayer services including operation of the collection services program. The division provides service and support to the department in the areas of accounting, purchasing, and facilities and asset management. The division also seeks to return unclaimed property remitted to the department to its rightful owners.

Information Technology and Processing Division (85.75 FTE) provides application development and support services, as well as network services in the areas of data, desktop, information security, and help desk support. The division also processes tax returns and payments for the department and for state agency partners and manages department records.

Liquor Control Division (29.75 FTE) administers the state's Alcoholic Beverage Code, which governs the control, sale, and distribution of alcoholic beverages. The division includes licensing of businesses, manufacturers, wholesalers, warehouses, importers, and liquor representatives.

Property Assessment Division (307.35 FTE) is responsible for the valuation and assessment of residential, commercial, agricultural, forestland, and business equipment property throughout the state for property tax purposes. The division has a central office located in Helena and six regional offices. There is a local office in each county seat.

The department also distributes various tax revenues based on requirements in law. The two largest distributions relate to the local government's entitlement share revenue and oil and natural gas production taxes. The entitlement share is recorded in the Director's Office Program. The oil and natural gas production taxes distributions to counties and school districts are recorded in the Property Assessment Division Program in fiscal year 2010-11. This activity is recorded under the Citizen Services & Resource Management Division Program in fiscal year 2011-12.

Advisory Councils, Boards, and Memberships

The department is a member of the Multistate Tax Commission, the Federation of Tax Administrators, the Western States Association of Tax Administrators, the National Alcohol and Beverage Control Association, and the National Association of Unclaimed Property Administrators. The department's advisory councils include:

Advisory Council for Multistate Tax Compact under §2-15-1311, MCA, has no rule making or rule adjudicating authority. The director appoints an advisory council for the purpose of complying with Article VI, section 1(B) of the Multistate Tax Compact.

Agricultural Land Valuation Advisory Council is created by §15-7-201(7), MCA, to advise the department concerning the valuation of agricultural property. This council must include a staff member from the Montana State University – Bozeman, College of Agriculture. This advisory council is not a policy making body and has no rule making authority.

The **Board of Review** established in §30-16-302, MCA, provides policy direction to the department in establishing and operating the one-stop business licensing program. The board is attached to the department for administrative purposes only and has separate rule making authority under §30-16-104, MCA.

Prior Audit Recommendations

The previous financial-compliance audit report of the department for the two fiscal years ended June 30, 2010, contained two recommendations. The department implemented both recommendations.

Chapter II - Findings and Recommendations

Inflation Adjustment

The department erred when calculating the inflation adjustment for tax rates, personal exemptions, and the standard deduction.

State laws require the department to calculate an inflation factor each year which is then used to determine tax rates, the standard deduction, and personal exemption amounts. The inflation factor is calculated by dividing the consumer price index (CPI) for June of the tax year by the CPI for June 2005. The department used the June 2011 CPI issued by the U.S. Department of Labor which showed an index for June 2005 that was different from the previous years. The department did not adjust its calculation formula to address the change in the June 2005 index amount. A department review of the calculation also failed to notice the amounts on the index were not those used in the formula.

We calculated the inflation rate using the numbers on the June CPI and determined the error resulted in a $10 to $20 miscalculation of the standard deduction and personal exemption amounts. We estimate this miscalculation resulted in an overcollection of individual income taxes of approximately $700,000. This equates to between $0 and $2 per individual for 75 percent of taxpayers and $3 or more for the remaining taxpayers.

Department personnel noted that in order to have tax information available as soon as possible to update tax forms and to provide to vendors for tax preparation software, the department strives to complete the calculation as soon as possible. As a result, the review did not identify the error in the calculation. Department personnel further noted that the inflation calculation is completed every year so the error is limited to the 2011 tax year.

Because of the impact on individual tax payers, we believe a more thorough review should be established to ensure amounts used in the formula tie back to the index.

Recommendation #1

We recommend the department strengthen procedures to review the inflation factor calculation for accuracy.

Unclaimed Property

The Department has not held an unclaimed property auction since 2001.

Unclaimed, or abandoned, property is any asset for which an owner has not generated activity during a period of time. Examples include uncashed checks, wages, bonuses, commissions, stocks and bonds, insurance proceeds, and certificates of deposit. Property holders are required to send written notice to the apparent owner of property with a value exceeding $50 within a specified period of time before reporting the unclaimed property to the department.

Section 70-9-812, MCA, directs the department to sell any property reported to it that is still unclaimed within three years if the department considers that the cost of the sale will not exceed the proceeds of the sale. Department personnel noted they do not have the expertise to value the property and believe most property would not be as valuable to individuals other than the rightful owners. We observed the property and noted it includes collectible coins, guns, and jewelry. State law does not prohibit the use of a low cost option such as an on-line sales auction.

Coins, guns, and jewelry are items that are inherently risky since they are small and susceptible to theft. While the department has controls in place to safeguard the property, holding on to valuable property beyond three years extends the risk of theft beyond that which state law requires and reduces proceeds available to the General Fund. The department is required to retain $100,000, which is used to pay claims. The remaining proceeds are to be deposited into the General Fund.

Recommendation #2

We recommend the department comply with state law by selling unclaimed property within three years of receipt when determined cost beneficial.

Advance from Liquor Fund

The department advanced $75,000 from the liquor fund to the Federal Mineral Impact Account.

The department administers a federal account on a reimbursement basis. This means the department makes expenditures and then requests reimbursement from the federal government. Due to the time between when expenditures are paid and when reimbursement is received, the federal account needs an advance or loan to keep the cash balance positive at fiscal year-end as required by state law. The liquor fund loaned the federal fund $75,000 on a long-term basis over 12 years ago.

We reviewed state law and noted liquor funds may only be used for administrative expenses of the liquor fund. The loan to the federal account is not an administrative expense of the liquor fund and is, therefore, not allowed by state law.

Department personnel noted that the advance came from the liquor fund because state law requires advances from the General Fund be paid back every year. Rather than submitting a form each year, the department requested and received approval from the Department of Administration, as required by law, for a one time long-term loan from the liquor fund.

