



DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

December 17, 2014

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator Edward J. Kasemeyer
Chairman, Senate Budget and Taxation Committee
Miller Senate Office Building, 3 West Wing
11 Bladen Street
Annapolis, Maryland 21401

Delegate Norman H. Conway
Chairman, House Appropriations Committee
House Office Building, Room 121
6 Bladen Street
Annapolis, Maryland 21401

Dear Senator Kasemeyer and Delegate Conway:

The Office of Legislative Audits (OLA) has conducted a review of the actions taken by the State Department of Assessments and Taxation (DAT) to resolve the four repeat findings (presented as three findings) in our December 16, 2013 audit report. This review was conducted in accordance with a requirement specified in the April 2014 *Joint Chairmen's Report* (JCR), page 33. The JCR required that, prior to release of \$100,000 of its administrative appropriation for fiscal year 2015, DAT must take corrective action on all repeat audit findings. The JCR language further provided that OLA submit a report to the budget committees listing each repeat audit finding along with a determination that each repeat finding was corrected within sufficient time to allow 45 days for the budget committees to review and release the funds prior to the end of fiscal year 2015.

The December 16, 2013 DAT audit report contained four repeat audit findings presented as three findings (findings 5, 10, and 11) that were addressed by five recommendations. In accordance with the aforementioned JCR requirement, DAT provided a report to OLA, dated October 31, 2014, detailing the corrective actions that DAT has taken with respect to these repeat audit findings. We reviewed this report and related documentation, performed limited tests and analyses of the information, and held discussions with DAT personnel, as deemed necessary, to assess the implementation status of the related recommendations. Our review did not constitute an audit conducted in accordance with generally accepted government auditing standards.

Exhibit 1 is DAT's October 31, 2014 status report, which indicated that it had made substantial progress in implementing corrective actions for all of the repeat findings. Our review determined that DAT had taken the necessary corrective actions to implement the recommendations for two findings and that actions are ongoing to resolve the remaining finding.

Senator Edward J. Kasemeyer
Delegate Norman H. Conway

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December 17, 2014

A summary of OLA's assessment of the status of each of the repeat audit findings is included in the attached Exhibit 2. Exhibit 3 contains OLA's assessment regarding the one repeat finding that had not been resolved. We wish to acknowledge the cooperation extended to us by DAT during this review.

We trust our response satisfactorily addresses the JCR requirement. Please contact me if you need additional information.

Sincerely,



Thomas J. Barnickel III, CPA
Legislative Auditor

cc: Senator James C. Rosapepe, Co-Chair, Joint Audit Committee
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee
Joint Audit Committee Members and Staff
Senator Thomas V. Mike Miller, Jr., President of the Senate
Delegate Michael E. Busch, Speaker of the House of Delegates
Governor Martin J. O'Malley
Comptroller Peter V.R. Franchot
Treasurer Nancy K. Kopp
Attorney General Douglas F. Gansler
Secretary T. Eloise Foster, Department of Budget and Management
Robert E. Young, Esq., Director, DAT
Owen Charles, Deputy Director, DAT
Darrin Aycock, Chief Financial Officer, DAT
Joan Peacock, Manager, Audit Compliance Unit, DBM
Karl S. Aro, Executive Director, Department of Legislative Services
Leah Clague, Policy Analyst, Department of Legislative Services

Exhibit 1 to December 17, 2014 Letter to Joint Chairmen



State of Maryland

DEPARTMENT OF ASSESSMENTS AND TAXATION

Office of the Director

MARTIN O'MALLEY
Governor

ROBERT E. YOUNG
Director

October 31, 2014

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
Office of Legislative Audits
State Office Building, Room 1202
301 West Preston Street
Baltimore, MD 21201

Dear Mr. Barnickel:

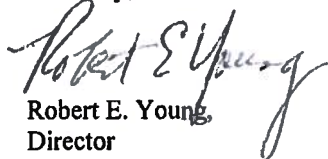
In accordance with the requirements of the April 2014 Joint Chairmen's Report, Page 33, which prohibits the State Department of Assessments and Taxation (SDAT) from spending \$100,000 of its administrative appropriation until the Department has demonstrated progress in resolving the four repeat findings in the December 2013 Office of Legislative Audits (OLA), enclosed is a report that outlines the status of the Department's progress and remediation efforts to resolve these repeat findings.

I am pleased to inform you that SDAT has made substantial progress in implementing corrective actions for all four repeat findings. We expect to have the corrective actions for all four findings fully implemented by the dates specified in the attached response for each finding. In addition, the Department has established a specific reporting process for each affected program by which the Department's senior management can verify that the newly implemented procedures are being adhered to by program staff. We have worked with the Audit Compliance Unit in the Department of Budget and Management and are confident that our corrective action plan will resolve all four repeat findings, as indicated in the attached report.

