UTAH STATE TAX COMMISSION

Management Letter
For the Year Ended June 30, 2018

Report No. 18-25

OFFICE OF THE
STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor
Jon Johnson, CPA, Deputy State Auditor
Sean Clayton, Audit Senior

MANAGEMENT LETTER NO. 18-25

December 10, 2018

Members of the Utah State Tax Commission
and
Scott W. Smith, Executive Director
Utah State Tax Commission

In planning and performing our audit of the basic financial statements of the State of Utah as of and for the year ended June 30, 2018, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, we considered the Utah State Tax Commission's (Tax Commission's) internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Tax Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Tax Commission's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or to detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control presented in the accompanying finding and recommendation to be a significant deficiency.

The Tax Commission's written response and Corrective Action Plan to the finding identified in our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the Tax Commission's internal control. The finding included in this report will be included in the State of Utah's "Independent State Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards."* That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Tax Commission's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

We appreciate the courtesy and assistance extended to us by the Tax Commission personnel during the course of our audit, and we look forward to a continuing professional relationship. If you have any questions, please contact me.

Sincerely,

Jon T Johnson

Jon Johnson, CPA
Deputy State Auditor
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cc: Scott Stevens, Chief Financial Officer

FINDING AND RECOMMENDATION

INADEQUATE INTERNAL CONTROLS OVER UNCOLLECTIBLE TAX ESTIMATES USED IN FINANCIAL REPORTING

The Tax Commission does not have adequate internal controls to ensure that the amount of uncollectible taxes are estimated appropriately. The Tax Commission uses statistical models to estimate the delinquent tax allowance. For the June 30, 2018 year-end estimates, the current methodology was insufficiently robust to estimate shifts in the future capture of delinquent taxes. Based on our recalculations using Tax Commission-provided data, the model drift resulted in tax receivable reporting errors for four major governmental funds, with the largest error representing a $19.4 million overstatement of the uncollectible tax allowance and a corresponding understatement of Education Fund taxes receivable.

Management is responsible for the fair presentation of its activities and balances in the annual financial statements. This includes responsibility for the accounting estimates included in the financial statements and appropriate internal controls over those accounting estimates.

Recommendation:

We recommend the Tax Commission improve its internal controls over the preparation of accounting estimates to ensure that the methodology reflects current data.

Tax Commission's Response:

We agree that reviewing uncollectible accounting estimates will help ensure the best methodology to reflect current data.

Corrective Action Plan:

Accounting estimates are an important element of the financial statements prepared by management. The Tax Commission has consistently used for 10 years a uniform statistical model to estimate the delinquent tax allowance. While the Tax Commission has not evaluated the "reperformance" (or "recalculations") methodology used by the Office of the State Auditor to compute model drift, we agree that evaluating a new delinquent tax allowance methodology may well enhance reporting of major governmental funds for the uncollectible tax allowance.

*To facilitate the creation of a new estimating methodology, the Tax Commission will consider two possible approaches, '**Scoring**' or the '**Percentage of Receivables / Aging'** method. Upon selection of the preferred method, the Tax Commission will create a plan for implementation.*

Description of Methods

1. ***Scoring** is a method used by the Taxpayer Services Division to evaluate the collectability of a delinquent account. Potentially, with a new analytics tool and modifications to existing scoring processes, a new predictive model could be produced to streamline and improve the creation of the uncollectible tax allowance.*

2. *The **Percentage of Receivables / Aging** method could be developed by calculating a historical percentage of bad debts to accounts receivable.*

Contact Person: Scott Stevens, Chief Financial Officer, 801-297-3872
Anticipated Correction Date: June 30, 2019