Section 16-2-108(4), MCA, requires the proceeds of the liquor fund to be transferred to the General Fund. It is possible the transfer to the General Fund was understated by $75,000 in the year the loan originated. Because this loan took place in 2000, we are unable to determine if the transfer made at that time was correct. Once the transfer was made, the subsequent year's transfers would not be affected by this loan.

Recommendation #3

We recommend the department:

A. *Repay the liquor fund for the $75,000 advance.*

B. *Seek other resources to provide a positive cash balance at fiscal year-end in the Federal Mineral Impact account.*

State Compliance

The department has not adopted administrative rules as required by three separate state laws.

Administrative Rules of Montana (ARM) are agency regulations, standards or statements of applicability that implement, interpret, or set policy. The rule making process under the Montana Administration Procedure Act provides a vehicle for the public to participate and comment on governmental actions. The table below outlines two state laws for which the department was required, but did not, adopt rules. The table also notes the reason the department did not adopt rules.

Table 1
Summary of Noncompliance

State Law	Requirement	Reason
§15-30-2327(3), MCA	The department shall adopt rules to prepare life expectancy tables that are derived from a federal tax publication.	The department stated the federal tax publication referred to is 880 pages long. They did not want to adopt rules that were that large since there is a $50 per page filing fee.
§16-4-901(5), MCA	The department shall adopt rules to provide procedures for the application for and the provision of a connoisseur's license.	The department believes the state law is sufficient and additional rules are not necessary.

The rule making process is the means by which the public can participate in state policy. The department should adopt rules to allow the public the access to comment during the process.

We further noted that rules have not been adopted as required by §15-68-401(3), MCA. This statute requires the department to adopt rules to provide procedures for the application for and provision of a seller's permit related to renting accommodations and campgrounds prior to June 1, 2003, and renting vehicles prior to July 1, 2003. The department indicated they adopted rules at one time, but repealed them as the rules were only needed during the transitional time in 2003. As such, the department should seek to amend the law requiring the adoption of rules.

Recommendation #4

We recommend the department:

A. *Comply with state law by adopting rules as required by statute or seek legislation to amend the requirement in state law.*

B. *Seek to amend the adoption of rules required by §15-68-401(3), MCA.*

Independent Auditor's Report and Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors
Cindy Jorgenson
Angie Grove

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, 2012, and 2011. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express opinions 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 opinions.

As described in note 1, these financial schedules are prepared on the basis of Montana state accounting policy, which is 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.

As discussed in note 7 to the financial schedules, in fiscal year 2010-11, the department did not consistently record the reversal of the fiscal year 2009-10 liquor accrual and the actual revenue receipts associated with the accrual consistent with state accounting policy. As a result, less than 12 months of liquor revenue was recorded for the fiscal year. The Enterprise Fund on the financial schedules is misstated as noted in the following table.

Financial Schedule	Line Item	Over (Under) Misstatement
Schedule of Changes in Fund Balances & Property Held in Trust (Fiscal year 2010-11)	Prior Year Revenues & Transfers-In Adjustments Total Additions Fund Balance, June 30	$(17,245,139) $(17,404,838) $(17,404,838)
Schedule of Revenues & Transfers-In (Fiscal year 2010-11)	Sale of Documents, Merchandise and Property Total Revenues & Transfers-In Prior Year Revenue & Transfers-In	$(13,557,802) $(17,404,838) $(17,245,139)

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In our opinion, except as noted in the preceding paragraph, 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, 2012, and 2011, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor

September 7, 2012

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	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, 2011	$ 5,807,987	$ 33,207,441	$ 233	$ 750,148	$ 1,491,522	$ (13,434,087)	$ 113,406	$ 0	$ 2,798,107	$ 1,020,915,981
PROPERTY HELD IN TRUST: July 1, 2011								$ 556,313		
ADDITIONS										
Budgeted Revenues & Transfers-In	1,563,463,049	300,645,761	286,739		8,193,703	101,583,593	192,010			103,613,964
Nonbudgeted Revenues & Transfers-In	4,173,514	1,262,276	37	2,260,976		73,637			4,490,169	26,282,244
Prior Year Revenues & Transfers-In Adjustments	9,064,645	4,004,693	3,041	104,919	(198,445)	17,405,554	10,746			(1,513,412)
Direct Entries to Fund Balance	(1,440,381,269)	(204,570,268)		(2,297,574)	(7,580,049)	(1,168,586)				(1,088,449)
Additions to Property Held in Trust								5,154,179		
Total Additions	136,319,939	101,342,462	289,817	68,321	415,209	117,894,198	202,756	5,154,179	4,490,169	127,294,347
REDUCTIONS										
Budgeted Expenditures & Transfers-Out	147,937,594	99,475,854	287,737		721,078	99,469,161	175,079			
Nonbudgeted Expenditures & Transfers-Out	(24,848)	30,887				615,705	13,246		4,108,589	72,725,047
Prior Year Expenditures & Transfers-Out Adjustments	(23,941)	263,213	3,041			(68,270)				
Reductions in Property Held in Trust								5,431,591		
Total Reductions	147,888,805	99,769,954	290,778	0	721,078	100,016,596	188,325	5,431,591	4,108,589	72,725,047
FUND BALANCE: June 30, 2012	$ (5,760,879)	$ 34,779,949	$ (728)	$ 818,469	$ 1,185,653	$ 4,443,515	$ 127,837	$ 0	$ 3,179,687	$ 1,075,485,281
PROPERTY HELD IN TRUST: June 30, 2012								$ 278,901		

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-9.