We look forward to your review and consideration of making a recommendation to the General Assembly to release the \$100,000 administrative appropriation withheld in our budget.

If you or your staff has any further questions concerning this information, please contact me.

Sincerely,



Robert E. Young
Director

cc: Honorable Edward J. Kasemeyer
Honorable Sheila Ellis Hixson
Honorable Norman H. Conway
Honorable James C. Rosapepe
Honorable Guy Guzzone
Karl S. Aro, Executive Director, Department of Legislative Services
Peggy J. Watson, Deputy Chief of Staff,
Joan Peacock, Manager, Audit Compliance Unit, DBM
Owen Charles, Deputy Director, SDAT
Darrin Aycock, Chief Financial Officer, SDAT
Jordan More, Policy Analyst, Department of Legislative Services

Administration of Certain Tax and Credit Programs

Finding 5

DAT had not performed timely and comprehensive verification procedures to help ensure the accuracy of information on certain returns and tax credit applications.

Current Status: In Progress

OLA's Recommendation 5:

- a. perform timely verifications of personal property tax returns, approved homeowners' and renters' tax credit applications, and franchise tax returns (repeat);*

Personal Property Tax Returns:

The Department has completed an audit of the 2011 and 2012 personal property returns. The audit of the 2013 returns will be completed by December 2014. A full audit of the 2014 personal property returns is estimated to be completed by October 1, 2015, which should resolve the personal property portion of this subsection of the finding. The Assistant Program Manager of the Personal Property Program will report the progress on the audits being performed on a quarterly basis to the Associate Director of the Department.

Homeowner's and Renter's Tax Credit Applications:

It should be noted that the timeliness of the tax credit application audits was adversely affected when the Department lost four positions in the 2009 Cost Containment. The Department received three new positions for the Tax Credit Programs in the FY 2015 Budget approved by the General Assembly.

Due to the small yield of the 5% Homeowner's and Renter's Tax Credit audits, the Department has revised its policy and has discontinued this audit for these two programs. This has allowed the Department to focus resources on the more productive audits of these applications which are the IRS/Comptroller audits and the 20% Differential audits.

The Department completed the 20% Differential audits for 2009 and 2010 for the Homeowner's and Renter's Tax Credit applications. The 20% Differential audits for 2011 and 2012 are in progress and the estimated completion date for these two years is in seven months by May 2015. The IRS/Comptroller audits for Homeowner's and Renter's for 2011 are currently in progress. The completion date for the IRS/Comptroller audits for the two programs is affected by the Comptroller's response to the Department's request for copies of the MD Income Tax Returns. During the income tax filing season, the Department is unable to obtain copies of the tax returns in an expedited manner.

The estimated start date for the 2013 year for the two types of audits is July of 2015. The Tax Credits Program manager will report on a quarterly basis to the Associate Director the progress being made. With the three new tax credit employees, the Tax Credit Program will seek to accelerate the timeliness of these audits.

The Tax Credit Program Manager will report to the Associate Director on a quarterly basis the ongoing progress in all types of audits.

Franchise Tax Returns:

The Department has made significant progress in reducing the backlog of audits for the Franchise Tax Returns from 2008 up to 2012. To date, audits have been completed for approximately 95% of these returns. The Department anticipates completing the remaining audits no later than November 15, 2014. The program staff is currently conducting audits of the 2013 Franchise Tax Returns. In accordance with the Department's policy, the audits of the 2013 returns for all companies paying \$1 million or more in annual Franchise Tax payments, are expected to complete by November 17, 2014, which is within 8 months of receipt. The Department's policy, which establishes this audit schedule, was discussed and agreed upon with OLA during the Department's Exit Conference.

Because of issues identified as a result of the audit, the Department modified the procedures for the audit process of the returns plus implemented new COMAR regulations that went into effect on September 15, 2014. The new language in COMAR helps to address returns filed without supporting documents by allowing the Department to assess an additional penalty of up to 25% of the estimated tax liability for failure to file these documents.

The Franchise Tax Unit will impose and collect the penalties imposed in the new COMAR regulation for any filer who fails to file the required return, files late, or underpays the tax when due. There may be a one-time waiver of the penalty if the taxpayer makes a written request for a waiver, provides substantial evidence of the reasonable cause for the request, and has made all payments and timely filings within the last 12 months. This exception is supported by Tax-General Article, Section 13-714 and 70 Op. Att'y Gen. 208 (1985).

The Franchise Tax Unity Program Manager will provide quarterly progress reports to the Associate Director on the timeliness and thoroughness of the specific audits being performed.

