

McGladrey & Pullen

Certified Public Accountants

State of Illinois Department of Revenue

Financial Audit
For the Year Ended June 30, 2008
Performed as Special Assistant Auditors
For the Auditor General, State of Illinois

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State of Illinois
Department of Revenue

Agency Officials
For the Year Ended June 30, 2008

Director	Brian A. Hamer
Assistant Director	Pat Welch
Associate Director	Jodie Winnett
Chief of Staff	Lainie Krozel (Acting 6/2/08 - Current)
	Lainie Krozel (10/1/07 – 6/1/08)
	Lainie Krozel (Acting 7/1/07 – 9/30/07)

Chief Fiscal Officer	Mark Lewis
Lottery	Jodie Winnett (Acting)
Liquor Control Commission	Lainie Krozel (6/2/08 – Current)
	Lainie Krozel (Acting 7/1/07 – 6/1/08)

Gaming Board	Mark Ostrowski
Racing Board	Marc Laino
Program Administrators:	
Administrative Services	Vacant (03/22/08-Current)
	Stephanie Arkin (07/01/07-03/21/08)

Account Processing	Carol Davlin
Information Services	Curt Smith
Tax Enforcement	Pat Welch (Acting)
Policy and Communications Office	Mike Klemens

Managers:	
Financial Control Bureau	Larry Lascody, Jr.
Returns and Deposits	Patti Walbaum

General Counsel	John McCaffrey
Administrative and Regulatory Shared Services Center:	

Director	Dave Hunt
Chief Fiscal Officer	Travis March
Customer Service Liasion	Vacant (6/16/08 – Current)
	Carolyn White (7/1/07 – 6/16/08)
Human Services Director	Christy Shewmaker
Administrative Director	Vacant (6/1/08-8/20/08)
	Shelly Martin (7/1/07 – 5/30/08)

Agency offices are located at:

Willard Ice Building
101 West Jefferson
Springfield, Illinois 62702

James R. Thompson Center
100 West Randolph, Suite 7-500
Chicago, Illinois 60601-3274

State of Illinois
Department of Revenue

Financial Statement Report

Summary

The audit of the accompanying basic financial statements of the State of Illinois, Department of Revenue (Department), was performed by McGladrey & Pullen, LLP.

Based on their audit, the auditors expressed an unqualified opinion on the Department's basic financial statements.

Summary of Findings

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings beginning on page 62 of this report, as findings 08-1 through 08-9. The auditors also consider findings 08-1 through 08-4 and 08-7 through 08-9 to be material weaknesses.

Exit Conference

The findings and recommendations appearing in this report were discussed with Department personnel at an exit conference on June 9, 2009. Attending were:

Department of Revenue

Brian Hamer	Director	Jodie Winnett	Assistant Director
Mark Lewis	Chief Fiscal Officer	John McCaffrey	Legal Counsel
Curt Smith	Chief Information Officer	Dan Hall	Audit Bureau
Larry Lascody	Financial Control Bureau	Wayne Ritchie	Account Processing
Jose Borjon	Audit Liaison	Marvin Becker	Shared Services
Norma Sutton	Administrative Services	Dave Hunt	Shared Services
Mike Klemens	Policy and Communications		

Office of the Auditor General

McGladrey & Pullen, LLP

Candice Long	Audit Manager	Linda Abernethy	Partner
Kathy Lovejoy	Audit Manager	Joe Evans	Partner
Alison Schertz	Audit Manager		
Jennifer Ballweg	State Auditor		
Daniel Nugent	State Auditor		

The responses to the recommendations were provided by Brian A. Hamer, Director, in a letter dated June 15, 2009.

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Illinois, Department of Revenue, as of and for the year ended June 30, 2008, which collectively comprise the State of Illinois, Department of Revenue's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Department of Revenue's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As discussed in Note 2, the financial statements of the State of Illinois, Department of Revenue are intended to present the financial position and changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the State of Illinois, Department of Revenue. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2008, and its changes in financial position including cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Illinois, Department of Revenue, as of June 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the financial statements, the June 30, 2007 net assets for governmental activities and the June 30, 2007 fund balance in the General fund have been restated (decreased by \$344 million), to correct errors in reporting prior unearned income tax revenues.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 23, 2009 on our consideration of the State of Illinois, Department of Revenue's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The State of Illinois, Department of Revenue has not presented a management's discussion and analysis and budgetary comparison information for the General Fund that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of Illinois, Department of Revenue's basic financial statements. The combining statements and schedules listed as supplementary information in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining statements and schedules listed as supplementary information in the table of contents have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, and Department management, and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Schaumburg, Illinois
June 23, 2009

State of Illinois
Department of Revenue

Statement of Net Assets

June 30, 2008 (Expressed in Thousands)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
ASSETS			
Unexpended appropriations	\$ 30,855	\$ -	\$ 30,855
Cash equity in State Treasury	1,426,843	10,047	1,436,890
Cash and cash equivalents	4	4,562	4,566
Investments	-	1,010	1,010
Taxes receivable, net	1,186,089	-	1,186,089
Intergovernmental receivables	25	-	25
Other receivables, net	8,765	16,868	25,633
Due from Department fiduciary funds	-	336	336
Due from Department funds	(74,117)	74,117	-
Due from State funds	519	-	519
Due from State of Illinois component units	345,734	-	345,734
Inventories	230	262	492
Prepaid expenses	-	104	104
Capital assets being depreciated, net	1,201	380	1,581
Total assets	<u>2,926,148</u>	<u>107,686</u>	<u>3,033,834</u>
LIABILITIES			
Accounts payable and accrued liabilities	1,158,778	71,048	1,229,826
Intergovernmental payables	933,916	-	933,916
Due to other Department fiduciary funds	30,937	-	30,937
Due to other State fiduciary funds	1,207	-	1,207
Due to other State funds	70,585	212	70,797
Due to State of Illinois component units	284	-	284
Unearned revenue	461,168	2,948	464,116
Long-term obligations:			
Portion due or payable within one year	900	173	1,073
Portion due or payable after one year	15,269	2,111	17,380
Total liabilities	<u>2,673,044</u>	<u>76,492</u>	<u>2,749,536</u>
NET ASSETS			
Invested in capital assets, net of related debt	1,201	380	1,581
Restricted for education	1,090	30,814	31,904
Unrestricted net assets	250,813	-	250,813
Total net assets	<u>\$ 253,104</u>	<u>\$ 31,194</u>	<u>\$ 284,298</u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue
Statement of Activities

For the Year Ended June 30, 2008 (Expressed in Thousands)

Functions/Programs	Program Revenues			Net (Expense) Revenues and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-type Activities	Total
Governmental activities						
General government	\$ 307,224	\$ 53,350	\$ 100	\$ (253,774)	\$ -	\$ (253,774)
Health and social services	12,808	-	-	(12,808)	-	(12,808)
Employment and economic development	5,000	-	-	(5,000)	-	(5,000)
Environment and business regulation	14,037	-	-	(14,037)	-	(14,037)
Intergovernmental-revenue sharing	5,134,925	-	-	(5,134,925)	-	(5,134,925)
Total governmental activities	5,473,994	53,350	100	(5,420,544)	-	(5,420,544)
Business-type activities						
Lottery	1,411,951	2,062,048	-		650,097	650,097
Total Department	\$ 6,885,945	\$ 2,115,398	\$ 100			
General revenues						
Taxes:						
Income taxes				13,374,171	-	13,374,171
Sales taxes				10,106,577	-	10,106,577
Motor fuel taxes				1,405,713	-	1,405,713
Public utility taxes				1,589,678	-	1,589,678
Other taxes				1,672,340	-	1,672,340
Interest and investment income				5,978	401	6,379
Other revenues				46,804	-	46,804
Appropriations from State Resources				253,527	-	253,527
Lapsed appropriations				(3,793)	-	(3,793)
Receipts collected and transmitted to State Treasury				(21,600,032)	-	(21,600,032)
Amount of SAMS transfers-in				(3,158,325)	-	(3,158,325)
Amount of SAMS transfers-out				1,575,003	-	1,575,003
Capital transfers to other State agencies				(77)	-	(77)
Transfers-in				648,251	-	648,251
Transfers-out				(374,152)	(648,456)	(1,022,608)
Total general revenues and transfers				5,541,663	(648,055)	4,893,608
Change in net assets				121,119	2,042	123,161
Net assets, July 1, 2007, as restated				131,985	29,152	161,137
Net assets, June 30, 2008				\$ 253,104	\$ 31,194	\$ 284,298

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

Balance Sheet -
Governmental Funds

June 30, 2008 (Expressed in Thousands)

	<u>General Fund</u>	<u>Nonmajor funds</u>	<u>Total Governmental Funds</u>
ASSETS			
Unexpended appropriations	\$ 11,343	\$ 19,512	\$ 30,855
Cash equity in State Treasury	414,296	1,012,547	1,426,843
Cash and cash equivalents	-	4	4
Taxes receivables, net	839,072	347,017	1,186,089
Intergovernmental receivables	-	25	25
Other receivables	-	8,765	8,765
Due from other Department funds	26,784	257,424	284,208
Due from other State funds	-	519	519
Due from State of Illinois component units	-	345,734	345,734
Inventories	230	-	230
Total assets	<u><u>\$ 1,291,725</u></u>	<u><u>\$ 1,991,547</u></u>	<u><u>\$ 3,283,272</u></u>
LIABILITIES			
Accounts payable and accrued liabilities	\$ 1,094,493	\$ 64,285	\$ 1,158,778
Intergovernmental payables	590	933,326	933,916
Due to other Department fiduciary funds	-	30,937	30,937
Due to other State fiduciary funds	628	579	1,207
Due to other Department funds	285,726	72,599	358,325
Due to other State funds	68,186	2,399	70,585
Due to State of Illinois component units	-	284	284
Unavailable revenue	75,534	34,248	109,782
Unearned revenue	321,121	140,047	461,168
Total liabilities	<u><u>1,846,278</u></u>	<u><u>1,278,704</u></u>	<u><u>3,124,982</u></u>
FUND BALANCES (DEFICITS)			
Reserved for:			
Encumbrances	-	754	754
Inventories	230	-	230
Long-term portion of due from other State of Illinois component units	-	345,734	345,734
Unreserved, undesignated			
General fund	(554,783)	-	(554,783)
Special revenue funds	-	366,355	366,355
Total fund balances (deficits)	<u><u>(554,553)</u></u>	<u><u>712,843</u></u>	<u><u>158,290</u></u>
Total liabilities and fund balances (deficits)	<u><u>\$ 1,291,725</u></u>	<u><u>\$ 1,991,547</u></u>	<u><u>\$ 3,283,272</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue
Reconciliation of Governmental Funds Balance Sheet
to Statement of Net Assets
June 30, 2008
(Expressed in Thousands)

Total fund balances-governmental funds	\$	158,290
<p>Amounts reported for governmental activities in the Statement of Net Assets are different because:</p>		
<p>Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.</p>		1,201
<p>Revenues in the Statement of Activities that do not provide current financial resources are deferred in the funds.</p>		109,782
<p>Some liabilities reported in the Statement of Net Assets do not require the use of current financial resources and therefore are not reported as liabilities in governmental funds. These activities consist of:</p>		
Compensated absences		(16,169)
Net assets of governmental activities	\$	<u>253,104</u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

**Statement of Revenues, Expenditures
and Changes in Fund Balances - Governmental Funds**

For the Year Ended June 30, 2008 (Expressed in Thousands)

	General Fund	Nonmajor funds	Total Governmental Funds
REVENUES			
Federal operating grants	\$ -	\$ 147	\$ 147
Income taxes	12,219,989	1,286,214	13,506,203
Sales taxes	7,382,089	2,719,101	10,101,190
Motor fuel taxes	-	1,410,656	1,410,656
Public utility taxes	1,187,252	403,248	1,590,500
Other taxes	627,409	1,044,345	1,671,754
Licenses and fees	6,449	44,068	50,517
Other charges for services	2,405	434	2,839
Interest and other investment income	-	5,978	5,978
Other	2,998	43,806	46,804
Total revenues	<u>21,428,591</u>	<u>6,957,997</u>	<u>28,386,588</u>
EXPENDITURES			
General government	152,479	152,792	305,271
Health and social services	-	12,808	12,808
Employment and economic development	-	5,000	5,000
Environment and business regulation	-	14,037	14,037
Intergovernmental	-	5,134,925	5,134,925
Capital outlays	246	195	441
Total expenditures	<u>152,725</u>	<u>5,319,757</u>	<u>5,472,482</u>
Excess (deficiency) of revenues over (under) expenditures	<u>21,275,866</u>	<u>1,638,240</u>	<u>22,914,106</u>
OTHER SOURCES (USES) OF FINANCIAL RESOURCES			
Appropriations from State resources	158,437	95,090	253,527
Lapsed appropriations	(2,207)	(1,586)	(3,793)
Receipts collected and transmitted to State Treasury	(19,373,687)	(2,226,345)	(21,600,032)
Amount of SAMS Transfers-in	(3,120,525)	(37,800)	(3,158,325)
Amount of SAMS Transfers-out	1,573,613	1,390	1,575,003
Transfers-in	1,233,160	1,526,352	2,759,512
Transfers-out	(1,682,309)	(803,104)	(2,485,413)
Net other sources (uses) of financial resources	<u>(21,213,518)</u>	<u>(1,446,003)</u>	<u>(22,659,521)</u>
Net change in fund balances	62,348	192,237	254,585
Fund balances (deficits), July 1, 2007, as restated	(616,358)	520,606	(95,752)
(Decrease) for changes in inventories	(543)	-	(543)
FUND BALANCES (DEFICITS), JUNE 30, 2008	<u>\$ (554,553)</u>	<u>\$ 712,843</u>	<u>\$ 158,290</u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue
Reconciliation of Statement of Revenues, Expenditures and Changes in
Fund Balances of Governmental Funds to Statement of Activities
For the Year Ended June 30, 2008
(Expressed in Thousands)

Net change in fund balances	\$	254,585
Change in inventories		(543)
		254,042
<p>Amounts reported for governmental activities in the Statement of Activities are different because:</p>		
Governmental funds report capital outlays as expenditures while governmental activities report depreciation expense to allocate those expenditures over the life of the assets. This is the amount by which depreciation exceeded capital outlays in the current period.		(218)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds. This amount represents the decrease in unavailable revenue over the prior year.		(131,877)
Some capital assets were transferred out to other State agencies and, therefore, no proceeds were received for the capital asset's value.		(77)
Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		
Increase in compensated absences obligation		(751)
		(751)
Change in net assets of governmental activities	\$	121,119

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

**Statement of Net Assets -
Proprietary Funds**

June 30, 2008 (Expressed in Thousands)

	Nonmajor Enterprise Fund State Lottery 0711
	<u> </u>
ASSETS	
Cash equity in State Treasury	\$ 10,047
Cash and cash equivalents	4,562
Investments, short-term	107
Other receivables, net	16,868
Due from other Department fiduciary funds	336
Due from other Department funds	74,333
Inventories	262
Prepaid expenses	104
Total current assets	<u>106,619</u>
Investments	903
Capital assets being depreciated, net	380
Total assets	<u>107,902</u>
LIABILITIES	
Accounts payable and accrued liabilities	71,048
Due to other Department funds	216
Due to other State funds	212
Unearned revenue	2,948
Current portion of long-term obligations	173
Total current liabilities	<u>74,597</u>
Noncurrent portion of long-term obligations	2,111
Total liabilities	<u>76,708</u>
NET ASSETS	
Invested in capital assets, net of related debt	380
Restricted for education	30,814
Total net assets	<u>\$ 31,194</u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

Statement of Revenues, Expenses and Changes in Fund
Net Assets - Proprietary Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Nonmajor Enterprise Fund State Lottery 0711
OPERATING REVENUES	
Charges for sales and services	\$ 2,057,270
Other	4,778
Total operating revenues	<u>2,062,048</u>
OPERATING EXPENSES	
Cost of sales and services	153,104
Prizes and claims	1,199,026
General and administrative	59,647
Depreciation	174
Total operating expenses	<u>1,411,951</u>
Operating income (loss)	<u>650,097</u>
NONOPERATING REVENUES (EXPENSES)	
Interest and investment income	<u>401</u>
Income (loss) before transfers	<u>650,498</u>
Transfers-out	<u>(648,456)</u>
Net income (loss)	<u>2,042</u>
Net assets (deficit), July 1, 2007	<u>29,152</u>
NET ASSETS (DEFICIT), JUNE 30, 2008	<u><u>\$ 31,194</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

Statement of Cash Flows -
Proprietary Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Nonmajor Enterprise Fund State Lottery 0711
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from sales and services (net of \$908,646 cash prizes paid by agents and \$103,758 commission retained by agents)	\$ 1,046,496
Cash payments to employees for services	(107,106)
Cash payments for lottery prizes	(301,255)
Cash receipts from other operating activities	4,778
Cash payments for other operating activities	(53)
Net cash provided (used) by operating activities	<u>642,860</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Transfers-out to other funds	(661,702)
Net cash provided (used) by noncapital financing activities	<u>(661,702)</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest and dividends on investments	401
Net cash provided (used) by investing activities	<u>401</u>
Net increase (decrease) in cash and cash equivalents	(18,441)
Cash and cash equivalents, July 1, 2007	<u>33,050</u>
CASH AND CASH EQUIVALENTS, JUNE 30, 2008	<u>\$ 14,609</u>
Reconciliation of cash and cash equivalents to the statement of net assets:	
Total cash and cash equivalents per the statement of net assets	\$ 4,562
Add: Cash equity with State Treasurer	10,047
CASH AND CASH EQUIVALENTS, JUNE 30, 2008	<u>\$ 14,609</u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

Statement of Cash Flows -
Proprietary Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	<u>Nonmajor Enterprise Fund State Lottery 0711</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:	
OPERATING INCOME (LOSS)	<u>\$ 650,097</u>
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Depreciation	174
Provision for uncollectible accounts	396
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	3,364
(Increase) decrease in due from other funds	107
(Increase) decrease in inventory	27
(Increase) decrease in prepaid expenses	237
Increase (decrease) in accounts payable and accrued liabilities	(4,639)
Increase (decrease) in intergovernmental payables	
Increase (decrease) in due to other funds	(3,445)
Increase (decrease) in due to component units	(1)
Increase (decrease) in unearned revenues	(3,490)
Increase (decrease) in other liabilities	33
Total adjustments	<u>(7,237)</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u><u>\$ 642,860</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

Statement of Fiduciary Net Assets

June 30, 2008 (Expressed in Thousands)

	<u>Investment Trust Fund</u>		<u>Deferred Prize Winners Trust Fund 0978</u>	<u>Agency Funds</u>
ASSETS				
Cash equity in State Treasury	\$ 1,684	\$	426,565	
Cash and cash equivalents	-		3,488	
Fixed income investments	569,503		-	
Taxes receivable, net	-		142,341	
Other receivables, net	-		504	
Due from other Department funds	-		30,937	
Total assets	<u>571,187</u>	<u>\$</u>	<u>603,835</u>	
LIABILITIES				
Accounts payable and accrued liabilities	-	\$	4,358	
Intergovernmental payables	-		595,977	
Due to other Department funds	336		-	
Other liabilities	1,348		3,500	
Total liabilities	<u>1,684</u>	<u>\$</u>	<u>603,835</u>	
NET ASSETS				
Held in trust for prizewinners	<u>569,503</u>			
Total net assets	<u>\$ 569,503</u>			

The accompanying notes to the financial statements are an integral part of this statement.