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	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, 2010	$ 4,112,745	$ 31,480,545	$ 233	$ 88,227	$ 1,193,408	$ 636,681	$ 109,812	$ 0	$ 2,483,570	$ 973,475,521
PROPERTY HELD IN TRUST: July 1, 2010								$ 160,863		
ADDITIONS										
Budgeted Revenues & Transfers-In	1,474,811,076	293,750,509	242,305		8,431,978	95,237,360	181,925			102,756,255
Nonbudgeted Revenues & Transfers-In	2,937,411	2,122,978		2,542,812		(144,856)			4,021,109	12,365,897
Prior Year Revenues & Transfers-In Adjustments	(3,353,408)	(1,405,636)		32,939	416,042	(17,244,721)	(117)			832,299
Direct Entries to Fund Balance	(1,321,513,234)	(178,576,599)		(1,913,830)	(6,688,242)	(2,220,028)				(1,036,086)
Additions to Property Held in Trust								4,587,365		
Total Additions	152,881,845	115,891,252	242,305	661,921	2,159,778	75,627,755	181,808	4,587,365	4,021,109	114,918,365
REDUCTIONS										
Budgeted Expenditures & Transfers-Out	151,242,824	113,078,373	242,305		1,861,664	93,397,236	170,040			
Nonbudgeted Expenditures & Transfers-Out	(6,615)	2,018,672				148,857	8,174		3,707,086	67,477,905
Prior Year Expenditures & Transfers-Out Adjustments	(49,606)	(932,689)				(3,847,570)			(514)	
Reductions in Property Held in Trust								4,191,915		
Total Reductions	151,186,603	114,164,356	242,305	0	1,861,664	89,698,523	178,214	4,191,915	3,706,572	67,477,905
FUND BALANCE: June 30, 2011	$ 5,807,987	$ 33,207,441	$ 233	$ 750,148	$ 1,491,522	$ (13,434,087)	$ 113,406	$ 0	$ 2,798,107	$ 1,020,915,981
PROPERTY HELD IN TRUST: June 30, 2011								$ 556,313		

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-9.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	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	$ 5,090,927	$ 31,340,233				$ 2,045,652				$ 38,476,812
Taxes	1,480,527,163	225,823,178	$ 37	$ 2,365,895	$ 7,995,258	27,070,928			$ 26,515,178	1,770,297,637
Charges for Services	7,136	14,680,785				2,120	$ 202,756			14,892,797
Investment Earnings	(2,217)							$ 8,551	71,741,935	71,748,269
Fines and Forfeits						137,356				137,356
Capital Contributions	77,000									77,000
Sale of Documents, Merchandise and Property						89,775,414				89,775,414
Grants, Contracts, and Donations	2,245,521	621,465						4,481,618		7,348,604
Transfers-in	56,507,109	22,709,773	3,041						30,125,683	109,345,606
Federal Indirect Cost Recoveries	29,248									29,248
Miscellaneous	12,289	1,619				31,314				45,222
Federal	32,207,032	10,735,677	286,739							43,229,448
Total Revenues & Transfers-In	1,576,701,208	305,912,730	289,817	2,365,895	7,995,258	119,062,784	202,756	4,490,169	128,382,796	2,145,403,413
Less: Nonbudgeted Revenues & Transfers-In	4,173,514	1,262,276	37	2,260,976		73,637		4,490,169	26,282,244	38,542,853
Prior Year Revenues & Transfers-In Adjustments	9,064,645	4,004,693	3,041	104,919	(198,445)	17,405,554	10,746		(1,513,412)	28,881,741
Actual Budgeted Revenues & Transfers-In	1,563,463,049	300,645,761	286,739	0	8,193,703	101,583,593	192,010	0	103,613,964	2,077,978,819
Estimated Revenues & Transfers-In	1,482,779,827	308,413,756	270,211		8,103,000	107,585,575	150,000		93,157,650	2,000,460,019
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 80,683,222	$ (7,767,995)	$ 16,528	$ 0	$ 90,703	$ (6,001,982)	$ 42,010	$ 0	$ 10,456,314	$ 77,518,800
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS										
Licenses and Permits	$ 199,413	$ (2,443,181)				$ (186,178)				$ (2,429,946)
Taxes	88,102,658	(77,244)			$ 90,703	218,703			$ 5,778,773	94,113,593
Charges for Services	(268,315)	(1,298,015)	$ (1)			(1,605)	$ 42,010			(1,525,926)
Investment Earnings	(2,073)	(1)							2,657,418	2,655,344
Fines and Forfeits						(36,744)				(36,744)
Sale of Documents, Merchandise and Property						(5,996,158)				(5,996,158)
Grants, Contracts, and Donations	(1,519,879)	6,922								(1,512,957)
Transfers-in	(4,467,187)	(4,308,788)							2,020,123	(6,755,852)
Federal Indirect Cost Recoveries	(18,330)									(18,330)
Miscellaneous	(3,000,000)	(200,000)								(3,200,000)
Federal	1,656,935	552,312	16,529							2,225,776
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 80,683,222	$ (7,767,995)	$ 16,528	$ 0	$ 90,703	$ (6,001,982)	$ 42,010	$ 0	$ 10,456,314	$ 77,518,800

