

Audit Report

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**Comptroller of Maryland  
Revenue Administration Division**

September 2016

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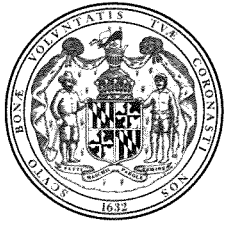
**OFFICE OF LEGISLATIVE AUDITS**  
**DEPARTMENT OF LEGISLATIVE SERVICES**  
**MARYLAND GENERAL ASSEMBLY**

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September 16, 2016

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Delegate C. William Frick, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Comptroller of Maryland – Revenue Administration Division (RAD) for the period beginning February 15, 2012 and ending June 30, 2015. RAD is primarily responsible for receiving and depositing various tax remittances, processing tax returns, maintaining taxpayer records, distributing taxes in accordance with State laws, issuing income tax refunds, and providing assistance to taxpayers.

Our audit disclosed that RAD had not determined the underlying cause(s) for erroneous subdivision codes assigned to numerous taxpayers in one county on its automated tax records. Prompted by concerns raised by certain officials, the Comptroller of Maryland conducted a review that disclosed erroneous codes had been recorded for more than 14,000 taxpayers, resulting in \$8.7 million in local income taxes being incorrectly distributed among the special taxing areas within the county and the county at large (not within a special taxing area) for tax years 2010 to 2014. Although steps had been taken to correct the incorrect distribution of local taxes for those tax years, RAD had not conducted a detailed analysis to determine what caused the subdivision coding errors, making it uncertain if other jurisdictions also experienced the problem and what actions are needed to resolve the matter.

While the specific causes of the tax distribution problem were not ascertained, our audit disclosed that RAD did not have sufficient policies and procedures to ensure subdivision codes recorded for taxpayers in the automated tax system were accurate. For example, RAD did not provide adequate guidance to employees who were responsible for identifying the proper special taxing area and subdivision codes (based on tax return addresses) when automated processes

failed to do so. Also, RAD did not ensure the sources of information used by these employees were always current as we noted that some address listings being used were published in 1995.

Our audit also disclosed that documentation was not always on file to support credits claimed by taxpayers for income taxes paid to another State. Out-of-state tax credits claimed by taxpayers for tax year 2013 totaled \$111.9 million and, based on our limited tests of some of the largest credits claimed, we noted supporting documentation was not on file for six returns claiming credits of \$27.2 million. Furthermore, critical adjustments to financial and nonfinancial taxpayer account data were not always reviewed as required to ensure their propriety.

Certain control deficiencies existed with respect to information systems security, cash receipts, and the issuance of replacement refund checks. For example, several employees with access to collections could also adjust taxpayer account information, and there was a lack of documentation that replacement checks, which totaled \$125 million during our audit period, had been verified as required by RAD's policy.

The Comptroller of Maryland's response to this audit, on behalf of RAD, is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by RAD.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "TJ Barnickel III", with a stylized flourish at the end.

Thomas J. Barnickel III, CPA  
Legislative Auditor

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## **Background Information**

### **Agency Responsibilities**

The Revenue Administration Division's (RAD) primary responsibilities include receiving and depositing various tax remittances, processing tax returns, maintaining taxpayer records, distributing taxes in accordance with applicable State laws, issuing income tax refunds, and providing assistance to taxpayers. RAD uses the Comptroller of Maryland's automated State of Maryland Tax (SMART) system to record and process tax return information and issue refunds for individual income taxes, as well as for certain other taxes, such as corporate income taxes, employer withholding taxes, and sales and use taxes. RAD also administers laws and regulations pertaining to the manufacture, storage, transportation, sale, and distribution of alcoholic beverages, tobacco, and motor fuel, and collects the related excise taxes. The significant taxes collected by RAD (sources greater than \$100 million annually), according to RAD's records, for fiscal years 2013 through 2015, are listed in Table 1.

**Table 1**  
**Selected Tax Collections and Distributions**  
**Applicable to Fiscal Years 2013 – 2015**  
**(sources greater than \$100 million annually)**

	Fiscal Year		
	2013	2014	2015
	(dollars stated in millions)		
<b>Gross income taxes collected</b>	<u>\$15,884</u>	<u>\$16,238</u>	<u>\$17,152</u>
Less:			
Refunds	2,527	2,578	2,601
Administrative expenses	<u>14</u>	<u>14</u>	<u>14</u>
Total refunds and expenses	<u>2,541</u>	<u>2,592</u>	<u>2,615</u>
Balance available for distribution	<u>\$13,343</u>	<u>\$13,646</u>	<u>\$14,537</u>
Distribution of remaining balance:			
To State's General Fund	\$8,255	\$8,535	\$9,124
To local subdivisions	4,698	4,888	5,185
To other Funds as provided by State Law (such as the Transportation Trust Fund)	390	223	228
Total distributions	<u><u>\$13,343</u></u>	<u><u>\$13,646</u></u>	<u><u>\$14,537</u></u>
<b>Gross sales and use tax collections</b> which are primarily credited to the State's General Fund	<u>\$4,128</u>	<u>\$4,211</u>	<u>\$4,426</u>
<b>Gross motor fuel tax collections</b> which are primarily credited to the Transportation Trust Fund	<u>\$775</u>	<u>\$879</u>	<u>\$961</u>
<b>Gross tobacco tax collections</b> which are primarily credited to the State's General Fund	<u>\$416</u>	<u>\$405</u>	<u>\$392</u>
<b>Gross estate tax collections</b> which are primarily credited to the State's General Fund	<u>\$196</u>	<u>\$182</u>	<u>\$210</u>

**Source:** RAD Records

**Note:** Distributions shown in this table relate to the stated fiscal year, but were not necessarily distributed in that year.