State of Illinois
Department of Revenue

Statement of Changes in Fiduciary Net Assets

For the Year Ended June 30, 2008 (Expressed in Thousands)

	<u>Investment Trust Fund</u>	<u>Deferred Prize Winners Trust Fund 0978</u>
ADDITIONS:		
Investment earnings:		
Interest, dividends and other investment income	\$ 39,345	
Net increase in the fair value of investments		18,574
Net investment income	<u>57,919</u>	
Individual account transactions:		
Shares sold		76,072
Shares redeemed		(189,016)
Net individual account transactions		<u>(112,944)</u>
Total additions		(55,025)
Net assets, July 1, 2007		<u>624,528</u>
Net assets, JUNE 30, 2008	\$	<u><u>569,503</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE**

Notes to Financial Statements

June 30, 2008

(1) Organization

The Department of Revenue (the Department) is a part of the executive branch of government of the State of Illinois (State) and operates under the authority of and review by the Illinois General Assembly. The Department operates under a budget approved by the General Assembly in which resources primarily from the General Revenue Fund are appropriated for the use of the Department. Activities of the Department are subject to the authority of the Office of the Governor, the State's chief executive officer, and other departments of the executive and legislative branches of government (such as the Department of Central Management Services, the Governor's Office of Management and Budget, the State Treasurer's Office, and the State Comptroller's Office) as defined by the Illinois General Assembly. All funds appropriated to the Department and all other cash received are under the custody and control of the State Treasurer, with the exception of the Surety Bond Fund, the Lottery Agent Security Deposits Fund, and the Evidence Fund.

The Department is organized to provide for administering, collecting, enforcing and determining distribution of the taxes imposed by the State's major tax acts. The Department also administers and oversees the operations of the Illinois Lottery, the Liquor Control Commission, the Illinois Gaming Board, and the Illinois Racing Board.

(2) Summary of Significant Accounting Policies

The financial statements of the Department have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

(a) Financial Reporting Entity

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

- 1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
- 2) Fiscal dependency on the primary government.

Based upon the required criteria, the Department has no component units and is not a component unit of any other entity. However, because the Department is not legally separate from the State of Illinois, the financial statements of the Department are included in the financial statements of the State of Illinois. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Division of Financial Reporting, 325 West Adams Street, Springfield, Illinois, 62704-1871.

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(b) Basis of Presentation

The financial statements of the State of Illinois, Department of Revenue, are intended to present the financial position, changes in financial position, and cash flows of only that portion of the governmental activities, each major governmental fund of the State of Illinois, the enterprise fund, and the aggregate remaining fund information of the State of Illinois that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Illinois as of June 30, 2008 the changes in financial position for the year then ended, and the cash flows in conformity with accounting principles generally accepted in the United States of America.

Government-wide Statements. The government-wide statement of net assets and statement of activities report the overall financial activity of the Department, excluding fiduciary activities. Eliminations have been made to minimize the double-counting of internal activities of the Department. These statements distinguish between the *governmental* and *business-type* activities of the Department. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties.

The statement of net assets presents the assets and liabilities of the Department's governmental and business-type activities with the difference being reported as net assets. The assets and liabilities are presented in order of their relative liquidity by class of asset or liability with liabilities whose average maturities are greater than one year reported in two components - the amount due within one year and the amount due in more than one year.

The statement of activities presents a comparison between direct expenses and program revenues for the different business-type activities of the Department and for each function of the Department's governmental activities. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges paid by the recipients of goods or services offered by the programs. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements. The fund financial statements provide information about the Department's funds, including fiduciary funds. Separate statements for each fund category - governmental, proprietary, and fiduciary - are presented. The emphasis on fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal value. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

The Department administers the following major governmental funds (or portions thereof in the case of shared funds – see note 2(d)) of the State:

General – This is the State's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. The

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE**

Notes to Financial Statements

June 30, 2008

services which are administered by the Department and accounted for in the general fund include, among others, general government services.

Additionally, the Office administers the following fund types:

Governmental Fund Types:

Special Revenue – These funds account for resources obtained from specific revenue sources that are legally restricted to expenditures for specified purposes. Special revenue funds account for, among other things, federal grant programs, taxes levied with statutorily defined distributions and other resources restricted as to purpose.

Proprietary Fund Types:

Enterprise – The State Lottery Fund accounts for operations of the State Lottery in which the net proceeds are used for the support of the State’s Common School Fund.

Fiduciary Fund Types:

Investment Trust – The Deferred Lottery Prizewinners Trust Fund accounts for the external portion of investment pools made on behalf of Lottery prizewinners.

Agency – These funds account for taxes and other assets collected and held by the Department, acting in the capacity of an agent, for distribution to other governmental units or designated beneficiaries.

(c) *Measurement Focus and Basis of Accounting*

The government-wide, proprietary, and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place. Nonexchange transactions, in which the Department gives (or receives) value without directly receiving (or giving) equal value in exchange, include income and replacement, sales, motor fuel, and excise taxes. On an accrual basis, revenues from these taxes are recognized in the fiscal year in which the underlying exchange transaction occurs. Revenue from grants, entitlements, and similar items are recognized in the fiscal year in which all eligibility requirements imposed by the provider have been met.

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures generally are recorded when the liability is incurred, as under accrual accounting. However, principal and interest on formal debt issues,

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Notes to Financial Statements

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claims and judgments, and compensated absences are recorded only when payment is due. Capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Significant revenue sources which are susceptible to accrual include income taxes, sales taxes, public utility taxes, motor fuel taxes, other taxes and interest. The tax revenues are recorded by the State as taxpayers earn income (personal income tax, corporate income tax, and other taxes), as sales are made (sales taxes, public utility taxes, motor fuel taxes, and other taxes), or as the taxable event occurs (other taxes) net of estimated overpayments and amounts not expected to be collected. All other revenue sources including fines, penalties, licenses, and other miscellaneous revenues are considered to be measurable and available only when cash is received. Estimates are used to assign estimated tax payments received or refunds applied to future tax periods for individual and corporate income taxes to the proper fiscal year.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The State also has the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance as it relates to the Department's operations.

(d) Shared Fund Presentation

The financial statement presentation for the General Revenue Fund, Education Assistance Fund, Motor Fuel Tax Fund, Public Utility Fund, Underground Storage Tank Fund, Illinois Gaming Law Enforcement Fund, Used Tire Management Fund, Natural Areas Acquisition Fund, Open Space Lands Acquisition and Development Fund, Common School Fund, Drycleaner Environment Response Trust Fund, Supplemental Low Income Energy Assistance Fund, Renewable Energy Resources Trust Fund, School Infrastructure Fund, Petroleum Resources Revolving Fund, International Tourism Fund, Tobacco Settlement Recovery Fund, Emergency Public Health Fund, Build Illinois Fund, and Local Tourism Fund represent only the portion of the shared fund that can be directly attributed to the operations of the Department. Financial statements for total fund operations of the shared State funds are presented in the State of Illinois' Comprehensive Annual Financial Report.

In presenting these financial statements, certain unique accounts are used for the presentation of shared funds. The following accounts are used in these financial statements to present the Department's portion of shared funds:

Unexpended Appropriations

This "asset" account represents lapse period warrants issued between July and August annually in accordance with the Statewide Accounting Management System (SAMS) records plus any liabilities relating to obligations re-appropriated to the subsequent fiscal year.

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Appropriations from State Resources

This “other financing source” account represents the final legally adopted appropriation according to SAMS records.

Lapsed Appropriations

Lapsed appropriations are the legally adopted appropriations less net warrants issued for the 14 month period from July to August of the following year and re-appropriations to subsequent years according to SAMS records.

Receipts Collected and Transmitted to State Treasury

This “other financing use” account represents all cash receipts received during the fiscal year from SAMS records.

Amount of SAMS Transfers-In

This “other financing use” account represents cash transfers made by the Office of the Comptroller in accordance with statutory provisions to the corresponding fund during the fiscal year per SAMS records in which the Department did not make a deposit into the State Treasury.

Amount of SAMS Transfers-Out

This “other financing source” account represents cash transfers made by the Office of the Comptroller in accordance with statutory provision from the corresponding fund during the fiscal year per SAMS records in which a legally adopted appropriation was not charged.

(e) *Eliminations*

Eliminations have been made in the government-wide statement of net assets to minimize the “grossing-up” effect on assets and liabilities within the governmental activities column of the Department. As a result, amounts reported in the governmental funds balance sheet as interdepartmental interfund receivables and payables have been eliminated in the government-wide statement of net assets. Amounts reported in the governmental funds balance sheet and proprietary statement of net assets as receivable from or payable to fiduciary funds have been included in the government-wide statement of net assets as receivable from and payable to external parties, rather than as internal balances.

**STATE OF ILLINOIS
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June 30, 2008

(f) Cash and Cash Equivalents

Cash equivalents are defined as short-term, highly liquid investments readily convertible to cash with maturities of less than 90 days at time of purchase. Cash and cash equivalents include cash on hand and cash in banks for locally held funds.

(g) Inventories

Inventories, consisting primarily of lottery tickets and postage and printing supplies, are valued at cost, principally on the first-in, first-out (FIFO) method. Significant inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

(h) Prepaid items

Payments made to vendors for services that will benefit periods beyond the date of this report are recorded as prepaid items on the government-wide statement of net assets.

(i) Interfund Transactions

The Department has the following types of interfund transactions between Department funds and funds of other State agencies:

Services provided and used—sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the governmental funds balance sheet or the government-wide and proprietary fund statements of net assets.

Reimbursements—repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Transfers—flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. In governmental funds, transfers are reported as other financing uses in the funds making transfers and as other financing sources in the funds receiving transfers. In proprietary funds, transfers are reported after nonoperating revenues and expenses.

(j) Capital Assets

Capital assets, which consist of equipment and automobiles, are reported at cost. Contributed assets are reported at estimated fair value at the time received. Capital assets are depreciated using the straight-line method.

The capitalization threshold for equipment and automobiles is \$5,000 and the estimated useful life is 3-15 years.

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June 30, 2008

(k) *Compensated Absences*

The liability for compensated absences reported in the government-wide and proprietary fund statements of net assets consists of unpaid, accumulated vacation and sick leave balances for Department employees. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g., social security and Medicare tax).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between January 1, 1984 and December 31, 1997 (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

(l) *Fund Balances*

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties as to use for specific purposes. Designations of fund balances represent tentative State plans that are subject to change.

(m) *Net Assets*

In the government-wide and proprietary fund statements of net assets, equity is displayed in three components as follows:

Invested in Capital Assets, Net of Related Debt – This consists of capital assets, net of accumulated depreciation, less the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted – This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use restricted resources first, then unrestricted resources when they are needed.

Unrestricted – This consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

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(n) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(o) Future Adoption of GASB Statements

Effective for the year ending June 30, 2009 the Department will adopt GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which establishes standards for accounting and financial reporting for pollution remediation obligations which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The Department has not yet determined the impact on the Department's financial statements as a result of adopting this statement.

(3) Deposits and Investments

(a) Deposits

The State Treasurer is the custodian of the Department's deposits and investments for funds maintained in the State Treasury. The Department independently manages deposits and investments maintained outside the State Treasury.

Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Detail on the nature of these deposits and investments is available within the State of Illinois' Comprehensive Annual Financial Report.

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Notes to Financial Statements

June 30, 2008

(b) Investments

As of June 30, 2008, the Department had the following investments outside of the State Treasury:

	Fair Value (Thousands)	Weighted Average Maturity (Years)
<i>Enterprise Funds</i>		
Annuities	\$ 1,010	7.165
<i>Fiduciary Funds</i>		
U.S. Treasury Bonds	\$ 569,503	4.339

Interest Rate Risk: The Department does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: Prior to July 30, 1985, the Department did not have a formal investment policy that limited investment choices. Subsequent to July 30, 1985, the Department is limited to investing in direct obligations of the United States of America or backed by the full faith and credit of the United States of America. The Department's investments in annuities are not rated.

(4) Taxes Receivable

Taxes receivable (amounts expressed in thousands) at June 30, 2008 are as follows:

	General Fund	Nonmajor Governmental Funds	Fiduciary Funds
Taxes receivable:			
Income	\$ 642,458	\$ 105,511	\$ -
Sales	621,984	187,127	115,749
Motor fuel tax	-	144,484	-
Public utility	11,399	12,852	24,780
Other	29,922	22,627	1,812
Total taxes receivable	1,305,763	472,601	142,341
Less: allowance for uncollectible taxes	466,691	125,584	-
Taxes receivable, net	\$ 839,072	\$ 347,017	\$ 142,341

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Notes to Financial Statements

June 30, 2008

(5) Interfund Balances and Activity

(a) Balances Due from/to Other Funds

The following balances (amounts expressed in thousands) at June 30, 2008 represent amounts due from other Department funds.

Fund	Due from			Description/Purpose
	Other Department Funds	Other State Funds	Other Department Fiduciary Funds	
General	\$ 26,784	\$ -	\$ -	Due from other Department funds pursuant to statutory tax allocations and for administrative cost reimbursements.
Nonmajor governmental funds	257,424	519	-	Due from other Department funds pursuant to statutory tax allocations, administrative cost reimbursements, and allocation of lottery proceeds and from other State fund for advances of services purchased.
Lottery	74,333	-	336	Due from General Fund for cumulative overpayment of lottery profits and from other Department fiduciary funds for unclaimed lottery prizes.
Fiduciary Funds	30,937	-	-	Due from other Department funds pursuant to statutory tax allocations.
	<u>\$ 389,478</u>	<u>\$ 519</u>	<u>\$ 336</u>	

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The following balances (amounts expressed in thousands) at June 30, 2008 represent amounts due to other Department and State of Illinois funds.

<u>Fund</u>	<u>Due to</u>				<u>Description/Purpose</u>
	<u>Other Department Funds</u>	<u>Other State Funds</u>	<u>Other Department Fiduciary Funds</u>	<u>Other State Fiduciary Funds</u>	
General	\$ 285,726	\$ 68,186	\$ -	\$ 628	Due to other Department funds pursuant to statutory tax allocations and cumulative overpayment of lottery profits, to other State funds for administrative expenses, and to other State fiduciary funds for payment of retirement benefits.
Nonmajor governmental funds	72,599	2,399	30,937	579	Due to other Department funds and other State funds pursuant to statutory tax and fee allocations, for administrative cost reimbursements, and for administrative expenses, other Department fiduciary funds pursuant to statutory tax allocations, and to other State fiduciary funds for payment of retirement benefits.
Lottery	216	212	-	-	Due to other Department and other State for allocation of lottery proceeds.
Fiduciary Funds	336	-	-	-	Due to Lottery Fund for unclaimed lottery prizes.
	<u>\$ 358,877</u>	<u>\$ 70,797</u>	<u>\$ 30,937</u>	<u>\$ 1,207</u>	

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(b) Transfers from/to Other Funds

Interfund transfers in (amounts expressed in thousands) for the year ended June 30, 2008, were as follows:

<u>Fund</u>	<u>Transfers in from</u>		<u>Description/Purpose</u>
	<u>Other Department Funds</u>	<u>Other State Funds</u>	
General	\$ 1,233,160	\$ -	Transfers from Lottery Fund for lottery profits and other Department funds pursuant to statutory tax allocations.
Nonmajor governmental funds	1,522,665	3,687	Transfers from other Department funds and other State funds pursuant to statutory tax allocations.
	<u>\$ 2,755,825</u>	<u>\$ 3,687</u>	

Interfund transfers out (amounts expressed in thousands) for the year ended June 30, 2008, were as follows:

<u>Fund</u>	<u>Transfers out to</u>		<u>Description/Purpose</u>
	<u>Other Department Funds</u>	<u>Other State Funds</u>	
General	\$ 1,313,494	\$ 368,815	Transfers to other Department funds and other State funds pursuant to statutory tax allocations.
Nonmajor governmental funds	797,767	5,337	Transfers to other Department funds and other State funds pursuant to statutory tax allocations and to other State funds for budget shortfalls.
Lottery Fund	644,564	3,892	Transfers to General Fund for lottery profits and to other State funds for budget shortfalls.
	<u>\$ 2,755,825</u>	<u>\$ 378,044</u>	

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(c) Balances Due from/ to State of Illinois Component Units

The Illinois Housing Development Authority owes the Department's nonmajor governmental funds \$345.734 million at June 30, 2008 for advances on loan programs.