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-9.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	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	$ 5,203,610	$ 32,149,227				$ 2,125,982				$ 39,478,819
Taxes	1,380,243,527	219,545,031		$ 2,575,751	$ 8,848,020	17,942,909			$ 30,329,311	1,659,484,549
Charges for Services	7,591	14,815,382				2,510	$ 181,808			15,007,291
Investment Earnings	(15,299)							$ 7,582	57,242,739	57,235,022
Fines and Forfeits						144,336				144,336
Sale of Documents, Merchandise and Property						57,618,054				57,618,054
Grants, Contracts, and Donations	2,852,701	549,054						4,013,527		7,415,282
Transfers-in	52,174,353	16,081,117	$ 24,925						28,382,401	96,662,796
Federal Indirect Cost Recoveries	19,128									19,128
Miscellaneous	(2,541)	24,037				13,992				35,488
Federal	33,912,009	11,304,003	217,380							45,433,392
Total Revenues & Transfers-In	1,474,395,079	294,467,851	242,305	2,575,751	8,848,020	77,847,783	181,808	4,021,109	115,954,451	1,978,534,157
Less: Nonbudgeted Revenues & Transfers-In	2,937,411	2,122,978		2,542,812		(144,856)		4,021,109	12,365,897	23,845,351
Prior Year Revenues & Transfers-In Adjustments	(3,353,408)	(1,405,636)		32,939	416,042	(17,244,721)	(117)		832,299	(20,722,602)
Actual Budgeted Revenues & Transfers-In	1,474,811,076	293,750,509	242,305	0	8,431,978	95,237,360	181,925	0	102,756,255	1,975,411,408
Estimated Revenues & Transfers-In	1,499,416,122	313,323,767	240,755		8,534,000	119,226,878	183,488		84,937,000	2,025,862,010
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (24,605,046)	$ (19,573,258)	$ 1,550	$ 0	$ (102,022)	$ (23,989,518)	$ (1,563)	$ 0	$ 17,819,255	$ (50,450,602)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS										
Licenses and Permits	$ 87,303	$ (4,059)				$ (480,702)				$ (397,458)
Taxes	(18,329,498)	(2,862,504)			$ (102,022)	(2,224,465)			$ 10,043,801	(13,474,688)
Charges for Services	2,072	(410,041)	$ (1)			(1,160)	$ (1,563)			(410,693)
Investment Earnings	(15,301)	0							3,763,264	3,747,963
Fines and Forfeits						(28,355)				(28,355)
Sale of Documents, Merchandise and Property						(21,254,836)				(21,254,836)
Grants, Contracts, and Donations	(927,020)	(96,480)								(1,023,500)
Transfers-in	(6,904,360)	(16,402,276)	(9,382)						4,012,190	(19,303,828)
Federal Indirect Cost Recoveries	(18,330)									(18,330)
Miscellaneous	(5,220)	(300,000)								(305,220)
Federal	1,505,308	502,102	10,933							2,018,343
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (24,605,046)	$ (19,573,258)	$ 1,550	$ 0	$ (102,022)	$ (23,989,518)	$ (1,563)	$ 0	$ 17,819,255	$ (50,450,602)

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Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	Business & Income Taxes Division	Citizen Services & Resource Management Division	Director's Office	Information Management & Technology Division	Liquor Control Division	Property Assessment Division	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT							
Personal Services							
Salaries	$ 6,142,144	$ 2,125,455	$ 2,917,260	$ 3,311,275	$ 1,219,129	$ 11,102,210	$ 26,817,473
Employee Benefits	2,143,583	794,956	875,430	1,166,644	442,959	4,284,979	9,708,551
Personal Services-Other		3,066			11,659		14,725
Total	8,285,727	2,923,477	3,792,690	4,477,919	1,673,747	15,387,189	36,540,749
Operating Expenses							
Other Services	322,339	356,383	1,485,232	3,102,001	336,616	651,186	6,253,757
Supplies & Materials	157,929	73,727	143,854	435,472	84,610	257,356	1,152,948
Communications	217,375	211,448	87,008	916,586	54,423	539,134	2,025,974
Travel	166,373	11,728	70,190	17,209	24,629	169,189	459,318
Rent	210,491	73,002	113,791	735,012	197	1,827,427	2,959,920
Utilities		803			56,376		57,179
Repair & Maintenance	23,175	14,467	32,471	2,620,676	44,912	76,693	2,812,394
Other Expenses	217,743	70,581	38,179	34,643	626,934	38,611	1,026,691
Goods Purchased For Resale					63,928,947		63,928,947
Total	1,315,425	812,139	1,970,725	7,861,599	65,157,644	3,559,596	80,677,128
Equipment & Intangible Assets							
Equipment		19,254		16,441	23,382		59,077
Intangible Assets						140,400	140,400
Total		19,254		16,441	23,382	140,400	199,477
Local Assistance							
From State Sources	91,667	98,311,382	99,971,803			171,045	198,545,897
Total	91,667	98,311,382	99,971,803			171,045	198,545,897
From Other Sources							
Distrib from Priv Purp Trusts		4,079,797					4,079,797
Total		4,079,797					4,079,797
Transfers-out							
Fund transfers					32,782,216	72,753,839	105,536,055
Total					32,782,216	72,753,839	105,536,055
Other Post Employment Benefits							
Other Post Employment Benefits		10,265			119,804		130,069
Total		10,265			119,804		130,069
Total Expenditures & Transfers-Out	$ 9,692,819	$ 106,156,314	$ 105,735,218	$ 12,355,959	$ 99,756,793	$ 92,012,069	$ 425,709,172
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	$ 8,647,470	$ 3,319,965	$ 105,514,216	$ 11,373,142		$ 19,034,012	$ 147,888,805
State Special Revenue Fund	758,612	98,525,042	106,201	124,804	$ 31,077	224,218	99,769,954
Federal Special Revenue Fund	286,737		1,000		3,041		290,778
Capital Projects Fund				721,078			721,078
Enterprise Fund		43,185	113,801	136,935	99,722,675		100,016,596
Internal Service Fund		188,325					188,325
Private Purpose Trust Fund		4,079,797				28,792	4,108,589
Permanent Fund						72,725,047	72,725,047
Total Expenditures & Transfers-Out	9,692,819	106,156,314	105,735,218	12,355,959	99,756,793	92,012,069	425,709,172
Less: Nonbudgeted Expenditures & Transfers-Out	(5,479)	4,091,279	(2,411)	(3,288)	646,781	72,741,743	77,468,625
Prior Year Expenditures & Transfers-Out Adjustments	91,206	3,163	(436)	(4,961)	(65,229)	150,298	174,041
Actual Budgeted Expenditures & Transfers-Out	9,607,092	102,061,872	105,738,065	12,364,208	99,175,241	19,120,028	348,066,506
Budget Authority	9,755,604	145,335,889	105,893,177	13,136,677	126,426,725	19,177,196	419,725,268
Unspent Budget Authority	$ 148,512	$ 43,274,017	$ 155,112	$ 772,469	$ 27,251,484	$ 57,168	$ 71,658,762
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	$ 15,286	$ 6,932	$ 142,719	$ 265,147		$ 27,046	$ 457,130
State Special Revenue Fund	10,333	43,263,886	189			30,122	43,304,530
Federal Special Revenue Fund	122,893						122,893
Capital Projects Fund				507,322			507,322
Enterprise Fund			12,204		$ 27,251,484		27,263,688
Internal Service Fund		3,199					3,199
Unspent Budget Authority	$ 148,512	$ 43,274,017	$ 155,112	$ 772,469	$ 27,251,484	$ 57,168	$ 71,658,762