## **Court Ruling on Income Taxes Paid to Other States**

Maryland's individual income taxes collected from State residents include a State income tax due to the State and a local income tax due to the State's local jurisdictions. Residents who earn income in another State are generally required to report that income on their Maryland income tax returns, but are allowed a credit against their State tax liability for taxes paid to the other state on that income. Previously, taxpayers were not allowed a corresponding credit against their local income tax liability.

On May 18, 2015, the United States Supreme Court ruled (*Comptroller of the Treasury of Maryland v. Wynne*) that not permitting the credit against the local tax liability was unconstitutional. As a result, residents of Maryland who have paid income taxes to another state on income earned in that state are now allowed a credit against Maryland's local income taxes. Residents may file amended income tax returns in Maryland for refunds of these taxes previously paid, generally subject to statutory time limits for amended returns. According to the Comptroller of Maryland's records, as of November 27, 2015, RAD had issued refunds totaling \$87.8 million, including \$4.8 million in interest, relating to 10,054 tax returns, as a result of this court ruling.

## **Status of Findings From Preceding Audit Report**

Our audit included a review to determine the status of the 10 findings contained in our preceding audit report dated August 23, 2013. We determined that RAD satisfactorily addressed 7 of these findings. The remaining 3 findings are repeated in this report.

## **Findings and Recommendations**

### **Local Income Tax Revenue Distribution**

#### **Background**

The Revenue Administration Division (RAD) of the Comptroller of Maryland is responsible for processing individual income tax returns and collecting and distributing the related income tax revenue on behalf of the State and its 24 jurisdictions (23 counties and Baltimore City). The State's income tax revenue is primarily distributed to the General Fund. Each jurisdiction's local income tax revenue is distributed in accordance with the local income tax rates established by ordinance or resolution, within parameters specified in State law. Taxpayers use those rates to determine the amount of their local income tax liability when preparing their tax returns.

RAD is also required by law to distribute a portion of the local income tax revenue collected to the municipal corporations and special taxing districts (collectively referred to as special taxing areas) established within most jurisdictions. There are 172 special taxing areas located within 21 counties in the State. Two counties and Baltimore City have no special taxing areas within their boundaries. The amount distributed to a special taxing area is generally equal to 17 percent of the local income tax collected from each taxpayer living within the boundaries of that special taxing area. Local income tax collected from taxpayers who do not live within a special taxing area is distributed entirely to the jurisdiction in which the taxpayer resided during the tax year, as is the remaining 83 percent of the local income tax collected from taxpayers residing in special taxing areas. During fiscal year 2015, RAD distributed approximately \$4.9 billion in local income taxes, of which \$111.1 million was distributed to special taxing areas.

Within the Comptroller of Maryland's automated State of Maryland Tax (SMART) system, each taxpayer is assigned a numeric subdivision code, based on the taxpayer's address at the end of the tax year. The subdivision code identifies the jurisdiction, as well as any applicable special taxing area. RAD uses subdivision codes to distribute local income taxes associated with the tax returns to the applicable subdivisions.

**Finding 1**

**RAD had not determined the underlying cause(s) for erroneous subdivision codes recorded in SMART for numerous taxpayers in one county. The erroneous codes resulted in \$8.7 million in local income taxes being incorrectly distributed among the county and its special taxing areas for tax years 2010 through 2014.**

**Analysis**

A review conducted by the Comptroller of Maryland disclosed that incorrect subdivision codes and related special taxing areas had been recorded in SMART for certain taxpayers in Montgomery County. The erroneous coding resulted in \$8.7 million in local income taxes being incorrectly distributed among the special taxing areas within the County and the County at large (not within a special taxing area) for tax years 2010 through 2014. Although steps have been taken to correct the incorrect distribution of local income taxes in Montgomery County for those tax years, RAD had not conducted a detailed analysis to determine the underlying cause(s) of the erroneous subdivision coding which impacts the local income tax distribution. Also, the applicable taxpayer records had not been corrected in SMART. During fiscal year 2014, RAD distributed approximately \$39.4 million in local income taxes to special taxing areas within the County, and \$1.3 billion to the County at large.

Based on concerns raised by certain State and local government officials, RAD became aware that some local income tax revenue collected from Montgomery County taxpayers may not have been properly distributed. In response, the Comptroller of Maryland's Bureau of Revenue Estimates (BRE) reviewed the propriety of taxing areas recorded in SMART for essentially all taxpayers within Montgomery County's 22 special taxing areas and the County at large using data from tax years 2010 through 2014. The review included a series of computer matches of address data recorded on tax returns in SMART with corresponding data available from selected sources, including certain State and local entities. BRE's review resulted in the following conclusions:

- Individual income tax returns filed for 14,861 of approximately 500,000 tax returns filed by Montgomery County taxpayers for tax year 2014 were assigned an incorrect subdivision code within SMART, and similar discrepancies were noted for tax years 2010 to 2013. As a result, local income taxes totaling approximately \$8.7 million had been incorrectly distributed to certain special taxing areas within the County for tax years 2010 through 2014 (as detailed in Exhibit 1). Specifically, over-distributions ranging from approximately \$5,000 to \$4.9 million were made to 8 special taxing areas. Those taxes should instead have been distributed to the

County's other 14 special taxing areas or to the County at large. The under-distributions for these 15 subdivisions ranged from approximately \$10,000 to \$6.1 million.