The following balances (amounts expressed in thousands) at June 30, 2008 represent amounts due to State of Illinois Component Units for reimbursements for expenses incurred.

<u>Fund</u>	<u>Due to Nonmajor Governmental Fund</u>
Illinois Toll Highway	\$ 10
University of Illinois	274
	<u>\$ 284</u>

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June 30, 2008

(6) Capital Assets

Capital asset activity (amounts expressed in thousands) for the year ended June 30, 2008 was as follows:

	<u>Balance July 1, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Net Transfers</u>	<u>Balance June 30, 2008</u>
Governmental activities:					
Capital assets being depreciated:					
Equipment	\$ 6,577	\$ 441	\$ 179	\$ (876)	\$ 5,963
Less accumulated depreciation:					
Equipment	<u>5,081</u>	<u>659</u>	<u>179</u>	<u>(799)</u>	<u>4,762</u>
Governmental activity capital assets, net	<u>\$ 1,496</u>	<u>\$ (218)</u>	<u>\$ -</u>	<u>\$ (77)</u>	<u>\$ 1,201</u>

Depreciation expense for governmental activities (amounts expressed in thousands) for the year ended June 30, 2008 was charged to functions as follows:

	General government			<u>\$ 659</u>	
	<u>Balance July 1, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Net Transfers</u>	<u>Balance June 30, 2008</u>
Business-type activities:					
Capital assets being depreciated:					
Equipment	\$ 2,146	\$ -	\$ 46	\$ (19)	\$ 2,081
Less accumulated depreciation:					
Equipment	<u>1,592</u>	<u>174</u>	<u>46</u>	<u>(19)</u>	<u>1,701</u>
Business-type activity capital assets, net	<u>\$ 554</u>	<u>\$ (174)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 380</u>

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June 30, 2008

(7) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2008 were as follows:

	Balance July 1, 2007	Additions	Deletions	Balance June 30, 2008	Amounts Due Within One Year
Governmental activities:					
Compensated Absences	\$ 15,418	\$ 9,674	\$ 8,923	\$16,169	\$ 900
Total governmental activities	\$ 15,418	\$ 9,674	\$ 8,923	\$16,169	\$ 900
Business-type activities:					
Compensated Absences	\$ 1,241	\$ 748	\$ 715	\$ 1,274	\$ 66
Obligations to Lottery prizewinners	1,044	-	34	1,010	107
Total business-type activities	\$ 2,285	\$ 748	\$ 749	\$ 2,284	\$ 173

Compensated absences have been liquidated by the applicable governmental funds that account for the salaries and wages of the related employees.

(b) Obligations to Lottery Prize Winners

The State has obligations to certain lottery prize winners for awards payable in annual installments ranging from nineteen years to the life of the prize winner, with the first payment being made after the claim is presented for payment. In addition, the State has fulfilled its obligations for certain other prize winners through the purchase of annuities under group contracts.

For certain prize winners, annuities were purchased in the name of the State for which the State has retained the rights of ownership. Effective July 30, 1985, State law provides that the State Treasurer, with the consent of the Director of Revenue, may contract to invest in securities, which provide payments corresponding to the Lottery's obligation to these winners. The present value of these annuities and the related liabilities owed to prize winners, \$1.010 million, have been reported in the financial statements of the State Lottery Fund, a nonmajor enterprise fund.

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In addition to the prize obligations discussed above, the State has provided for other payments corresponding to the Lottery's obligation to prize winners through the purchase of direct obligations of the federal government, primarily in the form of United States Treasury zero coupon bonds. As established by State law, such securities shall be maintained in the Deferred Lottery Prize Winners Trust Fund, a special trust fund separate and apart from all public money or funds of the State. These investments are purchased in amounts to provide for annual annuity payments to the prize winner(s) of each qualifying individual drawing. Since these monies are invested by the State on behalf of external legally separate entities (the prize winners), with specific investments being acquired for these individual entities for which the income from and changes in the value of the investments affect only the prize winners for whom they were acquired, in accordance with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, the Deferred Lottery Prize Winners Trust Fund is reported as an investment trust fund. The investments of the fund are reported at fair value, \$569.503 million at June 30, 2008, and the net assets are reported as held in trust for prizewinners.

(8) Pension Plan

Substantially all of the Department's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer defined benefit public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal year 2008 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2008. The SERS issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

A summary of SERS benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Department pays employer retirement contributions based upon an actuarially determined percentage of their payrolls. For fiscal year 2008, the employer contribution rate was 16.561%. Effective for pay periods beginning after December 31, 1991, the State opted to pay the employee portion of retirement for most State agencies (including the Department) with employees covered by the State Employees' and Teachers' Retirement Systems. However, effective with the fiscal year 2004 budget, the State opted to stop paying the portion or a part of the portion of retirement for many State agencies (including the Department) for certain classes of employees covered by the State Employees' and Teachers' Retirement Systems. The pickup, when applicable, is subject to sufficient annual appropriations and those employees covered may vary across employee groups and State agencies.

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June 30, 2008

(9) Post-employment Benefits

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employee's Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes \$5,000.

The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763-3838.

(10) Fund Deficits

The General Fund and the State Gaming, State & Local Sales Tax Reform, County & Mass Transit, Local Government Tax, Illinois Racing Board Grant, Illinois Tax Increment, Personal Property Tax Replacement, and Senior Citizen Real Estate Deferred Tax funds, nonmajor governmental funds, had fund balance deficits of \$554.553 million, \$9.340 million, \$1.789 million, \$825 thousand, \$3.575 million, \$15 thousand, \$78 thousand, \$15.303 million, and \$168 thousand, respectively, at June 30, 2008. The fund deficits in the General fund will be eliminated through the appropriation of future State revenues to the Department. The fund deficits in the State & Local Sales Tax Reform, County & Mass Transit, Local Government Tax, and the Personal Property Tax Replacement funds will be eliminated by future recognition of earned but unavailable revenues. The fund deficit of the State Gaming, Illinois Racing Board Grant, Illinois Tax Increment and the Senior Citizen Real Estate Deferred Tax funds will be eliminated through future revenues earned.

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE**

Notes to Financial Statements

June 30, 2008

(11) Risk Management

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; workers compensation and natural disasters. The State retains the risk of loss (i.e. self insured) for these risks.

The Department's risk management activities are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the general fund of the State. The claims are not considered to be a liability of the Department; and accordingly, have not been reported in the Department's financial statements for the year ended June 30, 2008.

(12) Commitments and Contingencies

(a) Operating leases

The Department leases certain office space under annual agreements which require the Department to make minimum lease payments. Rent expense under operating leases was \$8.556 million for the year ended June 30, 2008.

(b) Litigation

The Department is routinely involved in a number of legal proceedings and claims that cover a wide range of matters. In the opinion of management, the outcome of these matters is not expected to have any material adverse effect on the financial position or results of operations of the Department.

(13) Restatement

The Department restated the beginning fund balance in the General Fund from a deficit \$272.776 million to a deficit of \$616.358 million and beginning net assets for governmental activities from \$475.567 million to \$131.985 million due to the correction of errors in reporting prior unearned income tax revenue in the amount of \$343,582. The amounts reported for the year ended June 30, 2007 for the net change in fund balance for the General Fund and the change in net assets for governmental activities was overstated by approximately \$12 million as a result of these errors.

State of Illinois
Department of Revenue
Combining Schedule of Accounts
General Fund

June 30, 2008 (Expressed in Thousands)

	General Revenue Account 0001	Common School Special 0005	Education Assistance 0007	Income Tax Refund 0278	Common School 0412	Eliminations	Total
ASSETS							
Unexpended appropriation	\$ 11,343	\$ -	\$ -	\$ -	\$ -	-	11,343
Cash equity in State Treasury	224,747	39,826	4,561	132,518	12,644	-	414,296
Taxes receivable, net	660,611	102,425	23,404	51,184	1,448	-	839,072
Due from other Department funds	1,784	-	25,000	-	-	-	26,784
Inventories	230	-	-	-	-	-	230
Total assets	\$ 898,715	\$ 142,251	\$ 52,965	\$ 183,702	\$ 14,092	\$ -	\$ 1,291,725

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LIABILITIES

Accounts payable and accrued liabilities	\$ 182,189	\$ 47,989	\$ -	\$ 859,935	\$ 4,380	\$ -	\$ 1,094,493
Intergovernmental payables	563	-	-	27	-	-	590
Due to other State fiduciary funds	628	-	-	-	-	-	628
Due to other Department funds	116,063	-	-	95,330	74,333	-	285,726
Due to other State funds	68,186	-	-	-	-	-	68,186
Due to State of Illinois Component Units	-	-	-	-	-	-	-
Unavailable revenue	56,685	5,999	4,176	8,600	74	-	75,534
Unearned revenue	214,873	-	31,609	74,639	-	-	321,121
Total liabilities	639,187	53,988	35,785	1,038,531	78,787	-	1,846,278

FUND BALANCES (DEFICITS)

Reserved for:							
Inventories	230	-	-	-	-	-	230
Unreserved, undesignated	259,298	88,263	17,180	(854,829)	(64,695)	-	(554,783)
Total fund balances (deficits)	259,528	88,263	17,180	(854,829)	(64,695)	-	(554,553)
Total liabilities and fund balances	\$ 898,715	\$ 142,251	\$ 52,965	\$ 183,702	\$ 14,092	\$ -	\$ 1,291,725

State of Illinois
Department of Revenue

**Combining Schedule of Revenues,
Expenditures and Changes in Fund Balance -
General Fund**

For the Year Ended June 30, 2008 (Expressed in Thousands)

	General Revenue Account 0001	Common School Special 0005	Education Assistance 0007	Income Tax Refund 0278	Common School 0412	Eliminations	Total
REVENUES							
Income taxes	\$ 11,271,163	\$ -	\$ 889,328	\$ 59,498	\$ -	\$ -	\$ 12,219,989
Sales taxes	5,557,535	1,824,554	-	-	-	-	7,382,089
Public utility taxes	1,073,058	-	-	-	114,194	-	1,187,252
Other taxes	450,694	-	-	-	176,715	-	627,409
Licenses and fees	6,204	-	-	-	245	-	6,449
Other charges for services	1,380	-	1,025	-	-	-	2,405
Interest and investment income	-	-	-	-	-	-	-
Other	2,998	-	-	-	-	-	2,998
Total revenues	18,363,032	1,824,554	890,353	59,498	291,154	-	21,428,591
EXPENDITURES							
General government	150,635	-	-	1,844	-	-	152,479
Capital outlay	246	-	-	-	-	-	246
Total expenditures	150,881	-	-	1,844	-	-	152,725
Excess (deficiency) of revenues over (under) expenditures	18,212,151	1,824,554	890,353	57,654	291,154	-	21,275,866
OTHER SOURCES (USES) OF FINANCIAL RESOURCES							
Appropriations from State resources	158,437	-	-	-	-	-	158,437
Lapsed appropriations	(2,207)	-	-	-	-	-	(2,207)
Receipts collected and transmitted to State Treasury	(18,197,236)	-	(890,165)	-	(286,286)	-	(19,373,687)
Amount of SAMS transfers-in	(72,595)	-	(564,000)	-	(2,483,930)	-	(3,120,525)
Amount of SAMS transfers-out	1,573,613	-	-	-	-	-	1,573,613
Transfers-in	2,828	-	586,855	-	2,470,408	(1,826,931)	1,233,160
Transfers-out	(1,586,141)	(1,826,930)	-	(96,169)	-	1,826,931	(1,682,309)
Net other sources (uses) of financial resources	(18,123,301)	(1,826,930)	(867,310)	(96,169)	(299,808)	-	(21,213,518)
Net change in fund balances	88,850	(2,376)	23,043	(38,515)	(8,654)	-	62,348
Fund balances (deficits), July 1, 2007, as restated (Decrease) for changes in inventories	171,221 (543)	90,639 -	(5,863) -	(816,314) -	(56,041) -	- -	(616,358) (543)
FUND BALANCES (DEFICITS), JUNE 30, 2008	\$ 259,528	\$ 88,263	\$ 17,180	\$ (854,829)	\$ (64,695)	\$ -	\$ (554,553)

State of Illinois
Department of Revenue
Combining Balance Sheet -
Nonmajor Governmental Funds
 June 30, 2008 (Expressed in Thousands)

		Special Revenue									
Motor Fuel Tax	Public Utility	Underground Storage Tank	Illinois Gaming Law Enforcement	State Gaming	IDOR Federal Trust	Rental Housing Support Program	State & Local Sales Tax Reform	RTA Occupation and Use Tax Replacement			
0012	0059	0072	0085	0129	0140	0150	0186	0187			
\$ 18,280	\$ -	\$ 36	\$ 1,196	\$ -	\$ -	\$ -	\$ -	\$ -			
102,143	5	5,940	32	23,839	42	38,378	51,092	-			
118,100	1	6,520	652	2,458	-	-	14,817	-			
25	-	-	-	-	-	-	-	-			
-	5,500	-	-	10	-	-	-	-			
-	-	-	-	-	-	-	-	-			
-	-	-	-	426	-	-	-	-			
-	-	-	-	-	-	-	-	-			
\$ 238,548	\$ 5,506	\$ 12,496	\$ 1,880	\$ 26,733	\$ 42	\$ 38,378	\$ 65,909	\$ 5,691			
\$ 17,051	\$ -	\$ 319	\$ 46	\$ 445	\$ 1	\$ 17,590	\$ -	\$ -			
6,998	-	2	1,156	10,296	-	-	20,328	5,691			
-	-	-	-	-	-	-	-	-			
271	-	10	11	92	-	-	-	-			
-	-	-	-	25,000	-	-	45,190	-			
1,782	-	-	-	136	-	-	391	-			
-	-	-	-	104	-	-	-	-			
10,253	2	481	3	-	-	-	1,789	-			
-	-	-	-	-	-	-	-	-			
36,355	2	812	1,216	36,073	1	17,590	67,698	5,691			

ASSETS

Unexpended appropriations
 Cash equity in State Treasury
 Cash and cash equivalents
 Taxes receivable, net
 Intergovernmental receivables
 Other receivables, net
 Due from other Department funds
 Due from other State funds
 Due from State of Illinois component units
Total assets

LIABILITIES

Accounts payable and accrued liabilities
 Intergovernmental payables
 Due to other Department fiduciary funds
 Due to other State fiduciary funds
 Due to other Department funds
 Due to other State funds
 Due to State of Illinois component units
 Unavailable revenue
 Unearned revenue
Total liabilities

FUND BALANCES (DEFICITS)

Reserved for:
 Encumbrances
 Long-term portion of due from State of Illinois component units
 Unreserved, undesignated
 Total fund balances
Total liabilities and fund balances (deficits)

State of Illinois
Department of Revenue
Combining Balance Sheet -
Nonmajor Governmental Funds
 June 30, 2008 (Expressed in Thousands)

	Special Revenue										Illinois Tax Increment	
	County & Mass Transit 0188	Local Government Tax 0189	Illinois Sports Facility 0225	Emergency Public Health 0240	Racing Board License 0248	Illinois Racing Board Charity 0271	Debt Collection 0279	Illinois Racing Board Grant 0280				
ASSETS												
Unexpended appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Cash equity in State Treasury	68,445	287,591	4,313	2	91	30	69	3,563				
Cash and cash equivalents	-	-	-	-	-	-	-	-	-	-	-	-
Taxes receivable, net	19,238	76,982	3,938	-	-	-	-	1,477				
Intergovernmental receivables	-	-	-	-	-	-	-	-	-	-	-	-
Other receivables, net	-	-	625	496	-	-	-	4				
Due from other Department funds	-	-	-	-	-	-	-	-	-	-	-	-
Due from other State funds	-	-	-	-	-	-	-	-	-	-	-	-
Due from State of Illinois component units	-	-	-	-	-	-	-	-	-	-	-	-
Total assets	\$ 87,683	\$ 364,573	\$ 8,876	\$ 498	\$ 91	\$ 30	\$ 69	\$ 5,044				
LIABILITIES												
Accounts payable and accrued liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Intergovernmental payables	56,746	364,573	8,876	-	-	-	-	84	4,485			
Due to other Department fiduciary funds	30,937	-	-	-	-	-	-	-	-	-	-	-
Due to other State fiduciary funds	-	-	-	-	-	-	-	-	-	-	-	-
Due to other Department funds	-	-	-	-	-	-	-	-	-	-	-	-
Due to other State funds	-	-	-	-	7	-	-	-	-	-	-	-
Due to State of Illinois component units	-	-	-	-	-	-	-	-	-	-	-	-
Unavailable revenue	825	3,575	-	10	-	-	-	-	-	-	-	69
Unearned revenue	-	-	-	-	-	-	-	-	-	-	-	-
Total liabilities	\$ 88,508	\$ 368,148	\$ 8,876	\$ 10	\$ 7	\$ -	\$ 84	\$ 5,122				
FUND BALANCES (DEFICITS)												
Reserved for:												
Encumbrances	-	-	-	-	11	-	-	29				
Long-term portion of due from State of Illinois component units	-	-	-	-	-	-	-	-	-	-	-	-
Unreserved, undesignated	(825)	(3,575)	-	488	73	30	(44)	(78)				
Total fund balances	(825)	(3,575)	-	488	84	30	(15)	(78)				
Total liabilities and fund balances (deficits)	\$ 87,683	\$ 364,573	\$ 8,876	\$ 498	\$ 91	\$ 30	\$ 69	\$ 5,044				

State of Illinois
Department of Revenue
Combining Balance Sheet -
Nonmajor Governmental Funds
 June 30, 2008 (Expressed in Thousands)