- b. expand its data matches to identify entities that did not file personal property returns, and consider a risk-based approach for following up on non-filing entities;*

Corrective Action Taken:

Personal Property Tax Returns:

As recommended by OLA, the Department is performing a "Discovery" match to identify non-filers of subsequent year personal property returns. The Discovery program has been expanded to seven counties for 2014 to ensure a larger cross section of Maryland to locate businesses that did not file personal property returns. An analysis of the results is estimated to be completed by June 30, 2015. The Assistant Program Manager for Personal Property will report to the Associate Director on a quarterly basis the ongoing results of the Discovery program.

Note: A similar audit was previously performed by the Department on "forfeited" entities, per a recommendation by OLA, approximately six years ago. These audits produced no meaningful additional revenues to the State. Thus, the results of the audit currently being performed will be reviewed to also determine (1) if any adjustments to the audit process are needed to make the

audit meaningful and/or (2) if it is cost effective and in the best interest of the State to continue devoting Department resources to completing such audits.

- c. ensure that local jurisdictions submit monthly electronic redemption reports and generate exception reports of redeemed credits versus approved credits and perform documented reviews of the exception; and*

Corrective Action Taken:

Homeowner's and Renter's Tax Credit Applications:

On April 8, 2014, the Tax Credit Program Administration sent out a written directive to the County Finance Officers to submit in to the Department a monthly electronic redemption report of the transferred properties even where there are no properties being transferred that month in a given county. Only a few counties are still not submitting monthly electronic redemption reports on a routine basis. To ensure compliance, the Tax Credit Program Manager issued a warning letter on October 28, 2014 to those jurisdictions stating that that failure to provide this information each month will result in a loss of tax credits reimbursements until the reporting deficiency is corrected. The audits of the electronic redemption and exempt reports of redeemed credits versus approved credit are now being performed, reviewed and documented on a regular basis. Again, the Tax Credits Program Manager will advise the Associate Director on a quarterly basis the monthly results of this audit as well.

The three additional employee positions requested for the FY'15 Budget will be utilized to assist in the Department's ongoing activity in auditing this particular information.

- d. determine the cost benefits of instituting electronic filing for personal property tax returns.*

Corrective Action Taken:

Personal Property Tax Returns:

The Department is still on target with the project and anticipates the electronic filing system for personal property tax returns to be in place by January 1, 2015 with the start of the filing of returns for that year. This electronic filing system should free up resources which can be used to help implement corrective actions mentioned above.

Contract Monitoring

Finding 10
DAT did not adequately monitor certain contract billings.

Current Status: In Progress

The Department implemented the following measures to improve oversight of the contract monitoring and billings:

OLA's Recommendation 10:

We recommend that DAT establish procedures to ensure the propriety of contractor billings. Specifically, we recommend that DAT

a. maintain records necessary to perform verifications of contractor billings,

Corrective Actions Taken:

Lock Box Services: The Department has always maintained records to perform verifications of contractor billings. The Department uses the schedule provided by the State Treasurer's Office (STO), as lock box services are provided for under a statewide contract procured by the STO. In the future, if there are any changes in the rates being billed, the Department will contact the STO for written confirmation of the proper rates the Contractor is to bill the Department and to include any updated rate schedule. Imaging Services: The Department is in the process of implementing corrective actions that will provide for an independent verification of the contractor's monthly reported activity.

b. verify that billed costs agree with contractual terms and conditions (repeat), and

Corrective Actions Taken:

Lock Box Services: Our Chief Accountant currently reconciles on an ongoing basis the rates on the monthly invoices from Citi Bank to the fee schedule, provided by the State Treasurer's Office (STO), for the lock box services. The Department verifies that the fees paid agree with the latest fee schedule issued by STO.

Imaging Services: Although this particular contract is not part of the repeat finding, the Department is in the process of implementing procedures to verify billed costs agree with contract terms. The Contract Manager collects data regarding the number of images submitted by the staff and on the agency's server for comparison to the number of images scanned that are reported on the monthly billings from the vendor. This verification will be performed and documented prior to approving and paying the contractor's monthly invoice.

The Department will perform an annual reconciliation on the number of images charged by the vendor and the agency's count. This annual reconciliation will be reviewed by the Department's CFO.

c. seek recovery of any overpayments identified including those mentioned above (repeat).

Corrective Actions Taken:

Lock Box Services: Counsel for the Department sent a demand letter to Sun Trust Bank requesting a refund of the \$5,000 "over payment". In response, Sun Trust indicated that the fee increase for the time frame of the payments under review (April, May and June of fiscal year 2012) were allowed as a CPI increase under the contract with the Treasurer. Those increases were done annually based on the CPI increase. After receipt of that response, the Treasurer's Office has confirmed that the Contract did allow for an annual CPI increase. Therefore, based on

the best information the Department now has, these payments did not represent “over payments” but were made in accordance with a CPI increase that was consistent with past practices under the Contract.