- For an additional 1,393 income tax returns filed for tax year 2014, the taxpayer addresses as recorded in SMART could not be identified as legitimate addresses within Montgomery County, and no further investigation was conducted by reviewing the actual tax returns. Consequently, the extent to which distribution errors occurred for these returns was not determined. These returns included approximately \$2.2 million in local income taxes due for tax year 2014, a portion of which may be due to special taxing areas. The inability of BRE's computer matches to identify the legitimacy of these addresses may have occurred, for example, if address information on a tax return was not completely recorded in SMART. In such cases, the incomplete information would not allow BRE's automated process to identify the actual correct address and corresponding subdivision code.

The Comptroller's Office contracted with a public accounting firm to perform certain agreed-upon procedures for tax year 2014 relating to the results of BRE's review. The Office has stated in written testimony (during the fiscal year 2017 legislative budget hearings) that the firm's review found that BRE's identification of misallocated receipts and the proposed reallocations were proper. In this regard, the firm's February 2016 report indicates that based on its statistical approach, the errors identified by the firm with respect to BRE's proposed reallocations for the 14,861 returns were within the five percent tolerable error rate established by the firm.

Our judgmental selection of 60 Montgomery County tax returns filed for tax year 2014 disclosed 31 returns were assigned to an incorrect taxing area in SMART, resulting in the incorrect distribution of \$63,571 in local income taxes. For example, our comparison of address information on 20 returns for one taxing area with address data that RAD had received from that area disclosed 9 incorrectly assigned returns. As a result, local income taxes associated with these returns totaling \$32,596 had been incorrectly distributed. We determined that in all but one case the returns we found to be incorrectly assigned were also identified and appropriately addressed by BRE in its review. We determined that the one case not identified by BRE was included in the aforementioned 1,393 returns for which BRE could not identify the proper taxing area.

As of March 16, 2016, RAD had paid the aforementioned 14 special taxing areas and Montgomery County \$8.7 million for the amounts that were owed them as a result of these improper distributions. Funding for these payments came from the

Local Income Tax Reserve Fund, which is a fund maintained by RAD for the collection and distribution of local income taxes. In February 2016, BRE advised the 8 taxing areas that received an over-distribution for tax years 2010 to 2014 that they would be required to repay those funds, in equal amounts, over a 10-year period through a reduction in their regular tax distributions beginning in February 2019, and no interest would be assessed. The repayment of these funds over an extended period seems reasonable since it could have a significant impact on certain special taxing areas' financial circumstances. For example, the \$4.9 million overpayment to one special taxing area exceeds its total annual operating budget. We estimated, based on fiscal year 2016 interest rates, that the erroneous local tax distributions made, coupled with the extended repayment period, will cost the State approximately \$685,000 in interest over the repayment period.

The Office also stated in its written testimony to the budget committees that the scope of this issue is likely specific to Montgomery County and is likely the result of the automated processing system used by the Comptroller (SMART) being unable to properly accommodate taxing jurisdictions that share zip codes. However, without a more detailed analysis of the cause or causes, it is uncertain if other jurisdictions in the State also experienced this problem and what actions are needed to resolve the matter.

The information in Exhibit 1, which shows the details of the \$8.7 million that was incorrectly distributed, also shows certain significant fluctuations from year-to-year in the amounts of incorrect distributions that occurred within the same taxing area, raising questions as to whether there could be multiple causes. For example, according to the data, one taxing area with a net over-distribution received \$10,712 less than it was due for tax year 2013, but \$590,908 more than it was due for tax year 2014. We were advised that the Comptroller's Office is considering reviewing the propriety of taxing areas assigned in jurisdictions other than Montgomery County. However, as of June 23, 2016 no additional action had been taken.

As of June 23, 2016, RAD had not made any adjustments to subdivision codes recorded in SMART for discrepancies identified by BRE's review. We were advised that, because no adjustments had been made, it would be necessary to identify and correct any misallocation of local income taxes for tax year 2015, similar to the reallocation performed for tax years 2010 through 2014.

### **Recommendation 1**

**We recommend that RAD, in conjunction with the Comptroller's Office,**

- a. analyze the reasons the coding errors occurred, and implement process changes and correct tax data errors as needed to address the reasons identified;**
- b. determine whether such coding problems could be affecting distributions in other jurisdictions and, if so, expand the review of subdivision codes and special taxing areas to all relevant jurisdictions and take appropriate action with respect to any local income taxes that were incorrectly distributed; and**
- c. manually review the aforementioned 1,393 returns to ensure that special taxing areas are properly assigned and local income taxes are correctly distributed for these returns.**

### **Finding 2**

**RAD lacked sufficient policies and procedures to ensure that all subdivision codes assigned to taxpayers in SMART were proper. In particular, adequate guidance was not provided to employees responsible for identifying special taxing areas for tax returns that suspended from processing, and source data used by these employees were outdated and incomplete.**

### **Analysis**

RAD did not have sufficient policies and procedures to ensure that all subdivision codes and related special taxing areas assigned to taxpayers in SMART were proper. Consequently, there was a lack of assurance that all local income taxes were accurately distributed. As commented upon in Finding 1, RAD recently determined that local income taxes for one County had been improperly distributed due to the improper coding of numerous taxpayers.