	Special Revenue									
	Illinois Affordable Housing Trust 286	Used Tire Management 0294	Natural Areas Acquisition 0298	Open Space Lands Acquisition & Development 0299	Horse Racing Equity Trust 0313	Tax Compliance and Administration 0384	Quality of Life Endowment 0437			
ASSETS										
Unexpended appropriations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -			
Cash equity in State Treasury	7,717	7	302	704	76,489	1,703	872			
Cash and cash equivalents	-	-	-	-	-	-	-			
Taxes receivable, net	-	-	-	-	-	479	-			
Intergovernmental receivables	-	-	-	-	-	-	-			
Other receivables, net	14	1,881	-	-	-	147	2			216
Due from other Department funds	93	-	-	-	-	-	-			-
Due from other State funds	345,734	-	-	-	-	-	-			-
Due from State of Illinois component units	-	-	-	-	-	-	-			-
Total assets	\$ 353,558	\$ 1,888	\$ 302	\$ 704	\$ 76,489	\$ 2,329	\$ 1,090			
LIABILITIES										
Accounts payable and accrued liabilities	\$ 6,483	\$ -	\$ -	\$ -	\$ -	\$ 197	\$ -			
Intergovernmental payables	-	-	-	-	-	1	-			
Due to other Department fiduciary funds	-	-	-	-	-	-	-			
Due to other State fiduciary funds	-	-	-	-	-	29	-			
Due to other Department funds	-	363	-	-	-	-	-			
Due to other State funds	-	-	-	-	-	-	-			
Due to State of Illinois component units	-	-	-	-	-	-	-			
Unavailable revenue	-	44	-	-	-	-	-			189
Unearned revenue	-	-	-	-	-	-	-			-
Total liabilities	6,483	407	-	-	-	416	-			-
FUND BALANCES (DEFICITS)										
Reserved for:										
Encumbrances	-	-	-	-	-	-	-			-
Long-term portion of due from State of Illinois component units	345,734	-	-	-	-	-	-			-
Unreserved, undesignated	1,341	1,481	302	704	76,489	1,913	1,090			
Total fund balances	347,075	1,481	302	704	76,489	1,913	1,090			
Total liabilities and fund balances (deficits)	\$ 353,558	\$ 1,888	\$ 302	\$ 704	\$ 76,489	\$ 2,329	\$ 1,090			-

State of Illinois
Department of Revenue
Combining Balance Sheet -
Nonmajor Governmental Funds
 June 30, 2008 (Expressed in Thousands)

		Special Revenue																
		Municipal Economic Development 0650	Horse Racing 0632	Tobacco Settlement Recovery 0733	Personal Property Tax Replacement 0802	Dram Shop 0821	Senior Citizen Real Estate Deferred Tax 0930	Build Illinois 0960	Local Tourism 0969	Evidence Fund 1389	Total							
ASSETS																		
Unexpended appropriations	\$	-	\$	-	\$	-	\$	-	\$	-	\$							
Cash equity in State Treasury		137		-	301,650	2,524	43	16,391	1,582	-	1,012,547							
Cash and cash equivalents		-		-	-	-	-	-	-	4	4							
Taxes receivable, net		17		1	55,733	-	-	35,515	1,917	-	347,017							
Intergovernmental receivables		-		-	-	-	-	-	-	-	25							
Other receivables, net		-		-	240	-	-	-	-	-	8,765							
Due from other Department funds		-		-	95,330	-	-	9,450	-	-	257,424							
Due from other State funds		-		-	-	-	-	-	-	-	519							
Due from State of Illinois component units		-		-	-	-	-	-	-	-	345,734							
Total assets	\$	2,005	\$	138	\$	452,953	\$	2,524	\$	43	\$	61,356	\$	3,499	\$	4	\$	1,991,547
LIABILITIES																		
Accounts payable and accrued liabilities	\$	184	\$	-	\$	5,306	\$	143	\$	-	\$	11,672	\$	64	\$	-	\$	64,285
Intergovernmental payables		12		137		307,493		2		211		-		-		-		933,326
Due to other Department fiduciary funds		-		-	-	-	-	-	-	-	-	-	-	-	-	-	-	30,937
Due to other State fiduciary funds		58		-	100	4	-	-	-	-	-	-	-	-	-	-	-	579
Due to other Department funds		1,421		-	-	-	-	-	-	-	-	-	-	-	-	-	-	72,599
Due to other State funds		11		-	7	65	-	-	-	-	-	-	-	-	-	-	-	2,399
Due to State of Illinois component units		180		1	15,303	-	-	1,449	-	-	-	-	-	-	-	-	-	284
Unavailable revenue		-		-	140,047	-	-	-	-	-	-	-	-	-	-	-	-	34,248
Unearned revenue		-		-	-	-	-	-	-	-	-	-	-	-	-	-	-	140,047
Total liabilities	\$	1,866	\$	138	\$	468,256	\$	214	\$	211	\$	13,121	\$	168	\$	-	\$	1,278,704
FUND BALANCES (DEFICITS)																		
Reserved for:																		
Encumbrances		401		-	-	-	12	-	-	65	-	-	-	-	-	-	-	754
Long-term portion of due from State of Illinois component units		-		-	-	-	-	-	-	-	-	-	-	-	-	-	-	345,734
Unreserved, undesignated		(262)		-	(15,303)	2,298	(233)	48,235	3,331	(233)	4	4	4	4	4	4	4	366,355
Total fund balances		139		-	(15,303)	2,310	(168)	48,235	3,331	(168)	4	4	4	4	4	4	4	712,843
Total liabilities and fund balances (deficits)	\$	2,005	\$	138	\$	452,953	\$	2,524	\$	43	\$	61,356	\$	3,499	\$	4	\$	1,991,547

**State of Illinois
Department of Revenue**

**Combining Statement of Revenues,
Expenditures and Changes in Fund Balance -
Nonmajor Governmental Funds**

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Special Revenue											
	Motor Fuel Tax 0012	Public Utility 0059	Underground Storage Tank 0072	Illinois Gaming Law Enforcement 0085	State Gaming 0129	IDOR Federal Trust 0140	Rental Housing Support Program 0150	State & Local Sales Tax Reform 0186	RTA Occupation and Use Tax Replacement 0187			
REVENUES												
Federal operating grants	\$ 90	\$ -	\$ -	\$ -	\$ -	\$ 45	\$ -	\$ -	\$ -			
Income taxes	-	-	-	-	-	-	-	-	-			
Sales taxes	-	-	-	-	-	-	-	-	-			
Motor fuel taxes	1,336,736	-	73,919	-	-	-	-	-	262,981			
Public utility taxes	-	7,307	-	-	-	-	-	-	-			
Other taxes	-	-	-	3,105	696,835	-	21,826	-	-			
License and fees	715	9,326	-	306	720	-	-	-	-			
Other charges for services	-	-	-	-	-	-	-	-	-			
Interest and other investment income	-	-	-	-	-	-	-	-	-			
Other	-	-	-	-	-	-	-	-	-			
Total revenues	1,337,541	16,633	73,919	3,411	697,555	45	21,826	262,981	-			
EXPENDITURES												
General government	74,074	-	969	-	-	34	29,342	1	1			
Health and social services	-	-	-	-	336	-	-	-	-			
Employment and economic development	-	-	-	-	-	-	-	-	-			
Environment and business regulation	-	-	-	-	-	-	-	-	-			
Intergovernmental	61	-	-	2,307	123,443	-	-	58,955	25,576			
Capital outlay	81	-	-	-	63	11	-	-	-			
Total expenditures	74,216	-	969	2,307	123,842	45	29,342	58,956	25,577			
Excess (deficiency) of revenues over (under) expenditures	1,263,325	16,633	72,950	1,104	573,713	-	(7,516)	204,025	(25,577)			
OTHER SOURCES (USES) OF FINANCIAL RESOURCES												
Appropriations from State resources	91,276	-	1,001	2,809	-	-	-	-	-			
Lapsed appropriations	(1,066)	-	(31)	(489)	-	-	-	-	-			
Receipts collected and transmitted to State Treasury	(1,264,391)	(12,734)	(71,081)	(3,462)	-	-	-	-	-			
Amount of SAMS transfers-in	-	-	-	-	-	-	-	-	-			
Amount of SAMS transfers-out	-	-	-	-	-	-	-	-	-			
Transfers-in	-	-	-	-	-	-	-	-	25,577			
Transfers-out	-	-	-	-	-	-	-	(204,647)	-			
Net other sources (uses) of financial resources	(1,174,181)	(12,734)	(70,111)	(1,142)	(586,855)	-	-	(204,647)	25,577			
Net change in fund balances	89,144	3,899	2,839	(38)	(13,142)	-	(7,516)	(622)	-			
Fund balances (deficits), July 1, 2007	113,049	1,605	8,845	702	3,802	41	28,304	(1,167)	-			
FUND BALANCES (DEFICITS), JUNE 30, 2008	\$ 202,193	\$ 5,504	\$ 11,684	\$ 664	\$ (9,340)	\$ 41	\$ 20,788	\$ (1,789)	\$ -			

State of Illinois
Department of Revenue

**Combining Statement of Revenues,
Expenditures and Changes in Fund Balance -
Nonmajor Governmental Funds**

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Special Revenue						
	Illinois Affordable Housing Trust 286	Used Tire Management 0294	Natural Areas Acquisition 0298	Open Space Lands Acquisition & Development 0299	Horse Racing Equity Trust 0313	Tax Compliance and Administration 0384	Quality of Life Endowment 0437
REVENUES							
Federal operating grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Income taxes	-	-	-	-	-	-	-
Sales taxes	-	-	-	-	-	50	-
Motor fuel taxes	-	-	-	-	-	1	-
Public utility taxes	-	-	-	-	-	1,454	-
Other taxes	38,350	-	11,506	26,846	33,004	(37)	-
License and fees	36	13,726	-	-	-	1,042	-
Other charges for services	-	-	-	-	-	434	-
Interest and other investment income	2,278	-	-	-	-	-	4
Other	40,027	-	-	-	-	-	-
Total revenues	80,691	13,726	11,506	26,846	33,004	2,944	4
EXPENDITURES							
General government	41,726	-	-	-	-	2,371	-
Health and social services	12,474	-	-	-	-	-	-
Employment and economic development	-	-	-	-	-	-	-
Environment and business regulation	-	-	-	-	-	-	-
Intergovernmental	-	-	-	-	-	-	-
Capital outlay	-	-	-	-	-	-	-
Total expenditures	54,200	-	-	-	-	2,371	-
Excess (deficiency) of revenues over (under) expenditures	26,491	13,726	11,506	26,846	33,004	573	4
OTHER SOURCES (USES) OF FINANCIAL RESOURCES							
Appropriations from State resources	-	-	-	-	-	-	-
Lapsed appropriations	-	-	-	-	-	-	-
Receipts collected and transmitted to State Treasury	-	(13,807)	(11,526)	(26,894)	-	-	-
Amount of SAMS transfers-in	-	-	-	-	-	-	-
Amount of SAMS transfers-out	-	1,390	-	-	-	-	-
Transfers-in	-	-	-	-	-	-	1,086
Transfers-out	(3,775)	(1,438)	-	-	-	-	-
Net other sources (uses) of financial resources	(3,775)	(13,855)	(11,526)	(26,894)	-	-	1,086
Net change in fund balances	22,716	(129)	(20)	(48)	33,004	573	1,090
Fund balances (deficits), July 1, 2007	324,359	1,610	322	752	43,485	1,340	-
FUND BALANCES (DEFICITS), JUNE 30, 2008	\$ 347,075	\$ 1,481	\$ 302	\$ 704	\$ 76,489	\$ 1,913	\$ 1,090

State of Illinois
Department of Revenue

**Combining Statement of Revenues,
Expenditures and Changes in Fund Balance -
Nonmajor Governmental Funds**

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Predatory Lending Database Program 0478	Local Government Distributive 0515	Drycleaner Environmental Response 0548	Supplemental Low Income Energy Assistance 0550	Renewable Energy Resource 0564	School Infrastructure 0568	Petroleum Resources 0573	International Tourism 0621
REVENUES								
Federal operating grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Income taxes	-	-	-	-	-	-	-	-
Sales taxes	-	-	-	-	-	-	-	-
Motor fuel taxes	-	-	-	-	-	-	-	-
Public utility taxes	-	-	-	84,168	-	101,194	-	-
Other taxes	-	-	789	-	-	60,000	-	9,892
License and fees	-	-	2,410	-	5,262	-	-	-
Other charges for services	-	-	-	-	-	-	-	-
Interest and other investment income	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-
Total revenues	-	-	3,199	84,168	5,262	161,194	-	9,892
EXPENDITURES								
General government	-	-	-	-	-	-	-	-
Health and social services	-	-	-	-	-	-	-	-
Employment and economic development	-	-	-	-	-	-	-	-
Environment and business regulation	-	-	-	-	-	-	-	-
Intergovernmental	-	1,352,872	-	-	-	-	-	-
Capital outlay	-	1,352,872	-	-	-	-	-	-
Total expenditures	-	(1,352,872)	3,199	84,168	5,262	161,194	-	9,892
Excess (deficiency) of revenues over (under) expenditures								
	3,500	1,352,872	(3,256)	(84,637)	(5,291)	(158,169)	-	(9,862)
OTHER SOURCES (USES) OF FINANCIAL RESOURCES								
Appropriations from State resources	-	-	-	-	-	-	-	-
Lapsed appropriations	-	-	-	-	-	-	-	-
Receipts collected and transmitted to State Treasury	-	-	(3,256)	(84,637)	(5,291)	(158,169)	-	(9,862)
Amount of SAMS transfers-in	-	-	-	-	-	-	-	-
Amount of SAMS transfers-out	3,500	1,357,872	-	-	-	-	-	-
Transfers-in	-	(5,000)	-	-	-	-	-	-
Transfers-out	-	-	-	-	-	-	-	-
Net other sources (uses) of financial resources								
	3,500	1,352,872	(3,256)	(84,637)	(5,291)	(158,169)	-	(9,862)
Net change in fund balances								
	3,500	-	(57)	(469)	(29)	3,025	-	30
Fund balances (deficits), July 1, 2007	-	-	209	12,627	788	(2,081)	-	1,844
FUND BALANCES (DEFICITS), JUNE 30, 2008								
	\$ 3,500	\$ -	\$ 152	\$ 12,158	\$ 759	\$ 944	\$ -	\$ 1,874

**State of Illinois
Department of Revenue**

**Combining Statement of Revenues,
Expenditures and Changes in Fund Balance -
Nonmajor Governmental Funds**

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Special Revenue											Total
	Horse Racing 0632	Municipal Economic Development 0650	Tobacco Settlement Recovery 0733	Personal Property Tax Replacement 0802	Dram Shop 0821	Citizen Real Estate Deferred Tax 0930	Build Illinois 0960	Local Tourism 0969	Evidence Fund 1369			
REVENUES												
Federal operating grants	\$ -	\$ -	\$ -	\$ -	\$ 12	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 147
Income taxes	-	-	-	1,286,214	-	-	-	-	-	-	-	1,286,214
Sales taxes	-	-	-	-	-	-	430,072	-	-	-	-	2,719,101
Motor fuel taxes	-	-	-	-	-	-	-	-	-	-	-	1,410,656
Public utility taxes	-	184	-	208,941	-	-	-	-	-	-	-	403,248
Other taxes	8,360	-	-	-	-	-	115,323	17,586	-	-	-	1,044,345
License and fees	-	-	-	-	6,067	-	-	-	-	-	-	44,068
Other charges for services	-	-	-	-	-	-	-	-	-	-	-	434
Interest and other investment income	-	3	-	3,585	-	-	-	-	-	-	-	5,978
Other	-	-	-	-	163	3,603	-	-	-	-	2	43,806
Total revenues	8,360	187	-	1,498,740	6,242	3,603	545,395	17,586	2	2	6,957,997	
EXPENDITURES												
General government	-	378	-	114	-	3,771	-	-	2	-	-	152,792
Health and social services	-	-	(2)	-	-	-	-	-	-	-	-	12,808
Employment and economic development	-	-	-	-	-	-	-	-	-	-	-	5,000
Environment and business regulation	6,817	-	10	-	5,446	-	-	-	-	-	-	14,037
Intergovernmental	-	-	-	1,545,220	-	-	-	-	-	-	-	5,134,925
Capital outlay	16	-	-	7	17	-	-	-	-	-	-	195
Total expenditures	6,833	378	8	1,545,341	5,463	3,771	-	-	2	2	5,319,757	
Excess (deficiency) of revenues over (under) expenditures	1,527	(191)	(8)	(46,601)	779	(168)	545,395	17,586	-	-	1,638,240	
OTHER SOURCES (USES) OF FINANCIAL RESOURCES												
Appropriations from State resources	-	-	4	-	-	-	-	-	-	-	-	95,090
Lapsed appropriations	-	-	-	-	-	-	-	-	-	-	-	(1,586)
Receipts collected and transmitted to State Treasury	-	-	-	-	-	-	(540,069)	(17,533)	-	-	-	(2,226,345)
Amount of SAMS transfers-in	-	-	-	-	-	-	(37,800)	-	-	-	-	(37,800)
Amount of SAMS transfers-out	-	-	-	-	-	-	-	-	-	-	-	1,390
Transfers-in	-	187	-	95,330	-	-	37,800	-	-	-	-	1,526,352
Transfers-out	(1,389)	-	-	-	-	-	-	-	-	-	-	(803,104)
Net other sources (uses) of financial resources	(1,389)	187	4	95,330	-	-	(540,069)	(17,533)	-	-	-	(1,446,009)
Net change in fund balances	138	(4)	(4)	48,729	779	(168)	5,326	53	-	-	-	192,237
Fund balances (deficits), July 1, 2007	1	4	4	(64,032)	1,531	-	42,909	3,278	4	4	520,606	
FUND BALANCES (DEFICITS), JUNE 30, 2008	\$ 139	\$ -	\$ -	(15,303)	\$ 2,310	\$ (168)	\$ 48,235	\$ 3,331	\$ 4	\$ 4	\$ 712,843	