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-9.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	BUSINESS & INCOME TAXES DIVISION	CITIZEN SERVICES & RESOURCE MANAGEMENT DIVISION	DIRECTOR'S OFFICE	INFORMATION TECHNOLOGY & PROCESSING DIVISION	LIQUOR CONTROL DIVISION	PROPERTY ASSESSMENT DIVISION	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT							
Personal Services							
Salaries	$ 7,021,984	$ 1,040,453	$ 2,967,145	$ 3,046,888	$ 1,216,182	$ 11,054,262	$ 26,346,914
Employee Benefits	2,510,477	379,140	898,113	1,104,568	438,798	4,224,478	9,555,574
Personal Services-Other	(2,331)				(13,176)		(15,507)
Total	9,530,130	1,419,593	3,865,258	4,151,456	1,641,804	15,278,740	35,886,981
Operating Expenses							
Other Services	794,197	493,154	1,040,627	6,110,011	177,427	988,841	9,604,257
Supplies & Materials	265,986	50,045	168,813	872,543	75,189	1,133,847	2,566,423
Communications	207,960	111,997	62,731	723,939	72,266	628,079	1,806,972
Travel	264,095	12	112,016	22,352	20,163	114,791	533,429
Rent	295,921	35,836	157,168	753,536	1,247	2,035,897	3,279,605
Utilities		601			65,446		66,047
Repair & Maintenance	28,870	7,148	30,784	1,826,024	92,085	93,431	2,078,342
Other Expenses	286,572	5,564	51,287	29,268	138,177	60,271	571,139
Goods Purchased For Resale					59,823,839		59,823,839
Total	2,143,601	704,357	1,623,426	10,337,673	60,465,839	5,055,157	80,330,053
Equipment & Intangible Assets							
Equipment				455,971	(14,819)	39,105	480,257
Total				455,971	(14,819)	39,105	480,257
Local Assistance							
From State Sources	5,493,411	411,779	100,028,724			105,256,743	211,190,657
Total	5,493,411	411,779	100,028,724			105,256,743	211,190,657
From Other Sources							
Distrib from Priv Purp Trusts		3,694,864					3,694,864
Total		3,694,864					3,694,864
Transfers-out							
Fund transfers		2,001,276			27,308,116	67,489,613	96,799,005
Total		2,001,276			27,308,116	67,489,613	96,799,005
Other Post Employment Benefits							
Other Post Employment Benefits	10,533				123,792		134,325
Total	10,533				123,792		134,325
Total Expenditures & Transfers-Out	$ 17,177,675	$ 8,231,869	$ 105,517,408	$ 14,945,100	$ 89,524,732	$ 193,119,358	$ 428,516,142
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	$ 10,683,071	$ 1,923,699	$ 105,331,626	$ 12,875,205		$ 20,373,002	$ 151,186,603
State Special Revenue Fund	6,099,010	2,562,322	95,994	131,882	$ 18,405	105,256,743	114,164,356
Federal Special Revenue Fund	217,380				24,925		242,305
Capital Projects Fund				1,861,664			1,861,664
Enterprise Fund		50,984	89,788	76,349	89,481,402		89,698,523
Internal Service Fund	178,214						178,214
Private Purpose Trust Fund		3,694,864				11,708	3,706,572
Permanent Fund						67,477,905	67,477,905
Total Expenditures & Transfers-Out	17,177,675	8,231,869	105,517,408	14,945,100	89,524,732	193,119,358	428,516,142
Less: Nonbudgeted Expenditures & Transfers-Out	6,303	5,696,304	(766)	(1,037)	166,311	67,486,963	73,354,078
Prior Year Expenditures & Transfers-Out Adjustments	289,146	(514)	(11,550)	(43,936)	(3,846,620)	(1,216,906)	(4,830,380)
Actual Budgeted Expenditures & Transfers-Out	16,882,226	2,536,079	105,529,724	14,990,073	93,205,041	126,849,301	359,992,444
Budget Authority	19,402,306	2,614,974	106,441,367	16,225,217	143,416,426	152,565,813	440,666,103
Unspent Budget Authority	$ 2,520,080	$ 78,895	$ 911,643	$ 1,235,144	$ 50,211,385	$ 25,716,512	$ 80,673,659
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	$ 9,698	$ 4,519	$ 899,660	$ 6,746		$ 13,745	$ 934,368
State Special Revenue Fund	2,326,729	74,376	11,983			25,702,767	28,115,855
Federal Special Revenue Fund	170,205				$ 9,382		179,587
Capital Projects Fund				1,228,398			1,228,398
Enterprise Fund					50,202,003		50,202,003
Internal Service Fund	13,448						13,448
Unspent Budget Authority	$ 2,520,080	$ 78,895	$ 911,643	$ 1,235,144	$ 50,211,385	$ 25,716,512	$ 80,673,659

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-9.

Department of Revenue
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2012

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). In applying the modified accrual basis, the department records:

- Revenues when it receives cash or when receipts are realizable, measurable, earned, 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 (Private-Purpose Trust and Agency) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, 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 was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

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. The department records various tax receipts in the General Fund. The primary expenditures in the General

Fund include department payroll costs and distribution of the General Fund entitlement payments to cities and counties.