SMART automatically assigns the same subdivision code from the prior tax year for taxpayers who previously filed a Maryland return, if there has been no change of address. When individuals file a Maryland return for the first time or file a return with a different address from the previous year, RAD has certain automated procedures in place to help identify, assign, and record the proper subdivision code for the taxpayer. If these automated procedures are not successful in identifying a subdivision code, the return will suspend from processing, and RAD employees will manually investigate and determine the proper code. The number of returns suspended and manually investigated for coding issues during a filing season was not readily available. Our review identified the following conditions which may have contributed to the assignment of erroneous subdivision codes to taxpayers.

- Comprehensive written guidance was not provided to the 26 employees responsible for identifying the proper special taxing areas and corresponding subdivision codes for tax returns suspended from processing. Although RAD maintained a written manual that described certain procedures to be performed by these employees, the manual did not instruct employees on how to address certain common situations including (1) a taxpayer's failure to disclose his or her taxing area on the tax return; (2) a tax return with a stated taxing area that conflicted with the taxpayer's stated mailing address; and (3) a non-standard address, such as a post office box number.
- Sources of information used by these employees to identify special taxing areas for suspended returns, based on the taxpayer addresses, were not always current or complete. Address listings within each special taxing area were generally received directly from the taxing areas; however, RAD did not routinely inquire about or request updated listings. For example, we noted that listings used by employees for seven taxing areas in Montgomery and Allegany counties were published in 1995. We also found that certain address listings being used were incomplete, as they excluded all addresses for several known special taxing areas. The aforementioned BRE review, as well as our own review (both mentioned in Finding 1), disclosed errors in the assignment of taxing areas in Montgomery County for some of the same areas for which outdated address information existed.
- RAD lacked procedures to ensure that subdivision codes that were currently recorded in SMART, based on prior year returns, were accurate. As previously stated, returns that were received with the same address as the prior year were generally assigned by SMART to the same taxing area as the prior year. Without a procedure to periodically verify existing subdivision codes, any incorrect codes, such as codes for which the initial assignment was incorrect, would be allowed to continue for these taxpayers who submit returns with the same address in subsequent years.
- Current tax forms do not facilitate identification of a taxpayer's correct taxing area, which should correspond to the taxpayer's address on the last day of the tax year. For example, *Maryland Form 502 (Resident Income Tax Return)* requires the taxpayer to record his or her current mailing address (at the time of filing the return), and the county and the special taxing area, if any, in which the taxpayer resided on the last day of the year. However, the taxpayer is not required to provide his or her address as of the last day of the tax year, if different. Without knowing the taxpayer's address as of the last day of the tax year, RAD cannot verify the taxing area reported by the taxpayer. RAD

advised us that it is considering modifying future tax forms to require the taxpayer's full address as of the last day of the tax year.

## **Recommendation 2**

### **We recommend that RAD**

- a. establish comprehensive written policies and procedures for employees to follow when identifying special taxing areas and assigning subdivision codes for suspended returns,**
- b. ensure that current and complete address data are obtained on a routine basis from all special taxing areas,**
- c. take the necessary steps to ensure that correct subdivision codes have been assigned to all addresses recorded in SMART, and**
- d. consider revising tax forms so that taxpayers are required to submit sufficient address information to facilitate the proper assignment of taxing area subdivision codes.**

## **Out-of-State Tax Credits**

### **Finding 3**

**Required documentation was not always on file to support out-of-state tax credits claimed on paper tax returns filed by individual taxpayers.**

### **Analysis**

Required documentation was not always on file to support out-of-state tax credits claimed on paper tax returns filed by individual taxpayers. We examined 20 tax returns submitted in paper format for tax year 2013 that claimed out-of-state tax credits of approximately \$35.0 million. Our test included the 9 largest out-of-state tax credits claimed on paper returns that year. We noted 6 returns for which credits totaling \$27.2 million were allowed, even though required supporting documentation for these credits was not on file. A similar condition was commented upon in our preceding audit report.

Generally, Maryland residents must report income earned in another State on their Maryland income tax return, but are entitled to a credit against their Maryland tax liability for taxes paid to these other states. Individual taxpayers who submit a Maryland paper income tax return claiming an out-of-state tax credit are required by RAD to submit supporting documentation (for example, a copy of the tax return filed with the other state) with their return. RAD's procedures stipulate that credits be disallowed if the required documentation is not received. According to RAD's records, out-of-state tax credits totaling \$111.9 million were



claimed by taxpayers on approximately 14,300 paper tax returns for tax year 2013.

### **Recommendation 3**

**We recommend that RAD**

- a. ensure that all required documentation is submitted and retained to support out-of-state tax credits claimed (repeat);**
- b. take appropriate action, such as disallowing the claimed credit when the required documentation is not submitted (repeat); and**
- c. investigate the aforementioned six returns and recover any amounts due (repeat).**

## **Adjustments to Taxpayer Accounts**

### **Finding 4**

**Significant financial adjustments to corporate taxpayer accounts were not always independently reviewed, as required, and procedures did not provide assurance that all adjustments were identified for possible review.**

### **Analysis**

Significant financial adjustments to corporate taxpayer accounts processed by one RAD unit were not always reviewed by supervisory personnel in accordance with RAD's procedures. Such adjustments may, for example, reduce a corporation's tax liability in SMART due to information from an amended return. Our test of 10 financial adjustments processed by the unit during our audit period, which reduced taxpayer liabilities by \$157.2 million, disclosed that there was no documented supervisory review for 3 of these adjustments which totaled \$23.4 million. Furthermore, the unit did not use automated reports of adjustments processed to identify adjustments for review. Rather, the unit used documentation prepared by employees who processed the adjustments. Consequently, there was no assurance that all adjustments processed by the unit were identified for review. Similar conditions were commented upon in our preceding audit report.