State of Illinois
Department of Revenue
Combining Statement of Fiduciary Net Assets
Agency Funds

June 30, 2008 (Expressed in Thousands)

		Agency					
		County Water Commission Tax 0084	Non-Home Rule Municipal ROT 0088	Home Rule Municipal Soft Drink ROT 0097	Home Rule Municipal ROT 0138	Home Rule County ROT 0139	
ASSETS							
Cash equity in State Treasury	\$	9,969	\$ 15,655	\$ 1,580	\$ 106,776	\$ 42,913	
Cash and cash equivalents		-	-	-	-	-	
Taxes receivable, net	1,925	3,980	805	39,661	17,163	65	
Other receivables, net	17	25	-	155	-	-	
Due from other Department funds		-	-	-	-	-	
Total assets	\$	11,911	\$ 19,660	\$ 2,385	\$ 146,592	\$ 60,141	
LIABILITIES							
Accounts payable and accrued liabilities	\$	-	-	-	\$ 1,556	-	
Intergovernmental payables	11,911	19,660	2,385	145,036	60,141	-	
Other liabilities		-	-	-	-	-	
Total liabilities	\$	11,911	\$ 19,660	\$ 2,385	\$ 146,592	\$ 60,141	

State of Illinois
Department of Revenue
Combining Statement of Fiduciary Net Assets
Agency Funds

June 30, 2008 (Expressed in Thousands)

	Agency						
	Business District Retailers' Occupation Tax 0160	County Option Motor Fuel Tax 0190	County Public Safety ROT 0219	Sports Facility Tax Trust 0229	Metropolitan Pier & Expo. Auth. Trust 0337		
ASSETS							
Cash equity in State Treasury	\$ 307	\$ 6,312	\$ 13,478	\$ 2,595	\$ 8,918		
Cash and cash equivalents	-	-	-	-	-		
Taxes receivable, net	129	2,672	4,107	-	8,683		
Other receivables, net	-	10	-	-	15		
Due from other Department funds	-	-	-	-	-		
Total assets	\$ 436	\$ 8,994	\$ 17,585	\$ 2,595	\$ 17,616		
LIABILITIES							
Accounts payable and accrued liabilities	-	172	-	2,595	-		
Intergovernmental payables	436	8,822	17,585	-	17,616		
Other liabilities	-	-	-	-	-		
Total liabilities	\$ 436	\$ 8,994	\$ 17,585	\$ 2,595	\$ 17,616		

State of Illinois
Department of Revenue
Combining Statement of Fiduciary Net Assets
Agency Funds

June 30, 2008 (Expressed in Thousands)

	Agency			
	Illinois Tourism Tax 0452	Tax Suspense Trust 0583	Metro East Park & Recreation 0717	Municipal Telecommunications 0719
ASSETS				
Cash equity in State Treasury	\$ 4,755	\$ 12	\$ 1,102	\$ 49,034
Cash and cash equivalents	-	-	-	-
Taxes receivable, net	1,812	-	257	24,780
Other receivables, net	-	-	-	-
Due from other Department funds	-	-	-	-
Total assets	\$ 6,567	\$ 12	\$ 1,359	\$ 73,814
LIABILITIES				
Accounts payable and accrued liabilities	\$ 35	\$ -	\$ -	\$ -
Intergovernmental payables	6,532	-	1,359	73,814
Other liabilities	-	12	-	-
Total liabilities	\$ 6,567	\$ 12	\$ 1,359	\$ 73,814

State of Illinois
Department of Revenue
Combining Statement of Fiduciary Net Assets
Agency Funds

June 30, 2008 (Expressed in Thousands)

	Agency						
	RTA Public Transportation Tax 0741	RTA Sales Tax Trust 0812	Metro East Mass Transit District Tax 0841	Tennessee Valley Authority Local Trust 0861	Municipal Automobile Renting Tax 0868		
ASSETS							
Cash equity in State Treasury	5	\$ 154,855	\$ 7,245	\$ -	\$ -	\$ -	1,048
Cash and cash equivalents	-	-	-	-	-	-	-
Taxes receivable, net	-	34,277	1,541	-	-	-	544
Other receivables, net	-	204	12	-	-	-	1
Due from other Department funds	-	30,937	-	-	-	-	-
Total assets	5	\$ 220,273	\$ 8,798	\$ -	\$ -	\$ -	1,593
LIABILITIES							
Accounts payable and accrued liabilities	-	-	-	-	-	-	-
Intergovernmental payables	5	220,273	8,798	-	-	-	1,593
Other liabilities	-	-	-	-	-	-	-
Total liabilities	5	\$ 220,273	\$ 8,798	\$ -	\$ -	\$ -	1,593

State of Illinois
Department of Revenue
Combining Statement of Fiduciary Net Assets
Agency Funds

June 30, 2008 (Expressed in Thousands)

	Agency				
	County Automobile Renting Tax 0869	Surety Bond 1151	Lottery Agent Security Deposit 1309	Total	
ASSETS					
Cash equity in State Treasury	6	-	-	-	\$ 426,565
Cash and cash equivalents	-	2,848	640	-	3,488
Taxes receivable, net	5	-	-	-	142,341
Other receivables, net	-	-	-	-	504
Due from other Department funds	-	-	-	-	30,937
Total assets	11	\$ 2,848	\$ 640	\$ 640	\$ 603,835
LIABILITIES					
Accounts payable and accrued liabilities	-	-	-	-	\$ 4,358
Intergovernmental payables	11	-	-	-	595,977
Other liabilities	-	2,848	640	640	3,500
Total liabilities	11	\$ 2,848	\$ 640	\$ 640	\$ 603,835

State of Illinois
Department of Revenue

Combining Statement of Changes in Assets and Liabilities
Agency Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Balance at July 1, 2007	Additions	Deletions	Balance at June 30, 2008
County Water Commission Tax (0084)				
ASSETS				
Cash equity in State Treasury	\$ 8,311	\$ 37,542	\$ 35,884	\$ 9,969
Taxes receivable, net	1,934	37,186	37,195	1,925
Other receivables, net	28	336	347	17
Total assets	\$ 10,273	\$ 75,064	\$ 73,426	\$ 11,911
LIABILITIES				
Intergovernmental payables	\$ 10,273	\$ 37,522	\$ 35,884	\$ 11,911
Total liabilities	\$ 10,273	\$ 37,522	\$ 35,884	\$ 11,911
Non-Home Rule Municipal ROT (0088)				
ASSETS				
Cash equity in State Treasury	\$ 9,999	\$ 85,366	\$ 79,710	\$ 15,655
Taxes receivable, net	5,520	83,400	84,940	3,980
Other receivables, net	11	440	426	25
Total assets	\$ 15,530	\$ 169,206	\$ 165,076	\$ 19,660
LIABILITIES				
Intergovernmental payables	\$ 15,530	\$ 83,840	\$ 79,710	\$ 19,660
Total liabilities	\$ 15,530	\$ 83,840	\$ 79,710	\$ 19,660
Home Rule Municipal Soft Drink ROT (0097)				
ASSETS				
Cash equity in State Treasury	\$ 1,518	\$ 8,570	\$ 8,508	\$ 1,580
Taxes receivable, net	791	8,584	8,570	805
Total assets	\$ 2,309	\$ 17,154	\$ 17,078	\$ 2,385
LIABILITIES				
Intergovernmental payables	\$ 2,309	\$ 8,584	\$ 8,508	\$ 2,385
Total liabilities	\$ 2,309	\$ 8,584	\$ 8,508	\$ 2,385

State of Illinois
Department of Revenue

Combining Statement of Changes in Assets and Liabilities
Agency Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Balance at July 1, 2007	Additions	Deletions	Balance at June 30, 2008
Home Rule Municipal ROT (0138)				
ASSETS				
Cash equity in State Treasury	\$ 75,799	\$ 769,930	\$ 738,953	\$ 106,776
Taxes receivable, net	43,681	742,636	746,656	39,661
Other receivables, net	179	2,765	2,789	155
Due from other Department funds	20,485	-	20,485	-
Total assets	\$ 140,144	\$ 1,515,331	\$ 1,508,883	\$ 146,592
LIABILITIES				
Accounts payable and accrued liabilities	\$ 1,549	\$ 608	\$ 601	\$ 1,556
Intergovernmental payables	138,595	744,793	738,352	145,036
Total liabilities	\$ 140,144	\$ 745,401	\$ 738,953	\$ 146,592
Home Rule County ROT (0139)				
ASSETS				
Cash equity in State Treasury	\$ 36,365	\$ 325,494	\$ 318,946	\$ 42,913
Taxes receivable, net	17,337	323,980	324,154	17,163
Other receivables, net	94	1,311	1,340	65
Total assets	\$ 53,796	\$ 650,785	\$ 644,440	\$ 60,141
LIABILITIES				
Intergovernmental payables	\$ 53,796	\$ 325,291	\$ 318,946	\$ 60,141
Total liabilities	\$ 53,796	\$ 325,291	\$ 318,946	\$ 60,141
Business District ROT (0160)				
ASSETS				
Cash equity in State Treasury	\$ 227	\$ 2,530	\$ 2,450	\$ 307
Taxes receivable, net	\$ 121	\$ 2,538	\$ 2,530	\$ 129
Total assets	\$ 348	\$ 5,068	\$ 4,980	\$ 436
LIABILITIES				
Intergovernmental payables	\$ 348	\$ 2,538	\$ 2,450	\$ 436
Total liabilities	\$ 348	\$ 2,538	\$ 2,450	\$ 436

State of Illinois
Department of Revenue

Combining Statement of Changes in Assets and Liabilities
Agency Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Balance at July 1, 2007	Additions	Deletions	Balance at June 30, 2008
County Option Motor Fuel Tax (0190)				
ASSETS				
Cash equity in State Treasury	\$ 6,320	\$ 34,219	\$ 34,227	\$ 6,312
Taxes receivable, net	2,977	33,677	33,982	2,672
Other receivables, net	17	230	237	10
Total assets	\$ 9,314	\$ 68,126	\$ 68,446	\$ 8,994
LIABILITIES				
Accounts payable and accrued liabilities	\$ 180	\$ 568	\$ 576	\$ 172
Intergovernmental payables	9,134	33,339	33,651	8,822
Total liabilities	\$ 9,314	\$ 33,907	\$ 34,227	\$ 8,994
County Public Safety ROT (0219)				
ASSETS				
Cash equity in State Treasury	\$ 9,938	\$ 80,952	\$ 77,412	\$ 13,478
Taxes receivable, net	5,201	79,858	80,952	4,107
Total assets	\$ 15,139	\$ 160,810	\$ 158,364	\$ 17,585
LIABILITIES				
Intergovernmental payables	\$ 15,139	\$ 79,858	\$ 77,412	\$ 17,585
Total liabilities	\$ 15,139	\$ 79,858	\$ 77,412	\$ 17,585
Sports Facility Tax Trust (0229)				
ASSETS				
Cash equity in State Treasury	\$ -	\$ 7,446	\$ 4,851	\$ 2,595
Taxes receivable, net	24	7,422	7,446	-
Total assets	\$ 24	\$ 14,868	\$ 12,297	\$ 2,595
LIABILITIES				
Accounts payable and accrued liabilities	\$ 24	\$ 7,422	\$ 4,851	\$ 2,595
Total liabilities	\$ 24	\$ 7,422	\$ 4,851	\$ 2,595
Metro Pier & Exposition Authority Trust (0337)				
ASSETS				
Cash equity in State Treasury	\$ 13,831	\$ 117,590	\$ 122,503	\$ 8,918
Taxes receivable, net	9,895	115,997	117,209	8,683
Other receivables, net	29	367	381	15
Total assets	\$ 23,755	\$ 233,954	\$ 240,093	\$ 17,616
LIABILITIES				
Accounts payable and accrued liabilities	\$ -	\$ -	\$ -	\$ -
Intergovernmental payables	23,755	116,364	122,503	17,616
Total liabilities	\$ 23,755	\$ 116,364	\$ 122,503	\$ 17,616

State of Illinois
Department of Revenue

Combining Statement of Changes in Assets and Liabilities
Agency Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Balance at July 1, 2007	Additions	Deletions	Balance at June 30, 2008
Illinois Tourism Tax (0452)				
ASSETS				
Cash equity in State Treasury	\$ 3,038	\$ 18,309	\$ 16,592	\$ 4,755
Taxes receivable, net	1,939	18,182	18,309	1,812
Total assets	\$ 4,977	\$ 36,491	\$ 34,901	\$ 6,567
LIABILITIES				
Accounts payable and accrued liabilities	\$ -	\$ 35	\$ -	\$ 35
Intergovernmental payables	4,977	18,147	16,592	6,532
Total liabilities	\$ 4,977	\$ 18,182	\$ 16,592	\$ 6,567
Tax Suspend Trust (0583)				
ASSETS				
Cash equity in State Treasury	\$ 3	\$ 155	\$ 146	\$ 12
Total assets	\$ 3	\$ 155	\$ 146	\$ 12
LIABILITIES				
Other liabilities	\$ 3	\$ 155	\$ 146	\$ 12
Total liabilities	\$ 3	\$ 155	\$ 146	\$ 12
Metro East Park and Recreation (0717)				
ASSETS				
Cash equity in State Treasury	\$ 716	\$ 4,674	\$ 4,288	\$ 1,102
Taxes receivable, net	318	4,613	4,674	257
Total assets	\$ 1,034	\$ 9,287	\$ 8,962	\$ 1,359
LIABILITIES				
Intergovernmental payables	\$ 1,034	\$ 4,613	\$ 4,288	\$ 1,359
Total liabilities	\$ 1,034	\$ 4,613	\$ 4,288	\$ 1,359
Municipal Telecommunications Fund (0719)				
ASSETS				
Cash equity in State Treasury	\$ 41,903	\$ 295,722	\$ 288,591	\$ 49,034
Taxes receivable, net	8,493	312,009	295,722	24,780
Due from other Department funds	20,807	-	20,807	-
Total assets	\$ 71,203	\$ 607,731	\$ 605,120	\$ 73,814
LIABILITIES				
Accounts payable and accrued liabilities	\$ -	\$ -	\$ -	\$ -
Intergovernmental payables	71,203	312,009	309,398	73,814
Total liabilities	\$ 71,203	\$ 312,009	\$ 309,398	\$ 73,814

State of Illinois
Department of Revenue

Combining Statement of Changes in Assets and Liabilities
Agency Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Balance at July 1, 2007	Additions	Deletions	Balance at June 30, 2008
RTA Public Transportation Tax (0741)				
ASSETS				
Cash equity in State Treasury	\$ 4	\$ 1	\$ -	\$ 5
Total assets	\$ 4	\$ 1	\$ -	\$ 5
LIABILITIES				
Intergovernmental payables	\$ 4	\$ 1	\$ -	\$ 5
Total liabilities	\$ 4	\$ 1	\$ -	\$ 5
RTA Sales Tax Trust (0812)				
ASSETS				
Cash equity in State Treasury	\$ 66,334	\$ 822,078	\$ 733,557	\$ 154,855
Taxes receivable, net	32,543	696,069	694,335	34,277
Other receivables, net	180	2,333	2,309	204
Due from other Department funds	25,524	130,847	125,434	30,937
Total assets	\$ 124,581	\$ 1,651,327	\$ 1,555,635	\$ 220,273
LIABILITIES				
Intergovernmental payables	\$ 124,581	\$ 829,249	\$ 733,557	\$ 220,273
Total liabilities	\$ 124,581	\$ 829,249	\$ 733,557	\$ 220,273
Metro East Mass Transit Dist. Tax (0841)				
ASSETS				
Cash equity in State Treasury	\$ 4,764	\$ 31,510	\$ 29,029	\$ 7,245
Taxes receivable, net	1,864	30,947	31,270	1,541
Other receivables, net	13	239	240	12
Total assets	\$ 6,641	\$ 62,696	\$ 60,539	\$ 8,798
LIABILITIES				
Intergovernmental payables	\$ 6,641	\$ 31,186	\$ 29,029	\$ 8,798
Total liabilities	\$ 6,641	\$ 31,186	\$ 29,029	\$ 8,798
Tennessee Valley Authority Local Trust (0861)				
ASSETS				
Cash equity in State Treasury	\$ -	\$ 265	\$ 265	\$ -
Total assets	\$ -	\$ 265	\$ 265	\$ -
LIABILITIES				
Accounts payable and accrued liabilities	\$ -	\$ 265	\$ 265	\$ -
Total liabilities	\$ -	\$ 265	\$ 265	\$ -

State of Illinois
Department of Revenue

Combining Statement of Changes in Assets and Liabilities
Agency Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Balance at July 1, 2007	Additions	Deletions	Balance at June 30, 2008
Municipal Automobile Renting Tax (0868)				
ASSETS				
Cash equity in State Treasury	\$ 984	\$ 6,127	\$ 6,063	\$ 1,048
Taxes receivable, net	551	6,081	6,088	544
Other receivables, net	3	37	39	1
Total assets	\$ 1,538	\$ 12,245	\$ 12,190	\$ 1,593
LIABILITIES				
Intergovernmental payables	\$ 1,538	\$ 6,118	\$ 6,063	\$ 1,593
Total liabilities	\$ 1,538	\$ 6,118	\$ 6,063	\$ 1,593
County Automobile Renting Tax (0869)				
ASSETS				
Cash equity in State Treasury	\$ 35	\$ 24	\$ 53	\$ 6
Taxes receivable, net	-	29	24	5
Total assets	\$ 35	\$ 53	\$ 77	\$ 11
LIABILITIES				
Intergovernmental payables	\$ 35	\$ 29	\$ 53	\$ 11
Total liabilities	\$ 35	\$ 29	\$ 53	\$ 11
Surety Bond (1151)				
ASSETS				
Cash and cash equivalents	\$ 2,371	\$ 830	\$ 353	\$ 2,848
Total assets	\$ 2,371	\$ 830	\$ 353	\$ 2,848
LIABILITIES				
Other liabilities	\$ 2,371	\$ 830	\$ 353	\$ 2,848
Total liabilities	\$ 2,371	\$ 830	\$ 353	\$ 2,848
Lottery Agent Security Deposit (1309)				
ASSETS				
Cash and cash equivalents	\$ 463	\$ 275	\$ 98	\$ 640
Total assets	\$ 463	\$ 275	\$ 98	\$ 640
LIABILITIES				
Other liabilities	\$ 463	\$ 275	\$ 98	\$ 640
Total liabilities	\$ 463	\$ 275	\$ 98	\$ 640

State of Illinois
Department of Revenue

Combining Statement of Changes in Assets and Liabilities
Agency Funds

For the Year Ended June 30, 2008 (Expressed in Thousands)

	Balance at July 1, 2007	Additions	Deletions	Balance at June 30, 2008
Total - All Agency Funds				
ASSETS				
Cash equity in State Treasury	\$ 280,089	\$ 2,648,504	\$ 2,502,028	\$ 426,565
Cash and cash equivalents	2,834	1,105	451	3,488
Taxes receivable, net	133,189	2,503,208	2,494,056	142,341
Other receivables, net	554	8,058	8,108	504
Due from other Department funds	66,816	130,847	166,726	30,937
Total assets	\$ 483,482	\$ 5,291,722	\$ 5,171,369	\$ 603,835
LIABILITIES				
Accounts payable and accrued liabilities	\$ 1,753	\$ 8,898	\$ 6,293	\$ 4,358
Intergovernmental payables	478,892	2,633,481	2,516,396	595,977
Other liabilities	2,837	1,260	597	3,500
Total liabilities	\$ 483,482	\$ 2,643,639	\$ 2,523,286	\$ 603,835

McGladrey & Pullen

Certified Public Accountants

Independent Auditors' 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*

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Illinois, Department of Revenue, as of and for the year ended June 30, 2008, which collectively comprise the State of Illinois, Department of Revenue's basic financial statements and have issued our report thereon dated June 23, 2009. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Illinois, Department of Revenue's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Revenue's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Revenue's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of Current Findings – *Government Auditing Standards* to be significant deficiencies in internal control over financial reporting (findings 08-1 through 08-9).