Cash Receipts

Finding 11

Sufficient controls were not established over certain collections.

OLA's Recommendation 11a – Current Status: Resolved

We recommend that DAT

- a. document the performance of independent verifications of recorded collections to deposit (repeat); and*

Corrective Actions Taken:

The Department has implemented a new procedure and revised its business processes so that all checks will be entered into the receipts system on the same day even though the document for which the fee is paid will not be processed until later. The Department's lead accountant, who is independent of the cash collection functions, performs a daily verification of all of the cash receipts entered into the agency's automated system and the daily deposit. The lead accountant documents their review, which is also subject to further verification by the Chief Financial Officer. There is one exception to the same day deposit of all checks that involve Trade Name filings. The Department advised the OLA that it would not deposit those checks because the significant error rate by filers results in large numbers of checks being returned to the filers who decide to withdraw the filing. Instead the Department has developed an individual check log for the Trade Name filings.

OLA's Recommendation 11b – Current Status: In Progress

- b. generate output reports of “no fee” transactions recorded in the automated system, and ensure that supervisory personnel independent of the case receipts functions review these transactions for propriety (repeat).*

Corrective Actions Taken:

As of March 31, 2014, the Department began generating, on a monthly basis, a new “no fee” transaction report. Procedures were implemented that require this report to be reviewed on a test basis by a supervisory level employee independent of the cash receipt function. The review of

the “no fee” transaction report is documented with the supervisor’s initials, the date it occurred, and an attachment of the official letter request.

Due to resources available and limited ability to control access to the system, the designated independent reviewer of the “no fee” transaction report does have the ability to process a “no fee” transaction. A compensating control was discussed and agreed upon with OLA at the Exit Conference. The secondary review of the “no fee” transaction report will occur by an individual who does not have access to process a “no fee” transaction. This individual will review (1) the report only for “no fee” transactions processed by the designated reviewer and (2) in detail (i.e., to ensure “no fee” transaction was properly processed, including a review of supporting documentation) only those transactions indicated that were processed by the designated reviewer. This secondary review is documented.

Testing performed on these corrective actions being implemented included a May 2014 transactions review which disclosed that supporting documentation was not attached to the “no fee” transactions report and the compensating control (i.e., secondary review) was not independently performed in two limited instances where the report reviewer herself had performed the original no fee transaction. Department staff, responsible for these functions, was reminded of the proper procedures that should be performed.

The Charter Processing Program Manager, who supervises the employee reviewing and the no fee transaction report, will report on a quarterly basis the “no fee” audit results and provide the audit reports to the Associate Director of the Department.

Exhibit 2 to December 17, 2014 Letter to Joint Chairmen

Status of Repeat Findings in OLA's December 16, 2013 Audit Report on the State Department of Assessments and Taxation (DAT)

Prior Recommendations Pertaining to Repeat Findings	Status Based on OLA Review
Administration of Certain Tax and Credit Programs 5a. We recommend that DAT perform timely verifications of personal property tax returns, approved homeowners' and renters' tax credit applications, and franchise tax returns.	Not Resolved
Contract Monitoring 10. We recommend that DAT b. verify that billed costs agree with contractual terms and conditions, and, c. seek recovery of any overpayments identified including those mentioned in the report.	Corrected
Cash Receipts 11. We recommend that DAT a. document the performance of independent verifications of recorded collections to deposit; and b. generate output reports of "no fee" transactions recorded in the automated system, and ensure that supervisory personnel independent of the cash receipts functions review these transactions for propriety.	Corrected

Shaded recommendations are more fully described in Exhibit 3.

Exhibit 3 to December 17, 2014 Letter to Joint Chairmen

OLA's Findings Regarding Repeat Findings That Had Not Been Resolved

Administration of Certain Tax and Credit Programs

Prior Report Recommendation – Finding 5a

We recommend that DAT perform timely verifications of personal property tax returns, approved homeowners' and renters' tax credit applications, and franchise tax returns (repeat).

Status: Not Resolved

During our review, we found that the verifications for personal property and franchise tax returns were performed in a timely manner. Although some progress has been made, verifications of homeowners' and renters' tax credit applications were still not timely. The tax credit verification process consists of audits of certain applications selected based on risk and significance. At the time of our review, such audits had been completed for the applications received from homeowners and renters who were granted tax credits in years 2009 and 2010. Audits of applications for tax credits granted in years 2011 and 2012 had recently begun and were in progress and DAT's estimated start date for the 2013 audits was July 2015. In its status report, DAT stated that it received three new positions for the tax credit programs in the approved fiscal year 2015 budget, and these positions will be used to accelerate the timeliness of the audits. DAT advised us that delays in filling these positions, as well as unexpected turnover in a key auditor position have also hindered its ability to complete the audits sooner.