RAD's written procedures for the unit require supervisory review of all significant adjustments. Additionally, the procedures require that automated reports of adjustments processed are to be used to identify adjustments for review. RAD advised us that problems relating to use of the automated reports have been corrected, and that since October 2015 the reports have been used for reviewing and approving adjustments. According to RAD's records, during the period from July 2012 through June 2015, this unit processed adjustments that reduced corporate tax liabilities by \$696.5 million.

#### **Recommendation 4**

##### **We recommend that RAD**

- a. ensure that significant financial adjustments to corporate taxpayer accounts are reviewed by supervisory personnel in accordance with its procedures, and that these reviews are documented (repeat); and**
- b. use automated reports of adjustments processed to identify adjustments for review (repeat).**

#### **Finding 5**

**Controls were not in place to ensure adjustments to critical taxpayer account information were properly reviewed, and supporting documentation was not always on file.**

#### **Analysis**

Adequate controls were not in place over adjustments to critical taxpayer account information on SMART, such as a change to a taxpayer's address or identification number, and RAD did not always retain documentation to support these adjustments. According to RAD's records, approximately 40,000 nonfinancial adjustments to taxpayer account information were recorded on SMART during fiscal year 2015.

Our review of procedures and controls in place at the three RAD units responsible for processing approximately 34,000 of these adjustments disclosed that none of the units had adequate procedures in place to ensure the propriety of the adjustments. Supervisory personnel responsible for reviewing adjustments in two of the units used documentation prepared by the employees who processed the adjustments to identify transactions for review, rather than using available automated output reports of adjustments processed. Although output reports were generated by the third unit, certain adjustments were not subject to the supervisory review process and employees approved other adjustments without a review of source documentation.

In addition, our test of 40 adjustments (primarily address changes) processed by these three units during fiscal year 2015 disclosed that documentation was not on file to support the propriety of 10 of the adjustments, all of which were processed by the same unit.

Adequate control over taxpayer information recorded in SMART is critical to ensure that all transactions are accurately recorded and accounted for. For example, inaccurate or improper address changes in SMART could result in refund checks being diverted or inaccurate distributions of local income taxes. RAD's written procedures require use of automated reports of all adjustments to taxpayer account information for supervisory review. In addition, these procedures require that documentation supporting these adjustments be retained for audit purposes.

## **Recommendation 5**

### **We recommend that RAD**

- a. ensure that adjustments to critical taxpayer account information are reviewed by supervisory personnel for propriety by verifying output reports of adjustments processed to supporting documentation, at least on a test basis;**
- b. ensure that these reviews are documented; and**
- c. retain supporting documentation for adjustments processed.**

## **Information Systems Security and Control**

### **Background**

RAD supports processing for several key tax systems. The most significant tax systems supported include the system for the individual and corporate income taxes and the sales and use taxes (SMART), and the motor fuel tax system. RAD's centralized automated support for these systems includes processing tax remittances, tax returns, and tax refunds. The automated applications for these systems operate on the Comptroller of Maryland – Information Technology Division's (ITD) Annapolis Data Center mainframe computer, with security software used as the primary means to protect the applications and related tax data.

Additionally, the SMART system interfaces with the iFile, bFile, and Bill Pay systems. RAD operates these systems that allow individuals to file individual income tax returns (iFile), businesses to file returns for employer withholding taxes and sales and use taxes (bFile), and individuals and businesses to pay taxes (Bill Pay) over the Internet.

The iFile, bFile, and Bill Pay systems are three-tiered, consisting of a website tier, an application software tier, and the back-end database tier. The physical servers supporting these systems reside in the ITD's Annapolis Data Center computer room.

**Finding 6**

**Critical SMART, Bill Pay, and iFile database security and audit events were either not logged or not reviewed for propriety.**

**Analysis**

Critical SMART, Bill Pay, and iFile database security and audit events were either not logged or not reviewed for propriety.

- Bill Pay and iFile database security and audit events such as adding and configuring roles of system users and turning off the audit function were not logged even though the capability to perform such logging existed. A similar condition was commented upon in our preceding audit report.
- Detailed change reports supporting the items identified on a critical security system software report for the SMART database, such as changes in tax rates or tax liabilities, were not reviewed to ensure that the changes were proper. A similar condition was commented upon in our preceding audit report.
- SMART system database security reports of grants and revokes of users' privileges and the assignment of changes to a userid were not reviewed for propriety.

These conditions could result in unauthorized or inappropriate activities (affecting the integrity of the production database information) going undetected by management.

The State of Maryland *Information Security Policy* requires that information systems generate audit records to ensure accountability for security-relevant events, that the audit records be routinely reviewed by appropriate officials for suspicious activities or suspected violations, and that findings be reported for prompt resolution.