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider findings 08-1 through 08-4 and 08-7 through 08-9 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The State of Illinois, Department of Revenue's responses to the findings identified in our audit are described in the accompanying schedule of Current Findings – *Government Auditing Standards*. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, State of Illinois, Department of Revenue management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Schaumburg, Illinois
June 23, 2009

08-1. **FINDING** (The Department did not ensure revenue recognition relating to credit-carry forward amounts was proper)

The Department of Revenue (Department) does not have sufficient processes and controls in place to ensure revenue recognition related to the credit-carry forward is proper.

- During our audit of Individual Income Tax (IIT) and Business Income Tax (BIT) returns for taxpayers with credit-carry forward amounts, we noted deferred revenues were not properly accrued. A credit-carry forward occurs when a business or individual taxpayer has a tax overpayment which they elect to apply to a subsequent tax period (as opposed to requesting a refund). The Department's procedure for income tax related liabilities was to accrue the lapse period refunds for business and individual income taxes. This method resulted in revenue recognition during the current period for all overpayments that were not refunded. When a credit was requested to be carried to the next tax year by a taxpayer, the taxpayer intended that it be applied to a subsequent reporting period and used to offset tax liabilities of the subsequent period.

This situation resulted in the overstatement of revenue and understatement of deferred revenue for four governmental funds as well as governmental activities, in the draft financial statements. Because the Department had not previously adjusted its financial statements for the effects of credit-carry forward balances, a prior period adjustment was necessary to restate beginning fund balances and net assets for the impact from previous years.

In the draft financial statements provided to the auditors, income tax revenues were understated by approximately \$71 million at June 30, 2008 for governmental funds and governmental activities. Deferred (unearned) revenues were understated by approximately \$433 million for governmental funds and governmental activities. Also, beginning of the year fund balances/net assets were overstated by approximately \$344 million for governmental funds and governmental activities. Adjustments to record these credit-carry forward amounts were recorded in the final financial statements.

- During our audit of sales tax, and the related revenue and deferred revenue, we noted credits totaling \$11.8 million from the legacy tax system had not been recorded as a liability at June 30, 2008 in the financial statements. Although the amount of credits related to the sales tax types were converted to the new enterprise-wide tax system (GenTax) and were recorded, the adjustment was understated by approximately \$1 million. In total, credits of approximately \$13 million related to sales tax (Department – wide total) were not recorded in the financial statements. These amounts were deemed immaterial and were not recorded in the final financial statements.

In accordance with Generally Accepted Accounting Principles (GAAP), all assets, liabilities, revenues and expenses should be recorded. Specifically, GASB Statement No. 33 *Accounting and Financial Reporting for Nonexchange Transactions* requires "Governments should recognize assets from derived tax revenue transactions in the period when the exchange transaction on which the tax is imposed occurs or when the resources are received, whichever occurs first. Revenues should be recognized, net of estimated refunds and estimated uncollectible amounts, in the same period that the assets are recognized, provided that the underlying exchange transaction has occurred. Resources received in advance should be reported as deferred revenues (liabilities) until the period of the exchange." Credit-carry forward amounts represent resources received in advance and should be deferred.

08-1. **FINDING** (The Department did not ensure revenue recognition relating to credit-carry forward amounts was proper - continued)

In accordance with the Fiscal Control and Internal Auditing Act, 30 ILCS 10/3001 "All State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that: ... 4) revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources." All relevant data should be reviewed on an ongoing basis in connection with GAAP reporting to ensure the data and assumptions used to recognize revenue are current, reasonable and accurate.

The Department stated this occurred because it had, since 1980, interpreted GAAP to mean that carry forwards should not be accrued because the amounts were not reasonably estimable.

Since credit-carry forwards are a significant accounting estimate for the Department, the lack of an appropriate method for accruing this unearned revenue resulted in material misstatements in the draft financial statements and delayed issuance of audited financial statements. (Finding Code No. 08-1)

RECOMMENDATION

We recommend the Department strengthen its processes and procedures over financial reporting of credit-carry forward amounts. The preparation of accounting estimates requires management to obtain sufficient data, make reasonable assumptions and continuously examine the appropriateness of amounts recorded. The Department should analyze historical data used, assess whether the data is comparative and consistent with data of the current period and consider if it can be relied upon in formulating a current estimate. Relevant information such as the taxpayer's estimated income tax liability, income tax refunds and credits to be applied to future periods should all be considered in determining earned and unearned revenue.

We further recommend Revenue Accounting personnel be responsible for developing the income tax deferrals and revenues related to credit-carry forwards and ensure the methodology used to estimate the unearned revenue be re-examined annually.

DEPARTMENT RESPONSE

The Department has accepted the recommendation and has changed the way it accounts for credit-carry forwards on year-end financial statements, a change that, it is important to note, will have no impact on budgetary cash flows or revenues, which are accounted for on a cash basis, but will better estimate the fiscal year to which revenue should be credited.

After discussions with the Governmental Accounting Standards Board (GASB), the Illinois Office of the Comptroller (IOC) and others, the Department agrees to change the accounting treatment to estimate and record credit-carry forward amounts as deferred revenue for the current and subsequent years. The estimates include significant methodology assumptions that will vary based on analysis of historical data because of the variables and complexity discussed in 1-6 below. The Department follows the IOC Statewide Accounting Management System (SAMS) Manual and revenue accrual instructions. Strengthening of our processes and procedures would not have changed our accounting treatment for credit-carry forwards since it was a long-standing interpretation of GAAP. We will ask the IOC to revise the SAMS Manual and revenue accrual instructions accounting treatment for income tax credit-carry forwards.

- 08-1. **FINDING** (The Department did not ensure revenue recognition relating to credit-carry forward amounts was proper - continued)

The Department posts sales and excise tax credit-carry forward adjustments in accordance with IOC revenue accrual instructions and SAMS Manual form SCO-541, "Refunds and Credit Memoranda". For income taxes, credits or credit memoranda are not issued, they are elected by taxpayers in lieu of refunds in accordance with the Illinois Income Tax Act.

An income tax deferred revenue liability was not accrued in prior years because the Department considered the amounts not measureable (reasonably estimable) for the following reasons:

- (1) Taxpayers 'self assess' taxes and decide, sometimes on extended filings as late as October 15 (for December fiscal year end filers), to take a carry forward credit rather than a refund. Eighty percent of credit carry forward filers are extension filers, thus at June 30, the amounts are very difficult to measure.
- (2) Often, large corporate credit-carry forwards are reduced or eliminated by subsequent audits.
- (3) Many credit-carry forwards are never used because taxpayers go out of business or file bankruptcy, etc.
- (4) Corporations in Illinois have fiscal years ending in every month of the year, making any methodology to measure deferred revenue difficult. Also, corporate earnings are often seasonal.
- (5) Significant amounts of carry forwards are "earned" by fiscal year end. For example, for calendar year end corporations and individuals, 50% of any credit-carry forward deferred revenue is earned by June 30 (although sometimes this is not known until the extended filing date (October)).
- (6) Originally, carry forwards were not material to the State's financial statements. However, elections by taxpayers to carry forward overpayments have increased. One taxpayer currently has a credit of \$183 million (over 40%) of the total credit-carry forwards.

08-2. **FINDING** (Inaccurate accounts receivable balances)

The Department of Revenue's (Department) Withholding Income Tax (WIT), Business Income Tax (BIT) and Individual Income Tax (IIT) accounts included in the Department's accounts receivable calculation at June 30, 2008 were not accurate. As a result of the inaccuracies found, accounts receivable was adjusted by \$87,556,887 for the financial statements.

In testing the accounts receivable, the auditors and the Department agreed upon the following assumptions that would make an account an **invalid** accounts receivable. Invalid receivables are described as an account where no cash will be collected in the future based on the following reasons:

- a. Receivables were recorded as the result of a payment(s) being posted to the wrong account number (FEIN) or account period (APE);
- b. Receivables were recorded as the result of a return being posted to the wrong FEIN or APE;
- c. Receivables were recorded as the result of data entry errors;
- d. Receivables for which correspondence had been received prior to June 30 that after being processed after June 30 the receivable was eliminated; or
- e. Receivables for which a taxpayer initiated amended return had been received prior to June 30 that after being processed after June 30 the receivable was eliminated.

During our testing, we originally reviewed two samples of BIT and WIT account detail to ensure the accuracy and existence of the Department's June 30, 2008 accounts receivable information. During the course of our review, we tested 25 of the highest dollar accounts receivable balances and a statistically selected sample of receivable account balances for both BIT and WIT data from the financial reporting accounts receivable data file. The results of this testing are detailed below:

	WIT		BIT	
Top 25 Amounts				
Valid	4%	\$ 1,040,059	89%	\$ 245,732,359
Invalid	96%	22,717,208	11%	30,636,732
Total Sample	100%	\$ 23,757,267	100%	\$ 276,369,091
Top 25 number statistics				
Valid	8%	2	80%	20
Invalid	92%	23	20%	5
Total Sample	100%	25	100%	25
Statistical Sample \$				
Valid	85%	\$ 258,299	51%	\$ 13,350,319
Invalid	15%	45,642	49%	12,893,815
Total Sample	100%	\$ 303,941	100%	\$ 26,244,134
Statistical Sample #				
Valid	67%	6	67%	30
Invalid	33%	3	33%	15
Total Sample	100%	9	100%	45

*Note – Prior to the top 25 WIT test, the Department excluded two accounts, totaling \$9,471,302, deeming them invalid in financial statement reporting. Prior to the top 25 BIT test, the Department excluded 17 accounts, totaling \$162,510,437, deeming them invalid in financial statement reporting.

08-2. **FINDING** (Inaccurate accounts receivable balances - continued)

After our initial testing revealed a high percentage of invalid accounts, the auditors requested a listing of all cash payments received on the accounts receivable accounts from July 1, 2008 through December 31, 2008 from the Department. During the Department's own review of the December 2008 payments received on the receivable balances, the Department noted a high percentage of the total payments received on various tax accounts were actually misapplied payments that had been received by the Department prior to June 30, 2008. These payments were not applied to the correct accounts for various reasons, including taxpayer error.

Department of Revenue review of December 2008 receipts on June 30, 2008 accounts receivable				
Payments	WIT		BIT	
Misapplied	82%	\$ 1,730,938	62%	\$ 6,500,727
Accurate receipts on receivables received after 6/30/08	18%	383,322	38%	4,003,519
Total Receipts	100%	\$ 2,114,260	100%	\$ 10,504,246

The Department then tested the top 100 tax accounts for WIT, BIT, and IIT and the auditors tested a statistical sample of accounts below the top 100 accounts for each tax type. The results of this testing are detailed below as either a valid receivable or invalid receivable:

	WIT		BIT		IIT	
Top 100 Amounts						
Valid balance	8%	\$ 2,601,250	65%	\$ 95,117,704	87%	\$ 20,114,715
Invalid balance	92%	29,294,478	35%	52,164,698	13%	3,128,902
Total Sample	100%	\$ 31,895,728	100%	\$ 147,282,402	100%	\$ 23,243,617
Top 100 number statistics						
Valid balance	16%	16	56%	56	81%	81
Invalid balance	84%	84	44%	44	19%	19
Total Sample	100%	100	100%	100	100%	100
Statistical Sample \$						
Valid balance	60%	\$ 282,381	40%	\$ 1,240,003	94%	\$ 222,614
Invalid balance	40%	187,095	60%	1,852,838	6%	14,978
Total Sample	100%	\$ 469,476	100%	\$ 3,092,841	100%	\$ 237,592
Statistical Sample #						
Valid balance	75%	24	50%	11	92%	22
Invalid balance	25%	8	50%	11	8%	2
Total Sample	100%	32	100%	22	100%	24

08-2. **FINDING** (Inaccurate accounts receivable balances - continued)

The outcome of the testing related to each tax type detailed above, resulted in adjustments to the financial statements. Department officials agreed to the adjustments as follows:

	<u>WIT</u>	<u>BIT</u>	<u>IIT</u>
Financial Statement Adjustment	<u>(\$17,793,709)</u>	<u>(\$52,750,320)</u>	<u>(\$17,012,858)</u>

The valid/invalid amounts above do not include any billable interest differences noted in finding 08-6.

Additionally, we also compared the Business Income Tax accounts, which were “excluded and not billed,” to the accounts receivable database, noting:

- 70 accounts, totaling \$118.6 million, were not included in the accounts receivable; however, the Department had deducted them from the gross accounts receivable.
- 22 accounts were included in the accounts receivable database; however, the amounts the Department excluded did not agree to the accounts receivable amount, for a difference of \$22.4 million.
- As a result, an adjustment was made to the financial statements totaling \$26.1 million, net of an allowance of \$70.7 million.

Department personnel stated the causes related to receivables were primarily, (1) taxpayer misapplied payments were unknown as of the reporting date, (2) taxpayer and department data entry errors not corrected as of the reporting date, and (3) account processing backlog.

The Illinois Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) states all State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State’s resources.

In accordance with Generally Accepted Accounting Principles, receivables, net of an allowance for uncollectible accounts, should be recorded in the financial statements. Governments should recognize assets (cash or receivables) from derived tax revenue transactions in the period when the exchange transaction on which the tax is imposed occurs or when the resources are received, whichever occurs first. Revenues should be recognized, net of estimated refunds and estimated uncollectible amounts, in the same period that the assets are recognized, provided that the underlying exchange transaction has occurred. Resources received in advance should be reported as deferred revenues (liabilities) until the period of the exchange.

Without reliable, accurate data, the accounts receivable amounts will be materially misstated in the financial statements. (Finding Code No. 08-2)

RECOMMENDATION

We recommend the Department evaluate the controls over taxes receivable and implement the necessary edits and controls to better identify valid accounts receivables to report in the financial statements.

08-2. **FINDING** (Inaccurate accounts receivable balances - continued)

DEPARTMENT RESPONSE

The Department has agreed to the recommendation and has changed the way it makes estimates of accounts receivable on year-end financial statements, a change that it is important to note will have no impact on budgetary cash flows or revenues. The Department has made the accounting change (reducing its gross receivables 4.9 percent on the FY 08 financial statement) and will take steps to more expeditiously identify "invalid" accounts receivable, thereby also improving estimates of accounts receivable in the future.

We plan to manually review the accuracy of the highest dollar receivables, increase systemic and manual edits and prioritize the Department's review of high dollar inventory. By doing so, the Department's estimate of accounts receivable will be more accurate.

It is also important to note that the over reporting of accounts receivable identified as a result of the audit did not overstate revenues or fund balance in the fund financial statements. That is because in accordance with GAAP a corresponding credit to 'deferred revenue-unavailable' is recorded in the fund financial statements. Therefore, only the revenues and net assets in the entity-wide statements of activities and statement of net assets, respectively, were overstated.

08-3. **FINDING** (The Department did not ensure GAAP packages and draft financial statements were complete and accurate)

There were numerous errors in accounting reports (Generally Accepted Accounting Principles (GAAP) package forms) and draft financial statements that were given to the auditors.

During our audit, we noted several errors that were made in compiling the GAAP package forms. The GAAP package forms are required accounting reports that are submitted to the Office of the State Comptroller for State-wide reporting. These GAAP package forms are also provided to the auditors where they function as a trial balance for the financial statement audit portion of the engagement.