- **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include various earmarked tax accounts.
- **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds relate to the federal Mineral Royalty Audit Program.
- **Debt Service Fund** – to account for accumulated resources for the payment of principal and interest on general long-term obligation debt. The department deposits coal, metal mine, and resource indemnity taxes into this fund type.
- **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. Coal severance tax and cigarette tax revenues collected by the department in support of the state Long Range Building Program are accounted for in capital project funds.
- **Permanent Fund** – to account for financial resources that are permanently restricted to the extent that only earnings, and not principal, may be used for purposes that support the government's programs. The department uses this fund to account for its activity in the Permanent Coal Trust Fund; the Cultural Trust Fund; the Coal Severance Tax Income and Bond Funds; the Resource Indemnity Trust and Income Funds; the Treasure State Endowment, Income Regional Water System, and Regional Water Income Funds; and the Big Sky Economic Development 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; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. The department's Enterprise Fund accounts for the Liquor Control Division's administration of the alcoholic beverage code.

Fiduciary Fund Category

- **Private-Purpose Trust Fund** – to account for activity of any trust arrangement not properly reported in a pension fund or an investment trust fund where the principal and income benefit individuals, private organizations, or other governments. Department Private-Purpose Trust Funds are used to account for unclaimed property, escheated property, and unlocated mineral owner interests.
- **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a zero balance at fiscal year-end. Property Held in Trust, account 2504A, has a balance at fiscal year-end because bad debts captured during the offset process must be held in a custodial manner for thirty days for debtor notification and appeal. The department Agency Funds are used as clearing accounts to facilitate the distribution of receipts from the administration of the one-stop licensing program, the county collection reports, bad debt collections, dishonored checks, treasury deposit and bank corrections, Automated Clearing House (ACH) collections, and account receivable activity.

2. General Fund Balance

The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department's total assets placed in the fund exceed outstanding liabilities, resulting in a positive ending General Fund balance for the fiscal year ended June 30, 2011. This balance reflects the results of the activity of the department and not the fund balance of the statewide General Fund.

The negative fund balance in the General Fund for the fiscal year ended June 30, 2012 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 placed in the fund, resulting in negative ending General Fund balance.

3. Direct Entries to Fund Balance

Direct entries to fund balances in the General, State Special Revenue, Debt Service, Capital Projects, Enterprise, and Permanent funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies. The General Fund also includes adjustments for Insure Montana Tax Credits for previous periods that occurred at least two fiscal years prior.

4. Revenues Over (Under) Estimate

The Schedule of Total Revenues and Transfers-In for the fiscal year ended June 30, 2011, reports revenues under estimate by $24,605,046 in the General Fund, $23,989,518 in the Enterprise Fund and $19,573,258 in the State Special Revenue Fund. These are explained below:

General Fund – Overall, for the fiscal year ended June 30, 2011, individual income tax collections were less than House Joint Resolution (HJ) 2 estimates by $52 million because the assumptions underlying the estimates did not match actual experience. In addition, actual revenues collected for property tax (95 mills) were $4 million less than estimated, and corporation license tax revenues collected were $2 million less than estimated. Oil and natural production tax, coal production tax, metal mines tax, mineral royalty withholding tax and public contractor gross receipts tax exceeded revenue estimates by $41.8 million. This discrepancy is the result of several HJ2 assumptions. First, HJ2 was based on the assumption that oil production would be 25.5 million barrels with an average price of $48.78 per barrel, and gas production would be 121.2 Mcf with an average price of $5.14 million. However, actual oil production was 24.7 million barrels with an average price of $80.61 per barrel and gas production was 78.0 Mcf with an average price of $3.64. Secondly, HJ2 assumed coal production would be 44.0 million tons with a contract sales price of $9.88 per ton when actual production was 36.3 million tons with a contract sales price of $10.92 per ton. Thirdly, HJ2 assumed the taxable value of metal production to be $340.5 million when actual production was $908.7 million. Also, HJ2 did not anticipate the increase in public construction projects due to federal stimulus funds. In addition, interest earnings transferred to the general fund by the Board of Investments were $1.5 million less that estimated, and U.S. Mineral Leasing Royalties exceeded the HJ2 estimates by $1.5 million.

In fiscal year 2011, liquor excise tax and license tax revenues were less than the estimate by $5.2 million due to the department's implementation of a prior audit recommendation and less taxes collected than estimated. In fiscal year 2012, actual tax collections were $88 million greater than estimated, the majority of which is due to higher collections of individual income tax, corporation license tax, and mineral royalty withholding.

State Special Revenue Fund – Revenues in the state special revenue fund were less than estimated for the fiscal year ending June 30, 2011, due to a liquor license tax revenue estimate of $6.5 million inadvertently duplicated. In addition, Treasure State Endowment Fund (TSEF) transfer requests were $8.9 million less than estimated. Coal tax revenue collections were $3 million less than estimated; the result of the HJ2 assumption that coal production would be 44.0 million tons with a contract sales price of $9.88 per ton when actual production was 36.3 million tons with a contract sales price of $10.92 per ton.

Enterprise Fund – Revenues in the enterprise fund were less than estimated due to several factors including accounting for the implementation of a prior year audit recommendation; reversal of revenues accrued in the prior year; and a difference in how actual receipts versus estimated receipts are presented on the schedule of Total Revenues and Transfers-In.

The Schedule of Total Revenues and Transfers-In for the fiscal year ended June 30, 2011, reports revenues over estimated by $17,819,255 in the permanent fund. This is explained below:

Permanent Fund – Revenue collections in the permanent fund exceed revenues estimated for the fiscal year ending June 30, 2011, due to two factors. First, the fiscal year 2011 coal production tax revenue estimate was based on fiscal year 2010 recognized revenue before the close of the fiscal year instead of fiscal year 2010 collected revenue after the close of the fiscal year; and secondly, fiscal year 2011 coal production tax revenue collections were greater than prior year collections.

5. Nonbudgeted Expenditures and Transfers-out

Nonbudgeted Expenditures and Transfers-Out in the permanent fund, on the Schedule of Changes in Fund Balance and Property Held in Trust, for the fiscal year ending June 30, 2011, is approximately $67.5 million. This amount is also reflected on the Schedule of Total Expenditures and Transfers-Out and is related to the coal tax transfers required by state law. These include transfers from the Coal Tax Bond Fund, distributions of investment earnings on the Treasure State Endowment Funds, Big Sky Economic Development Fund, Resource Indemnity Trust Fund and the coal tax trust funds.