**Recommendation 6**

**We recommend that RAD implement appropriate database monitoring controls over the SMART, Bill Pay, and iFile tax systems. Specifically, we recommend that RAD**

- a. log all critical Bill Pay and iFile database security and audit events (repeat);**
- b. ensure that reviews of the propriety of the critical security system software reports for the SMART system include a review of the supporting detail change reports (repeat); and**

- c. review all significant database (including SMART, Bill Pay, and iFile) security reports for propriety on a timely basis, document these reviews and retain the reviews for future reference.

## Cash Receipts

### **Finding 7**

**RAD did not establish sufficient controls over checks for payment of income taxes which were received in the mail and remotely deposited. Additionally, several employees were assigned incompatible functions, and certain adjustments to payments recorded in SMART were not independently reviewed.**

### **Analysis**

Controls were not sufficient over checks for payment of income taxes which were received in the mail and were processed using the remote deposit system. Remote deposit is a process whereby checks are scanned and the images of the checks are sent electronically to the bank for deposit. In addition, several employees had access to collections and the ability to record adjustments in taxpayer accounts, and certain adjustments to check payment amounts recorded in taxpayer accounts in SMART were not reviewed as required. Most checks received by RAD for income tax payments are received through the mail. According to RAD's records, mail collections totaled approximately \$4 billion during fiscal year 2015 of which at least \$3.4 billion was deposited remotely.

- RAD did not reconcile its record of checks that had been remotely deposited and were subsequently destroyed with its initial record of checks received. This reconciliation is required by the Office of the State Treasurer to ensure that all checks were destroyed, reducing the possibility that the checks could be misappropriated.
- Fifteen employees with access to mail collections, of which 11 were responsible for processing the collections, also had the capability to record critical financial adjustments to taxpayer accounts in SMART, such as to reduce a tax liability. Although RAD had a process to review financial adjustments in SMART, only selected transactions were reviewed and, as previously mentioned (Finding 4), the reviews for certain transactions were not adequate. According to RAD's records, these 15 employees processed adjustments totaling approximately \$2.5 million during our audit period.

- Supervisory personnel did not consistently review certain adjustments to check payments automatically recorded in SMART, in accordance with its procedures. In a process separate from the remote deposit function, checks received in the mail for income tax payments were scanned to record the related payments in taxpayer accounts in SMART. Certain RAD employees manually adjusted the check amounts in SMART when necessary to correct the automated postings. RAD's procedures called for output reports to be generated weekly, for supervisory review purposes, of all manual adjustments that reduced a recorded payment to zero. These adjustments were deemed to be the highest risk, since they could indicate that the corresponding check had been misappropriated. However, we noted that, during the period from February 19, 2012 through June 27, 2015 (175 weeks), no reports were retained and no adjustments had been reviewed for 105 of those 175 weeks. In addition, 6 of the 70 weekly reports that were available were not signed as evidence that they were reviewed.

As a result of these conditions, receipts could be lost or misappropriated without detection. The Office of the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies* requires that agencies independently reconcile destroyed checks to the record of incoming checks. The Comptroller of Maryland's *Accounting Procedures Manual* requires the establishment of sufficient internal controls over collections, including adequate separation of cash receipt processing duties.

#### **Recommendation 7**

##### **We recommend that RAD**

- a. reconcile records of remotely deposited checks that have been destroyed with the record of checks received,**
- b. ensure that employees who have access to collections do not have the capability to record critical adjustments to taxpayer accounts in SMART,**
- c. ensure that all adjustments recorded in SMART to reduce check payments to zero are subject to the required supervisory review, and**
- d. conduct a review of adjustments to check payments recorded in SMART during the aforementioned weeks that the review was not performed.**

## Replacement Checks

### **Finding 8**

**RAD lacked documentation that checks, which were issued to replace refund checks that were returned to RAD, were reviewed as required by RAD's policy.**

### **Analysis**

RAD lacked documentation that replacement refund checks, which totaled approximately \$125 million during our audit period, were reviewed for propriety in accordance with RAD's policy. Replacement checks may be generated, for example, when an original refund check is returned by a taxpayer due to an error or death of the taxpayer.

The output reports that were used by supervisory personnel to select replacement checks for review were not complete, and the required number of checks was not reviewed for propriety. We compared the replacement checks listed on four weekly output reports generated during the period from February 2013 through May 2015 with data that we obtained separately from RAD of all replacement checks processed. We noted that three of the weekly reports did not include a total of 750 checks in the aggregate amount of \$721,044. As a result, these checks were not subject to the independent supervisory review process.

Furthermore, RAD's policy requires that one check from each page of the output reports be selected for supervisory review of supporting documentation to ensure the propriety of these payments; however, our review of 15 output reports generated during this period disclosed that, of the 13,084 replacement checks listed on 256 pages, there was documentation of an independent supervisory review for only 29 of these checks.

### **Recommendation 8**

**We recommend that RAD**

- a. ensure that output reports used to select replacement checks for review include all replacement checks generated;**
- b. ensure that replacement checks on output reports are reviewed according to its policy; and**
- c. review for propriety, at least on a test basis, the aforementioned 750 checks not included in output reports.**

## **Audit Scope, Objectives, and Methodology**

We have conducted a fiscal compliance audit of the Comptroller of Maryland – Revenue Administration Division (RAD) for the period beginning February 15, 2012 and ending June 30, 2015. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine RAD's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included the processing, evaluating, verifying, and recording of tax data as reported by taxpayers and other parties; the collection of tax receipts; and the distribution of tax refunds. We also determined the status of the findings included in our preceding audit report.