Based on our audit of amounts reported in the GAAP package forms and draft financial statements, we noted the following errors:

- Nine cash accounts, totaling approximately \$17 million, were not recorded as of June 30, 2008. The unrecorded cash accounts ranged from (\$80,000) to \$13.6 million. These amounts were deemed immaterial and were not recorded.
- The Department of Revenue (Department) used inaccurate reports to accrue Motor Fuel Tax credits. This resulted in the overstatement of Motor Fuel Tax Fund liabilities by approximately \$9.7 million and corresponding revenue was understated by \$9.7 million. This error was corrected for the final financial statements.
- Taxes receivable and revenue were overstated in the General Fund by approximately \$14.9 million due to an allocation error between taxes recorded in the General Fund and taxes recorded in Fund 719 - the Municipal Telecommunications Fund. These amounts were deemed immaterial and were not recorded.
- During our audit of income taxes and the related revenue and deferred revenue, we noted that a duplicate entry was made in the amount of \$2.2 million to record accounts receivable for amounts "in protest". Amounts "in protest" are the tax assessments, penalties and interest where the taxpayer is disputing the amount. Also, additional amounts for allocated and unallocated Business Income Tax were not correct and resulted in an understatement of receivables and revenues totaling approximately \$1 million.

The net effect of these errors was an overstatement of \$1.2 million for taxes receivable and income tax revenue (Department-wide). These amounts were deemed immaterial and were not recorded.

In accordance with GAAP, all assets, liabilities, revenues and expenditures/expenses should be recorded in the Department's financial statements. Also, a good system of internal control ensures an adequate segregation of duties exists so that those individuals initiating journal entries are segregated from individuals approving and posting journal entries.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/30010) states, "All State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that: ... 4) revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources."

08-3. **FINDING** (The Department did not ensure GAAP packages and draft financial statements were complete and accurate - continued)

Per Department management, there were insufficient procedures in place at year-end to ensure all entries recorded in the GAAP package forms were reviewed by a supervisor prior to submission to the Office of the State Comptroller. Fiscal year 2008 was also unique because certain source revenue and receivables supporting reports were provided from both the legacy tax systems and the Gen Tax System, and the content of some reports changed as they moved from the legacy systems. Additionally, there were oversight and responsibility uncertainties as the result of the implementation of Shared Services.

Due to the inadequate review procedures for GAAP reporting, there were errors in the amounts reported in the GAAP package forms as detailed in items 1 through 4 above. In addition, under the present system, additional errors could be made in preparing the GAAP package forms and financial statements of future periods and not be detected by Department employees in the course of performing their assigned duties. (Finding Code No. 08-3)

RECOMMENDATION

We recommend the following:

- The Department should institute new procedures for preparing the GAAP package forms which includes supervisory review of all supporting schedules and reports used in the formation of accruals and adjustments, as well as supervisory review of the completed GAAP packages, prior to submitting them to the Office of the State Comptroller.
- All cash accounts should be reviewed to ensure they are properly recorded in the GAAP package forms.
- Reports used for recording Motor Fuel Tax liabilities should be reviewed to ensure the reports are complete and accurate.
- Entries to adjust allocations between the General Fund and the Telecommunications Tax Fund should be made to both funds.
- The process for determining taxes receivable, tax revenue, and deferred revenue for the governmental funds should be re-evaluated. The current process is primarily manual and complex and involves several electronic spreadsheets. As such it is highly susceptible to errors. At a minimum, the spreadsheets used to calculate these amounts should be reviewed by a supervisor and all amounts should be compared to the underlying documentation used in its preparation.

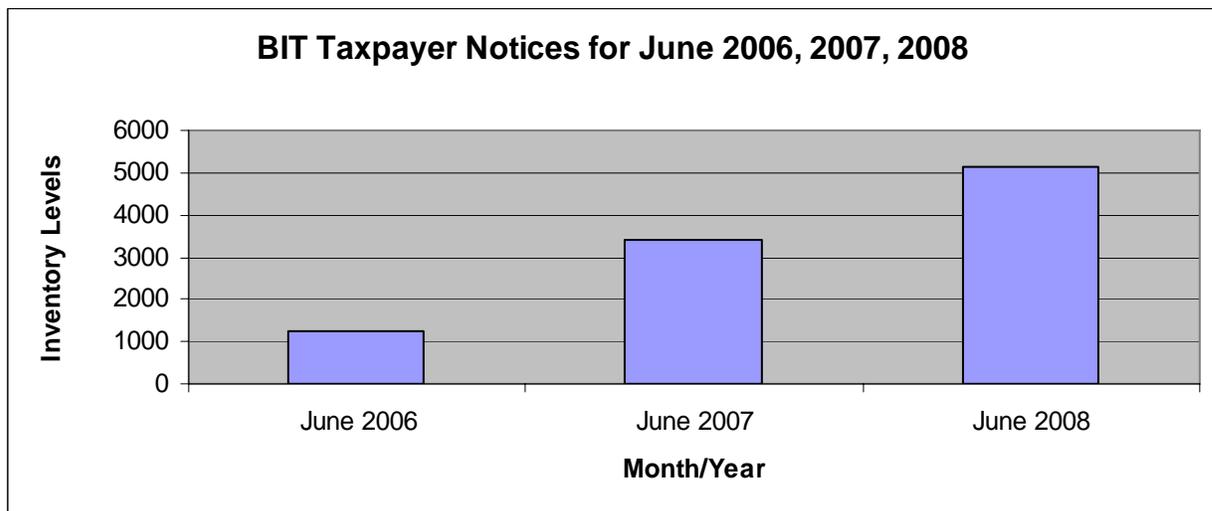
DEPARTMENT RESPONSE

The Department agrees with the recommendation. The Department will more closely review financial reports before they are transmitted to the comptroller and reviewed by auditors so that adjustments are correct and revenues are recognized in the appropriate fiscal year for year-end financial reporting.

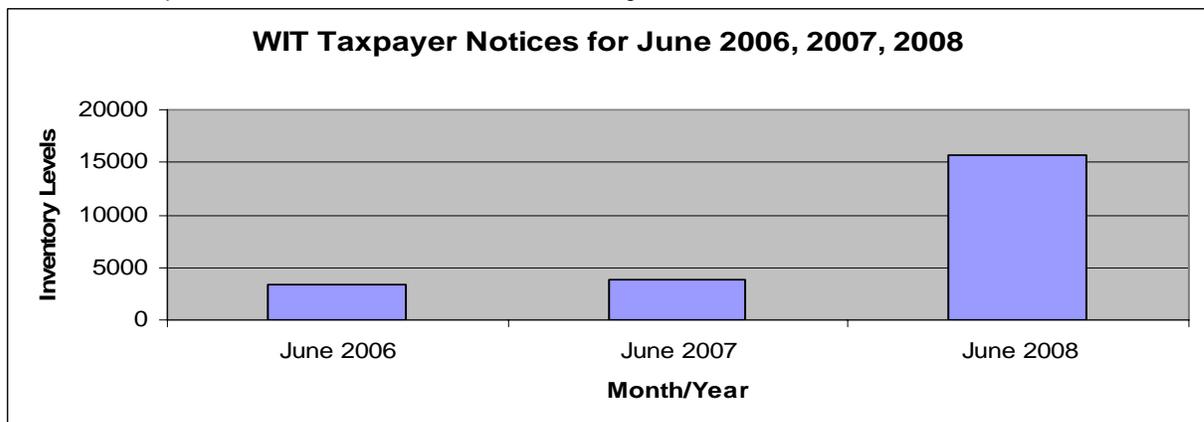
08-4. **FINDING** (Taxpayer information that was material to the financial statements was not considered or processed timely)

The Department of Revenue (Department) did not consider or process taxpayer information received by the Department by June 30, 2008 that resulted in auditor adjustments to the financial statements. Due to the Department's conversion to a new enterprise-wide tax system (GenTax), which went into production December 2007, the Department had experienced a significant increase in the backlog of processing Business Income Tax (BIT) and Withholding Income Tax (WIT) information.

At June 30, 2008, the Department had incurred a significant backlog of taxpayer information relating to BIT accounts and WIT accounts. The Department provided the following charts to document the inventory levels for the past few years at June 30th of each year. The increase in unprocessed taxpayer information prior to fiscal year-end increases the likelihood the information utilized for financial statement preparation could be misstated. As indicated, the backlog was significantly higher at June 30, 2008 than the previous years.



Source: Department of Revenue – Business Processing Division



Source: Department of Revenue – Business Processing Division

08-4. **FINDING** (Taxpayer information that was material to the financial statements was not considered or processed timely - continued)

In addition, during our detailed testing of accounts receivable, we noted several accounts where the taxpayer had provided the Department additional or corrected information; however, the information had not been processed by the Department as of June 30, 2008. The Department tested the top 100 tax accounts receivable for WIT, BIT, and Individual Income Tax (IIT) and the auditors tested a statistical sample of accounts below the top 100 accounts for each tax type. The auditors reviewed the accounts to determine if the accounts would be resolved once the information was processed by the Department, resulting in no cash being received and therefore, an invalid accounts receivable at June 30, 2008. The results of this testing are detailed below:

	WIT		BIT		IIT	
Top 100 Amounts						
Invalid due to backlog	78%	\$ 24,797,146	28%	\$ 41,653,750	5%	\$ 1,267,542
Remaining accounts	22%	7,098,582	72%	105,628,652	95%	21,976,075
Total Sample	100%	\$ 31,895,728	100%	\$ 147,282,402	100%	\$23,243,617
Top 100 number statistics						
Invalid due to backlog	70%	70	32%	32	6%	6
Remaining accounts	30%	30	68%	68	94%	94
Total Sample	100%	100	100%	100	100%	100
Statistical Sample \$						
Invalid due to backlog	14%	\$ 65,615	41%	\$ 1,270,637	6%	\$ 14,978
Remaining accounts	86%	403,861	59%	1,822,205	94%	222,614
Total Sample	100%	\$ 469,476	100%	\$ 3,092,842	100%	\$ 237,592
Statistical Sample #						
Invalid due to backlog	3%	1	45%	10	8%	2
Remaining accounts	97%	31	55%	12	92%	22
Total Sample	100%	32	100%	22	100%	24

Of the accounts receivable identified as **invalid due to backlog** for the top 100 sample and the statistical samples identified above, we noted the time to process the accounts was significant. The following chart depicts the number of days to process the **invalid due to backlog** accounts in our samples:

Days to Process	WIT	BIT	IIT
	Invalid due to backlog	Invalid due to backlog	Invalid due to backlog
0-30 days	1	0	0
31-90 days	2	0	3
91-180 days	24	6	4
181 days and over	44	36	1
Total Invalid due to backlog	<u>71</u>	<u>42</u>	<u>8</u>
Total samples tested	<u>132</u>	<u>122</u>	<u>124</u>

08-4. **FINDING** (Taxpayer information that was material to the financial statements was not considered or processed timely - continued)

As a result, the reports of taxpayer accounts generated for the period ending June 30, 2008 to support the accounts receivable for financial reporting did not accurately reflect information received by the Department because the Department did not consider the information received prior to June 30, 2008 that would be material to the financial statements, but was not processed as of fiscal year-end. (See Finding 08-2)

In accordance with Generally Accepted Accounting Principles (GAAP) and as stated in GASB Statement No. 33 *Accounting and Financial Reporting for Nonexchange Transactions*, "Governments should recognize assets from derived tax revenue transactions in the period when the exchange transaction on which the tax is imposed occurs or when the resources are received, whichever occurs first." There is no provision in the standard to delay recognition of these types of transactions until the accounts are fully processed.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) states all State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

The Department stated that in planning for the installation of a new tax system to handle Business Income Tax and Withholding Income Tax, the Business Processing Division anticipated and planned for growth in inventories while staff concentrated on conversion, purification, development and testing responsibilities.

Without important taxpayer information regarding payments, returns or corrections posted to taxpayer accounts in a timely manner, the accounts receivable amounts due to the State and recorded in the financial statements will be misstated and inaccurate. (Finding Code No. 08-4)

RECOMMENDATION

We recommend the Department take action to ensure taxpayer information is timely considered or processed to ensure taxpayer's records and financial statement information reflects accurate information. Further, we recommend that material account balances be up to date, including the review of all received information for possible adjustments to accounts.

DEPARTMENT RESPONSE

The Department agrees with the recommendation. We made a business decision which we believe was compelling to accept a temporary increase in some inventories in order to bring on line a new tax system which will substantially increase the quality of tax administration and enforcement.

The personnel who would have worked on these accounts were involved in data conversion, purification, development, and testing. The increases in these inventories were anticipated, planned for, and have since been resolved and inventories have returned to pre-implementation levels.

Although the Department cannot eliminate inventories, the Department will take steps to reflect the cases in inventory in our estimates of receivables for our year-end financial statements.

08-5. **FINDING** (Inadequate controls over data reconciliations)

The Department of Revenue (Department) had not developed, implemented, or documented procedures to reconcile records to the source data.

During our review of the new enterprise-wide tax system (GenTax), we noted the Department did not have adequate controls in place to ensure the reconciliation of information. Specifically, we noted GenTax receives and sends data to several of the Department's other systems; however, there was not a procedure in place to ensure the data reconciled between each system.

As a result of the lack of reconciliations, we noted the amount collected and the amount posted to the taxpayer accounts for February 1, 2008 differed by approximately \$27 million. However, the Department indicated on May 19, 2009 that the data provided to the auditors was in error. Regular and timely reconciliations of the data were not performed.

Additionally, during our review, we noted the GenTax extract file did not contain a complete and accurate population of data, specifically missing several transactions. These missing transactions resulted in the Department over-allocating approximately \$5.5 million to the State and local governments. Although the Department determined the inaccuracy of the allocation on June 30, 2008, the allocations were not corrected until January 2009.

Department personnel stated a location code was inadvertently left off some taxpayer accounts in the new system, a problem that was identified by the Department's review of monies allocated to local governments.

The Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) states all State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

Failure to extract complete and accurate data from GenTax resulted in an over-allocation of approximately \$5.5 million among various tax types. Further, the over-allocation in funds has resulted in the Department reducing current tax allocations to compensate for the over-allocation. In addition, failure to perform data reconciliations did not allow the Department to immediately identify and correct any errors. (Finding Code No. 08-5)

RECOMMENDATION

We recommend the Department conduct a review and identify appropriate reconciliation methods throughout GenTax to ensure the accuracy and completeness of extracted data.

08-5. **FINDING** (Inadequate controls over data reconciliations - continued)

DEPARTMENT RESPONSE

The Department agrees with the recommendation and has recently put in place a system to make the necessary reconciliations before allocations are made to local governments.

The \$27 million difference was a communications error. The auditors asked the Department's Financial Control Bureau how much money was deposited on February 1, 2008. They asked the same question of the Department's staff of the integrated tax project. The number provided by the Financial Control Bureau was correct; but the information provided by the integrated tax project staff was incorrect. The differences in the figures have been explained.

The \$5.5 million misallocation was identified by Department personnel in making a manual review conducted to make sure that under the new system allocations to local governments were accurate. The Department found the cause of the problem, a missing code, and identified all other accounts that had missing codes and corrected them. And the Department corrected the funds that had been misallocated.

The Department further put in place a system to reconcile funds between its processing and its accounting system.

08-6. **FINDING** (Inaccurate penalties and interest reporting)

The Department of Revenue (Department) migrated from legacy tax systems for Business Income Tax (BIT), Withholding Income Tax (WIT) and some Sales Taxes in December 2007 to a new enterprise-wide tax system (GenTax). As a result of the migration, several accounts were noted in the detailed testing which revealed penalties and interest were not calculated correctly. Specifically, we noted:

- Taxpayers were not charged interest and penalty assessments from November 2, 2007 to December 9, 2007. (These dates correspond to the date the legacy system was stopped for data conversion and the start date of GenTax). No assessment was performed by the Department to determine the financial impact. However, the Department's Board of Appeals issued a General Order, dated April 15, 2008, three months **after** the transition to GenTax and titled GenTax Transition Issues. The General Order finds, "that to bill and try to collect penalties and interest under circumstances where billings were interrupted for a period of time because of transition issues, and taxpayers had paid all tax, would be confusing to taxpayers and cause substantial work for both the Accounts Processing Bureau and the Collections Bureau." The Order also authorized the Department to waive the interest and penalties when a circumstance caused by the transition of the Department's legacy systems to the GenTax system arises that supports penalty and/or interest relief.

At the auditors' request, the Department estimated the impact of foregoing interest for this time period to be \$105,696 for BIT and \$16,669 for WIT. No estimation was made for Sales Tax interest and no estimation was made for penalties not assessed. These amounts were deemed immaterial by the Department and were not adjusted in the financial statements.

- Interest accrued for January through June 2008, was based on 365 days instead of 366 days (due to leap year) as required in the Department's Publication 103. The Department deemed this issue immaterial and no adjustments were made to the financial statements.

The Department's Publication 103, Penalties and Interest for Illinois Taxes, states, "Interest begins to accrue the day after the date the payment is due through the date you pay the tax." Additionally, interest is to be calculated daily, using 366 days during leap year.

- The auditors notified the Department that GenTax did not post interest charges to taxpayer accounts for the month of June 2008 (period of June 1 through June 30) until July 2008. The accounts receivable reports were ran as of June 30, 2008 and did not include the interest charges posted in July. Therefore, the interest charges were not posted to accounts receivable reports for the year end financial reporting. The Department estimated charges for the June interest charges for BIT to be \$693,754 and the WIT interest charges to be \$136,921. The Department did not estimate the interest related to Sales Tax. As a result of auditors' testing, an adjustment for interest charges related to BIT and WIT was included in an adjustment to the Net Taxes Receivable detailed in Finding 08-2.

The Department stated that: it made a business decision not to manually calculate penalty and interest on a small number of accounts during the conversion process because of the resources it would have taken to do so; the leap year interest calculation is insignificant; and the Department believes that a hardware failure on June 30 caused penalty and interest to be updated late and cross fiscal years.