6. Unspent Budget Authority

The Schedule of Total Expenditures and Transfers-out for fiscal year 2011 reports unspent budget authority under the Property Assessment Division of $25,702,767 in the State Special Revenue Fund and $50,202,003 under the Liquor Control Division in the Enterprise Fund.

The unspent budget authority in the Property Assessment Division is created due to fiscal year 2011 revenue collected or accrued and distributed to local governments being less that estimated. Fiscal year 2011 combined oil and natural gas production tax estimates were created based on higher oil and gas prices than were realized. In addition, distributions of tobacco and cigarette taxes to Indian Tribal Governments under revenue sharing agreements for fiscal year 2011 were less than the prior fiscal year.

In fiscal year 2012, the budget authority for distribution of oil and gas taxes was moved to the Citizen Services and Resource Management Division as they are responsible for all tax distributions. Distributions of actual oil and gas tax revenues were less than estimated due to actual oil and gas prices being less than estimated as similarly noted for fiscal year 2011.

The Liquor Control Division receives language appropriations for funds necessary to maintain adequate inventories; pay freight charges; and transfer profits, taxes, and liquor licensing revenues to the appropriate accounts. In fiscal year 2011, the appropriation was not to exceed $143 million. The department purchased inventory and distributed profits and taxes based upon the volume of sales and did not spend up to the total appropriation authority. The language appropriation for the transfer of licensing revenues also includes appropriation authority for both the Department of Revenue and the Department of Justice to administer liquor licensing. By law, the transfer of the licensing revenue is net of the appropriation authority for the Department of Revenue and the Department of Justice and deferred revenues. Likewise, for fiscal year 2012, transfers were made based upon the volume of sales which were less than the language appropriation granted.

7. Prior Year Revenues

The negative prior year revenue of $17 million in fiscal year 2011 is due to the reversal of the fiscal year-end 2010 accounts receivable balance. The positive prior year revenue of $17 million in fiscal year 2012 relates to a correcting entry to restore the accounts receivable balance reversed in fiscal year 2011. The department in implementing an audit recommendation from a prior audit for the fiscal years ended June 30, 2007 and 2008, modified how the liquor accounts receivable balance was accrued at fiscal year-end. Accounting entries were made as a result of the department's understanding of the recommendation after concurring with the Legislative Auditors. When recording these transactions the department inadvertently reversed the accounts receivable balance in fiscal year 2011, thereby misstating the receivables balance and related revenue accounts. In fiscal year 2012, the department made a correcting entry to properly restore the accounts receivable balance and properly state prior year revenues for fiscal year 2011. As indicated in the auditor's letter on page A-1, the financial statements were not misstated for fiscal year 2012.

8. Program Change

On the Schedule of Expenditures & Transfers-Out for fiscal year 2010-11 the distributions made to local governments for Combined Oil and Gas revenue as required by §15-36-331, MCA, were reported in the Property Assessment Division.

In fiscal year 2011-12, this activity is reported in the Citizen Services & Resource Management Division. This change was made to more accurately reflect the division that makes the distribution.

9. Program name change

The Information Technology & Processing Division shown on the fiscal year 2010-11 Schedule of Expenditures & Transfers-Out was renamed the Information Management & Technology Division in fiscal year 2011-12. The duties and responsibilities of the division did not change. The name change was requested to more accurately reflect the responsibilities of the division in regards to processing returns and the quantity, quality and relevance of the data it generates.

Department of Revenue

Department Response

Montana Department of Revenue

Dan Bucks
Director

Brian Schweitzer
Governor

October 11, 2012

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OCT 12 2012
LEGISLATIVE AUDIT DIV.

Tori Hunthausen, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Ms. Hunthausen:

Thank you for the opportunity to respond to the Financial Compliance Audit Report recently completed for the two fiscal years ended June 30, 2011 and 2012. This audit report includes four recommendations. The department concurs with three of the recommendations and partially concurs with the fourth. Our response to the recommendations is as follows:

Recommendation # 1

We recommend the department strengthen procedures to review the inflation factor calculation for accuracy.

Concur. The department will strengthen its review procedures of the inflation factor computations by having two people calculate the annual inflation factor and compare the results before they are finalized for publication of the annual tax forms. Although the impact of the calculation error for the 2011 tax year is not material and the individual amount for taxpayers is de minimus, the department believes this change to its review procedures should eliminate a similar miscalculation from occurring in the future.

The department would note that in cases of where a taxpayer makes an error it refrains from billing amounts that are larger than the per taxpayer effect of the department's miscalculation in this case.

Please refer to the attached response from Dan Dodds, Senior Economist for the Department of Revenue, for a detailed explanation to the legislative audit finding.

Recommendation #2

We recommend the department comply with state law by selling unclaimed property within three years of receipt when determined cost beneficial.

Partially Concur. The department will follow state statute and work to stage an auction of the unclaimed property it has received, but it also recommends state statute be extended to require the sale through auction after six years to allow rightful owners more time to claim property that has sentimental value to them. State statute currently indicates abandoned property shall be sold at a public auction within three years of receipt to the highest bidder if "*in the judgment of the administrator this affords the most favorable market for the property*". The department's storage capacity for unclaimed property is not an issue. The department has received this property from abandoned safe deposit boxes. An auction of this property has not been held recently, as it is felt the sentimental value of the abandoned property to the rightful owner often outweighs the value of what would be received in a periodic auction and such proceeds certainly would have minimal impact to the overall general fund balance.

The department also believes that there is less of a risk for theft of the stored property with the controls in place, than the risk of theft or other hazards associated with converting the property to cash through an auction process and ultimately getting the cash deposited in the bank. As well, it is difficult to manage whether the department truly is receiving fair market value through an auction process.

Recommendation # 3

We recommend the department:

A. Repay the liquor fund for the $75,000 advance.
B. Seek other resources to provide a positive cash balance at fiscal year-end in the Federal Impact account.