Our audit did not include certain support services (such as processing of invoices, maintenance of accounting records, and related fiscal functions) provided to RAD by the Office of the Comptroller. These support services are included within the scope of our audit of the Office of the Comptroller. In addition, our audit did not include certain support services provided to RAD by the Comptroller of Maryland – Information Technology Division related to the procurement and monitoring of information technology equipment and services and the operation of the Annapolis Data Center. The operation of the Annapolis Data Center includes the development and maintenance of RAD applications and maintenance of the operating system and security software environment. These support services are included in the scope of our audits of the Information Technology Division.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of RAD's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the



tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the Comptroller's SMART system for the purpose of testing certain areas, such as tax credits and refunds. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

RAD's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings related to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect RAD's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to RAD that did not warrant inclusion in this report.

The response from the Comptroller of Maryland, on behalf of RAD, to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Comptroller of Maryland regarding the results of our review of its response.

**Exhibit 1**  
**Net Local Income Tax Under/Over Distributions**  
**Tax Years 2010 – 2014 as Determined by the Comptroller of Maryland**

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>Total</u>
<b><u>Subdivisions with Net Under-Distributions</u></b>						
Montgomery County	\$ 1,837,583	\$ 1,853,638	\$ 1,357,034	\$ 768,339	\$ 266,827	\$ 6,083,421
Chevy Chase Section 3	(13,201)	4,728	16,909	(4,614)	63,305	67,127
Chevy Chase Section 5	(22,651)	18,832	22,313	6,153	188,848	213,495
Chevy Chase View	(6,439)	2,434	32,718	47,446	57,009	133,168
Chevy Chase Village	(55,638)	14,055	49,109	149,957	694,258	851,741
Drummond	596	(18,138)	(2,796)	21,229	33,856	34,747
Friendship Heights	9,115	(54,462)	2,145	(23,671)	82,951	16,078
Garrett Park	3,917	8,452	(2,509)	(1,792)	2,373	10,441
Martin's Additions	(283)	15,019	16,620	43,633	182,030	257,019
North Chevy Chase	2,612	12,695	19,743	18,982	12,253	66,285
Oakmont	2,557	4,402	9,513	9,282	21,203	46,957
Poolesville	(33,104)	9,679	29,845	69,783	85,016	161,219
Somerset	(39,858)	(4,728)	21,268	39,039	196,143	211,864
Takoma Park	8,572	51,407	79,905	120,740	192,686	453,310
Washington Grove	4,056	13,712	15,366	2,630	13,170	48,934
<b>Total</b>						<u>\$ 8,655,806</u>
<b><u>Subdivisions with Net Over-Distributions</u></b>						
Barnesville	\$ (4,293)	\$ (8,730)	\$ (11,768)	\$ (9,008)	\$ (8,059)	\$ (41,858)
Brookeville	(30,728)	(41,690)	(38,549)	(63,185)	(99,877)	(274,029)
Chevy Chase	(1,172,426)	(1,461,346)	(1,324,717)	(630,569)	(330,017)	(4,919,075)
Gaithersburg	(357,511)	(390,040)	(316,649)	(453,123)	(958,790)	(2,476,113)
Glen Echo	(2,967)	(12)	1,438	(7,601)	4,124	(5,018)
Kensington	22,532	12,653	18,393	(36,567)	(22,339)	(5,328)
Laytonsville	(67,305)	(67,480)	(61,698)	(77,795)	(86,063)	(360,341)
Rockville	(85,136)	24,921	66,366	10,712	(590,908)	(574,045)
<b>Total</b>						<u>(\$ 8,655,806)</u>

**Source:** Bureau of Revenue Estimates Records

**Note:** Totals may not add up due to rounding

## APPENDIX



**Peter Franchot**  
*Comptroller*

**Sharonne R. Bonardi**  
*Deputy Comptroller*

September 9, 2016

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

Dear Mr. Barnickel:

Enclosed is the Comptroller's response to the Office of Legislative Audits' ("OLA") report on the Revenue Administration Division ("RAD") for the period beginning February 15, 2012 and ending June 30, 2015. The Comptroller appreciates the opportunity to comment on the analyses, findings, and recommendations by OLA.

The Comptroller continues to be proud of the level of work and service that RAD provides for the taxpayers of Maryland. RAD remains committed to providing first-class taxpayer service, ensuring the integrity and security of sensitive taxpayer data in our custody, and protecting Marylanders from tax fraud and identity theft.

To date, RAD has processed more than 3 million tax returns and disbursed more than 2 million refunds totaling \$2.4 billion in an average of 2.1 business days. Additionally, RAD has worked ahead of schedule in processing the thousands of highly technical and complex tax returns resulting from the Supreme Court decision in the *Comptroller of the Treasury of Maryland v. Wynne* case. In Fiscal Year 2016, RAD's dedicated taxpayer services personnel answered more than 47,000 emails, more than 534,000 phone calls, and assisted more than 120,000 taxpayers at our 12 regional branch offices.

We continue to employ innovative and advanced technology to ensure that our office remains on the forefront in data security and tax fraud prevention. The agency's security systems and protocols have proven to be effective safeguards against external threats to our databases and network. The prevention of security breaches in our databases is a top priority for the Comptroller, and the agency is dedicated to utilizing all available resources towards this critically important effort.