08-6. **FINDING** (Inaccurate penalties and interest reporting - continued)

The Illinois Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) states all State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

Without accurate posting of interest and penalties, the account balances will be misstated and taxpayer information inaccurate. (Finding Code No. 08-6)

RECOMMENDATION

We recommend the Department implement procedures and controls to identify problems with penalties and interest calculations in a timely manner.

DEPARTMENT RESPONSE

The Department agrees with the recommendation and acknowledges that in these instances penalty and interest was not properly reported on the financial statements. It is critical to note that taxpayers were still charged the proper amount of penalty and interest.

These cases represent exceptions for the following reasons:

- A business decision not to manually calculate penalty and interest for 38 days while the legacy tax system was being replaced by the new tax system.
- An immaterial difference in daily rates due to leap year; that issue is being addressed by programmers.
- An interruption in an overnight monthly interest update on June 30, 2008 that prevented interest from being updated until July (in the FY 09 fiscal year). Interest was understated on the financial statement. However, all interest was updated on the next run and taxpayers who were billed after July 1 were charged the correct interest. No one paid incorrect penalty and interest. The software has been modified to now restart interrupted jobs.

08-7. **FINDING** (Lack of supervisory approval of large adjustments and monitoring of tax accounts)

The Department of Revenue (Department) lacked adequate supervisory approval of large adjustments and did not have an adequate procedure in place to monitor and investigate unusual balances. Material adjustments and issues were not effectively communicated between the Business Processing Division and the Financial Control Bureau.

During our testing of Withholding Income Tax (WIT) accounts, we found the following deficiencies in the Department's controls and processing:

- 8 of 66 (12%) receivable accounts tested, totaling \$4,109,359, were the result of data entry errors made by the Department in entering taxpayer information. All of these accounts were originally included in the accounts receivable calculation for the financial statements. For example, one taxpayer's tax liability was entered at \$1,109,643 when it should have been entered as \$109,643. No procedures were in place to monitor unusual account balances or discrepancies between payments claimed to payments received.

Upon inquiry, the Department stated there were no edits to suspend unusual balances for review at the time these accounts were entered.

- 3 of 66 (5%) accounts tested had payments that were received by the Department, but were held in pending due to an error in the tax liability period by the taxpayer. These pending payments were not reflected in the taxpayers' account balances in GenTax since they were not associated with the right tax liability. Any payment received by the Department that is not associated with a tax return gets suspended until it is manually posted or a return is filed. All three accounts receivable balances were resolved once the payments were manually posted.

For two of these accounts, the taxpayer erroneously applied the payments to a future quarter of withholding income tax where a return was not yet posted. There is not an edit in place to prevent taxpayers from applying payments to future quarters for withholding income tax.

Upon further investigation of pending payments at June 30, 2008, the auditors discovered the following payments that were in excess of one tax liability period into the future:

	BIT		WIT	
	Number of payments	Total payments	Number of payments	Total payments
December 31, 2008			1,092	\$ 19,224,386
August 31, 2009	2	\$ 455		
September 30, 2009	2	\$ 3,100		
December 31, 2009	4	\$ 55,280		
January 31, 2012	1	\$ 262		
January 31, 2020	1	\$ 610		
October 31, 2028	1	\$ 1,000		
December 31, 2031	1	\$ 5,500		
June 30, 2036			1	\$ 694

08-7. **FINDING** (Lack of supervisory approval of large adjustments and monitoring of tax accounts - continued)

Department personnel stated accounts with pending payments are initially reviewed within 100 days – at which time, if proper support is received, the account is adjusted.

Applicable edits to prevent posting to tax periods in excess of one tax period into the future would reduce the risk of taxpayers entering the wrong tax liability period. Monitoring of payments applied to future tax periods would also increase the likelihood that misapplied payments could be resolved in a timely manner. Pending payments should be reviewed and any impact on financial reporting considered.

- 1 of 66 (2%) receivable accounts tested, totaling \$1,755, was an invalid accounts receivable account created as a result of a user error combined with an erroneous non-filer notice being sent to a taxpayer. The erroneous notices were the result of the GenTax conversion problem with purged 2002 and 2003 Withholding Income Tax (WIT) data. The 2002 and 2003 tax data was purged if the tax liability equaled the tax payments in the legacy system. The legacy file used for conversion bypassed purged information and no information was converted for the purged 2002 and 2003 WIT filing periods. GenTax recognized these periods as non-filers and sent out non-filer notices.

In following up on this exception, the auditors determined the accounts receivable data contained 58 additional withholding receivables that were erroneously included, totaling \$291,772.

The Department stated the error occurred when taxpayers responded to non-filer notices that were sent out by the Department after conversion. When the taxpayers re-filed their returns in response to the non-filer notices, tax liabilities were created in GenTax; however, the taxpayers' previous payments were not recognized and pulled from the legacy tax system.

In addition to the deficiencies noted above, the Department does not have adequate controls over account adjustments and changes. In testing WIT and Business Income Tax (BIT), the auditors noted that high dollar adjustments were made to various accounts with no review or supervisory approval noted. Due to taxpayer accounts potentially being a receivable or liability for the State of Illinois, supervisory approval for material adjustments to taxpayer accounts would assist the Department in identifying potential problems with the reporting functions. The material adjustments made by the Business Processing Division should also be communicated to the Financial Control Bureau of the Department for evaluation and financial statement impact.

- 9 of 25 (36%) of the top 25 WIT accounts receivable were adjusted by amounts ranging from \$326,623 to \$1,741,101 with no evidence of supervisory review or approval.
- 6 of 25 (24%) of the top 25 BIT accounts receivable were adjusted by amounts ranging from \$2,911,425 to \$13,428,965 with no evidence of supervisory review or approval.

The Department stated they do not have a dollar threshold for approving adjustments, but the Department performs quality review on randomly selected accounts.

The Illinois Fiscal Control and Internal Auditing Act (30 ILCS 10/3001) states that all State agencies shall establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

08-7. **FINDING** (Lack of supervisory approval of large adjustments and monitoring of tax accounts - continued)

Without reliable and accurate taxpayer accounts, the accounts receivable and accounts payable information for the Department could be materially misstated in the financial statements. Without proper supervisory review, monitoring and control over adjustments made to taxpayer accounts, the Department increases the risk that errors or irregularities would not be found or corrected in a timely manner. (Finding Code No. 08-7)

RECOMMENDATION

We recommend the Department evaluate the controls over WIT accounts and implement necessary edits and controls to identify the processing problems in a timely manner. We further recommend the Department implement a supervisory authorization and review for material adjustments to taxpayer accounts. Additionally, we recommend that all material adjustments be communicated between the Business Processing Division and the Financial Control Bureau for consideration in the financial statement reporting process.

DEPARTMENT RESPONSE

The Department agrees with the recommendation, again noting that the impact is on year- end financial statements, not on budgetary revenues or cash flows. The Business Processing Division (BPD) is in the process of implementing necessary edits and controls to assist in the identification of problems in a timely manner and ensuring material adjustments are reviewed. To further ensure that the account information is reliable and accurate, BPD is in the process of reworking the way Withholding Tax returns are handled. Business Processing will also work with Revenue Accounting to develop a means to effectively communicate when material adjustments are made which may impact the accounts receivable.

08-8. **FINDING** (Weaknesses in the development and change management of GenTax)

The Department of Revenue (Department) had not ensured the development process and change management process for GenTax was properly controlled and documented. In addition, the Department had not utilized its historic practice of following its Project Control Methodology to promote effective and controlled development of GenTax.

After a competitive procurement process, the Department entered into a contract with a vendor for the development of an integrated tax system named GenTax. The contract was signed in October 2006 and continues through June 2012. The contract maximum is approximately \$49.2 million and through fiscal year 2008, the Department had paid approximately \$13.2 million.

In December of 2007, the Business Income Tax, Withholding Income Tax, and Sales Tax systems went into production and replaced the applicable legacy systems. For the fiscal year ended June 30, 2008, GenTax processed over \$15 billion of tax collections, as well as other transactions.

During our review, we identified the following significant weakness:

- Development Methodology - The vendor supplied its own development methodology; however, our review of the documentation found that it was not generally followed. In particular, required reviews and approvals of deliverables by Department staff were not obtained.
- Data Conversion – Documentation to support the accuracy of converting data from the legacy system to GenTax was not provided.
- Parallel System Tests - A standard systems development practice is to run parallel (process transactions on the new and old system to verify the accuracy of results) for a period of time. The Department did not run GenTax parallel with the legacy system prior to the cutover to certain GenTax modules on December 7, 2007.
- User Testing Documentation – Documentation to adequately support the adequacy and completion of user testing was not provided.
- Vendor Testing – A system test approach was developed by the vendor; however, documentation to support the completion of the testing was not provided.
- System and User Documentation – There was a general lack of documentation in all phases and areas to support the development, maintenance, and use of the system.
- Reliance on Vendor – The transfer of knowledge from the vendor to the Department had not been effectively accomplished, even though major portions of the system had been in production since December 7, 2007.

These weaknesses contributed to the issues outlined in Finding 08-5 and 08-6.

In addition, rather than using the Department's established standard, a less rigid change management process was utilized for GenTax.

Although portions of GenTax were in production, an effective change management process was not followed. The process to control changes to GenTax did not meet the requirements outlined in the Department's standard and was not always followed.

08-8. **FINDING** (Weaknesses in the development and change management of GenTax - continued)

Generally accepted Information Technology (IT) guidance endorses the implementation of system development standards and change management standards that require new system developments and changes be properly approved, thoroughly tested, and consistently documented. The standards require systems have adequate written policies and procedures, adequate written system documentation, and adequate input, processing, and output controls. IT general and application controls are necessary to preserve the integrity of the system, to provide reliance on the results produced by the system, and to ensure that the processing of transactions is performed in accordance with laws and regulations and with management's design and intent.

Department personnel stated that in November of 2006, the Department of Revenue began a five-year effort to replace its antiquated tax processing computer systems, some of them nearly 40 years old. It selected a vendor that offered a "commercial-off-the-shelf" software package that had been implemented in several other tax departments. Along with the new system came the vendor's rapid development technology which has allowed the department to modernize its withholding income tax, business income tax, retailer's sales tax, and individual income tax systems in less than two years. The implementation has not followed the traditional model for large IT projects.

The lack of an effective and controlled system development process may lead to excessive expenditures, over-reliance on contractors, and a system that does not meet the needs of the Department. In addition, an inadequate development process increases the risk that the system will not have the required accuracy, integrity, availability, and security. (Finding Code No. 08-8)

RECOMMENDATION

The Department should ensure the development of the critically important GenTax is effectively controlled and documented. In particular, the Department should:

- Ensure all required steps in the development process are completed, reviewed, approved, and documented prior to system implementation.
- Ensure the accuracy of converting data from the legacy system to GenTax is monitored, reviewed, approved, and documented.
- Ensure appropriate system and user testing is conducted, reviewed, approved, and documented prior to system implementation.
- Ensure adequate system and user documentation is available to support the development, maintenance, and use of the system.
- Accelerate the transfer of knowledge from the vendor to the Department.
- Ensure all required steps in an effective change management process are utilized with GenTax.
- Ensure all changes are adequately reviewed, tested, approved, and documented prior to system implementation.

08-8. **FINDING** (Weaknesses in the development and change management of GenTax - continued)

DEPARTMENT RESPONSE

The Department agrees that its tax system implementation should be effectively controlled and documented. The Department supplied a great deal of documentation, but it was found lacking. The Department committed 37 full-time staff to work with the vendor on development.

This implementation – the largest in the agency's experience – was accomplished with a "commercial-off-the-shelf" product that was developed specifically for tax administration. The Department adopted the vendor's rapid implementation methodology to maximize benefits and its return on investment. It replaced aging mainframe systems with modern technology in record time, without interrupting the flow of State revenues while remaining largely invisible to taxpayers.

We acknowledge that documentation on a project of this scale can always be improved, and over the last three years documentation has improved. We have incorporated the auditor's recommendations into the documentation process, knowledge transfer is progressing, full system documentation is in place and we continue to update operation procedures.

The implementation of a new tax system that positions the Department to move forward is a significant accomplishment that speaks for itself.

08-9. **FINDING** (Deficiencies in GenTax)

The Department of Revenue (Department) did not have sufficient internal control over the new enterprise-wide tax system (GenTax) functions, which affect the integrity of processing taxpayer information, financial data, and financial reporting.

After a competitive procurement process, the Department entered into a contract with a vendor for the development of an integrated tax system named GenTax. The contract was signed in October 2006 and continues through June 2012. The contract maximum is approximately \$49.2 million and through fiscal year 2008, the Department had paid approximately \$13.2 million.

In December of 2007, the Business Income Tax (BIT), Withholding Income Tax (WIT), and Sales Tax systems went into production and replaced the applicable legacy systems. For the fiscal year ended June 30, 2008, GenTax processed over \$15 billion of tax collections, as well as other transactions.

During our review, we identified a myriad of deficiencies in the production modules of GenTax. Some deficiencies included:

- The capability to enter some return types was not available which led to the creation of backlog returns waiting for entry into GenTax. Per Department management, a decision was made to delay the implementation of the capability; however, documentation to support the decision was not provided to the auditors.
- Information on several screens was not accurate and staff was told not to provide the information to the taxpayer.
- The system did not allow a 10-year carry back period for net loss deduction, causing some taxpayer accounts to be inaccurate.
- Allocations for the disbursements of taxes to local governments were inaccurate. (See Finding 08-5)
- Numerous problems with system generated correspondence. Some problems included:
 - Inaccurate letters sent to taxpayers where the notice of tax amount in the letter did not equal the dollar amount in GenTax.
 - Over 3,200 taxpayers received conflicting letters as one letter stated the taxpayer had a credit while another letter stated the taxpayer owed the State.
 - In February and March of 2008, approximately 84,000 letters were generated from GenTax which contained erroneous information. The problem was identified from an independent manual review and letters correcting the error had to be generated. This error cost the State approximately \$29,000 to correct.

Generally accepted Information Technology (IT) guidance requires systems have adequate written policies and procedures, adequate written system documentation, and adequate input, processing, and output controls. IT general and application controls are necessary to preserve the integrity of the system, to provide reliance on the results produced by the system, and to ensure the processing of transactions is performed in accordance with laws and regulations and with management's design and intent.

08-9. **FINDING** (Deficiencies in GenTax - continued)

Department personnel stated the implementation of new tax processing systems for withholding income tax, business income tax, and sales tax – all on the same day – was transformational - the single largest implementation in the history of the Department. As with any project of this size there are problems that are discovered “in production,” but because of planning and hard work the issues associated with this project have been relatively minor. Needed changes have been tracked in an on-line “Solution Request” or SQR system, in which users describe a problem, a programmer is assigned, and the user and programmer work together to develop, test and implement a fix.

The system deficiencies and lack of sufficient internal control over GenTax could affect the integrity of processing taxpayer information, financial data, and financial reporting. (Finding Code No. 08-9)

RECOMMENDATION

The Department should perform a thorough review of the modules of GenTax currently in production. From a general perspective, the Department must ensure the system provides the required functionality, integrity, and accuracy to support taxpayer information, financial data and reporting. Specifically, the Department should:

- Ensure the capability to enter all return types is implemented.
- Ensure the accuracy of all screens.
- Ensure the system allows the 10-year carry back period for net loss deductions.
- Ensure the accuracy of local government allocations.
- Ensure the accuracy of all system generated correspondence.

DEPARTMENT RESPONSE

The Department agrees with and has implemented the recommendation. The three taxes implemented on December 7, 2007 account for nearly half the Department’s total collections. Despite over 1,000 test cases and the full- or part-time attention of over 70 Department personnel, a deployment of this magnitude invariably has some flaws. The Department has created processes to review work, identify issues and track solutions.

In fact, each deficiency cited in this finding had already been identified by the Department at the time of the audit and steps were being taken to resolve each. For example, the largest problem cited in this finding in terms of number of taxpayers

affected involves 46,000 Withholding accounts that were assessed late payment penalties because the new system did not have a delay in place to account for the time it takes to get payments posted if a payment is sent on the due date. Payments that were posted on February 1 were actually sent one day earlier, on January 31, and were timely. When the problem was identified it was immediately addressed; taxpayers were promptly notified, and penalties were reversed.

It is important to note that a system transition of this magnitude was invisible to the vast majority of taxpayers and there was no interruption to State revenues.

Prior Findings Not Repeated

A. **FINDING** (Lack of control and monitoring over the tax allocation methodology utilized by the Department)

During the prior engagement, we noted the Department did not adequately monitor and adjust the sales tax allocations to the Home Rule Municipal Retailers Occupation Tax Fund, the Local Government Tax Fund and other funds in a timely manner. In addition, the Department had not updated its tax allocation methodology since 2003. In addition, the Department did not monitor and adjust the amount of telecommunications tax collected on behalf of various local governments. There were no compensating controls in place, such as the analysis of fund balances, to detect allocation errors.

During the current engagement, we noted the Department issued a policy to provide guidance on how to update the percentages used to allocate sales tax dollars to appropriate funds. The new policy requires the Department to review the allocations every 6 months, and requires supervisory review of this analysis. During our review, we examined the analysis prepared by the Department during the fiscal year and determined the Department is reviewing the allocations every 6 months and changing the allocations as warranted by this analysis. We were also provided an analysis of year end balances in each fund which supported the adequacy of amounts that were allocated to those funds. (Finding Code No. 07-1)

B. **FINDING** (Inappropriate lapse period expenditures)

During the prior engagement, the Department violated provisions of the State Finance Act by prepaying future fiscal years' expenses out of current year appropriated funds and created false and misleading billing invoices to support the payments.

During the current engagement, we did not note any instances of prepayments or false invoices during our testing. (Finding Code No. 07-2)