Concur. The department's one federal fund is for the administration of the federal mineral royalty audit program. The department bills the United States Department of Interior monthly for operating costs of this program. There is a time lag from when the department bills the federal government and when the federal reimbursement is received. This creates a cash shortage at the start of each fiscal year when operating expenses are paid.

Prior to the department requesting a long-term loan from the liquor fund in 2000, the department used a short-term loan from the general fund each year to offset the cash shortfall. It was believed this was an inefficient process because the department had to request a loan each year from the Department of Administration, repay it each fiscal year-end, and start the process over again at the beginning of the next fiscal year. The department was looking for a long-term solution which was believed to be the long-term advance from the liquor fund.

The department will repay the $75,000 to the liquor fund and will annually seek a general fund short-term loan each fiscal year to cover initial expenses until federal reimbursement is received. The department will also explore whether a permanent general fund advance to the federal fund is a viable alternative.

Recommendation # 4

We recommend the department:

A. Comply with state law by adopting rules as required by statute or seek legislation to amend the requirement in state law.
B. Seek to amend the adoption of rules required by §15-68-401(3), MCA.

Concur in Legislative Recommendation. The department concurs with the recommendation that the laws be amended to eliminate the requirement for rules in the cases cited. The department requests the legislative audit committee advance legislation to amend this requirement for the state statutes identified as the department finds rules in these areas to be wasteful and unnecessary.

The Internal Revenue Service prepares actuarial tables that are extensively voluminous; the latest set is nearly seven hundred pages. As §15-30-2327(3), MCA, indicates the department shall adopt rules to prepare life expectancy tables that are derived from the federal actuarial tables. The cost to annually duplicate these pages comes at a huge cost and is not an efficient use of state resources. The department believes it would be more appropriate to amend the statute to refer to the federal tables, but not require such reference by adopting administrative rules.

Secondly, the department believes the application process for a connoisseur's license as referenced in §16-4-901, MCA, is a simple process that is easily understood. The application is a one-page form and adopting administrative rules to provide application procedures is not necessary.

Finally, as the audit indicates §15-68-401(3), MCA, requires adoption of rules for securing a seller's permit for persons engaged in renting accommodations and campgrounds prior to June 1, 2003 and rental vehicles prior to July 1, 2003. The purpose of this statute was to require the department to address by administrative rule how seller's permits would be issued for the businesses that were renting accommodations, campgrounds and rental vehicles prior to the passage of the legislation in 2003. The department did adopt administrative rules as required to address this situation, but has since repealed these administrative rules. The administrative rules were repealed because there are no longer any facilities that were in business prior to the effective date of the 2003 legislation that have not obtained a seller's permit. The department's recommendation would be for the legislature to repeal this section of the statute requiring administrative rules for this one time provision.

Thank you for allowing us to respond to the financial compliance audit report and the opportunity to discuss the issues with you and your staff during the exit conference.

I would also like to thank your staff who conducted the audit for their professionalism and their fairness in working through the issues that were raised.

Sincerely,

Dan Bucks, Director

Enclosure

Montana Department of Revenue

Dan Bucks
Director

Brian Schweitzer
Governor

To: Dan Bucks, Director

From: Dan Dodds, Senior Economist

Date: October 10, 2012

Subject: Response to Legislative Audit Finding and Recommendation #1.

This audit finding addresses an error in adjusting the income tax parameters for inflation. This memo explains how the error occurred, what the department should do to ensure that this error, or something similar, does not occur again, and estimates the impact of the error.

Background

Sections 15-30-2101, 2103, 2110, 2114, and 2132, MCA direct the department to adjust the income tax rate table, the personal exemption, the maximum and minimum standard deductions, and the partial exemption of pension income for inflation. These sections direct the department to perform the calculations using the Consumer Price Index (CPI) for June of the current year and June of a base year. For the rate table, the personal exemption, and the maximum and minimum standard deductions, the base year is 2005. For the partial pension exemption it is 2009.

The CPI is calculated and published by the Bureau of Labor Statistics (BLS) of the U.S. Department of Commerce. Each month, the BLS publishes a newly calculated CPI for the previous month. Periodically, the BLS issues newly revised values for the CPI for one or more previous months, sometimes revising the whole series back to 1947.

The BLS is likely to revise the CPI for any particular month several times in the following year and less frequently thereafter. <u>There is never a point at which the CPI for a particular month becomes final and unchangeable.</u> Thus, the base year values for the inflation adjustment calculations may change from one year to the next.

The Error and How It Occurred

Every year I go to the BLS website and download a table with monthly CPI values back to 2005. I copy this table into a spreadsheet that is set up to do the inflation adjustment calculations. I then copy the column of June CPI values to another location in the spreadsheet. The inflation adjustment formulas in the spreadsheet use the CPI numbers in this second location.

Apparently, when I copied and pasted the June CPI values from one location in the spreadsheet to another, I missed copying the June 2005 value. The BLS had revised the June 2005 CPI since I had done the calculation for the 2010 returns. Using the older June 2005 CPI caused the maximum and minimum standard deductions and the personal exemption amount to be $10 low and two rate brackets to begin $100 low.

Preventing This Type of Error

I have changed the inflation adjustment spreadsheet to eliminate the second copying and pasting operation, where it looks like the error occurred. However, the possibility of similar errors cannot be eliminated with this sort of mechanical change. In the future, we should have a second person review the calculations.

Estimated Impact

I estimated the impact of this error by recalculating tax liability for all 2010 returns with the parameters on the 2011 returns and with the parameters calculated using the correct June 2005 CPI. The error increased total tax liability by about $0.7 million. With individual tax liabilities rounded to the nearest dollar, as tax returns direct, 36% of returns had no change in tax liability, and a few had a decrease in tax liability. Thirty-six percent had an increase of either $1 or $2, and the remaining returns had an increase of $3 or more.

This will not affect future tax returns since the inflation adjustment is always done from fixed base year values rather than from the last year’s adjusted values.