*Mr. Thomas J. Barnickel III, page 2*  
*September 9, 2016*

Thanks to the diligent work of our Questionable Returns Detection Team, we've detected and blocked more than 11,600 fraudulent returns worth nearly \$20 million in 2016 alone – on top of the 64,859 fraudulent returns that the Comptroller's Office has blocked and detected since 2007. Our continued efforts to prevent tax fraud and identity theft have been nationally recognized for its accuracy and effectiveness, and our agency will continue to take appropriate measures to aggressively protect Marylanders from being victimized by financial criminals.

Respect, responsiveness, and results are the core pillars that guide the work of the Comptroller's 1,100 employees every day. In that spirit, the Comptroller welcomes any opportunities for growth and improvement that will make our agency more effective and efficient in executing its statutory responsibilities.

The Comptroller appreciates your objective appraisal of RAD's operations and the detailed analyses, findings, and recommendations included within the report. Additionally, we commend your auditors for their professionalism and thorough review. Should you have any further questions, please do not hesitate to contact us.

Sincerely,

A handwritten signature in black ink, appearing to read "S. Bonardi".

Sharonne R. Bonardi, J.D., M.B.A.  
Deputy Comptroller

A handwritten signature in black ink, appearing to read "Wayne P. Green".

Wayne P. Green, C.P.A.  
Director, Revenue Administration Division

**COMPTROLLER OF MARYLAND  
REVENUE ADMINISTRATION DIVISION  
RESPONSES TO OLA FINDINGS AND RECOMMENDATIONS**

## **Local Income Tax Revenue Distribution**

### **RAD Response to OLA Analysis**

After internal reviews by RAD management revealed inconsistencies in the distribution of tax revenue to Montgomery County municipalities, the Comptroller took swift action to address this matter to provide proper recourse for jurisdictions affected and to prevent such errors from recurring in the future. The Comptroller took immediate steps to ensure that municipalities that did not receive the accurate revenue distribution were credited and worked closely with municipal leaders and other stakeholders to develop a remittance plan and timeline that is satisfactory to the jurisdictions that received more funds than they were owed.

The internal reviews and subsequent audit by an independent, third-party auditor found that RAD's distribution model contained coding errors and process opportunities that resulted in the misallocation of revenue to several Montgomery County jurisdictions. It should be noted that this distribution model was in place for many years, long before the incumbent Comptroller took office. However, the Comptroller is committed to ensuring that these incidents are prevented in the future and welcomes the opportunity to adopt a series of changes that would ensure greater accuracy moving forward.

The Comptroller will also conduct an internal statewide audit to ensure that all municipalities' and counties' accounts are properly accounted for and are accurately reconciled. This proactive action by the Comptroller seeks to confirm that the modifications to the distribution process will significantly improve the accuracy in which RAD distributes the local income tax revenue to the various taxing jurisdictions throughout the state.

The distribution of local income tax funds is a very complex component of tax administration that relies very heavily on information provided by the taxpayer and cooperation from local government entities. Prior to the OLA audit, and as stated in the analysis, RAD had identified several contributing factors for the coding errors.

To address this issue, RAD contracted with an independent auditor to examine the review process with the goal of confirming the root cause of the errors and assess the overall effect and impact these coding errors had on the business process. The initial analysis by the Bureau of Revenue Estimates (BRE) represented approximately 3.6% of the tax returns filed. Accordingly, the distributions were initially determined to be 96.4% accurate. RAD modified its processes and improved its accuracy, per the independent auditor's findings, to a rate of 99.7%.

We do acknowledge that during the start of the OLA audit, the actual underlying causes of the misallocation error were not yet determined; however, RAD management had identified potential inconsistencies and began its review before the commencement of the audit. RAD has completed its review and determined the reasons the coding errors occurred, has developed appropriate process enhancements to increase the accuracy of future local income tax distributions, and has reconciled the previous distributions. RAD provided information to the OLA auditors on the timely actions that the Comptroller took to immediately address this issue.

Furthermore, it is worth noting that the OLA analysis included inconsistent data that could be misinterpreted and requires further clarification. For example, OLA indicates that \$8.7 million was incorrectly distributed for five tax years: 2010 through 2014; however, OLA only noted the total distributions for fiscal year 2014: \$39.4 million to the special taxing areas and \$1.3 billion to Montgomery County. For tax years 2010 through 2014, more than \$6 billion was distributed. The reallocation represented less than 0.2% of the total distribution during this period.

### ***OLA Recommendation 1***

**We recommend that RAD, in conjunction with the Comptroller's Office,**

- a. Analyze the reasons the coding errors occurred, and implement process changes and correct tax data errors as needed to address the reasons identified;**
- b. Determine whether such coding problems could be affecting distributions in other jurisdictions and, if so, expand the review of subdivision codes and special taxing areas to all relevant jurisdictions and take appropriate action with respect to any local income taxes that were incorrectly distributed; and**
- c. Manually review the aforementioned 1,393 returns to ensure that special taxing areas are properly assigned and local income taxes are correctly distributed for these returns.**

### **RAD Responses to the Recommendations**

**Recommendation A: Analyze the reasons the coding errors occurred, and implement process changes and correct tax data errors as needed to address the reasons identified.**

RAD concurs with the recommendation.

RAD has analyzed and determined the reasons the coding errors occurred. As a result of this analysis, RAD has developed appropriate process enhancements to increase the accuracy of future local income tax distributions. It should be noted that the recommended actions have either already been completed or are ongoing. Since the reallocation errors were discovered, the Comptroller and RAD management have taken proactive and immediate steps to address this matter. These improved processes and procedures will be implemented by January 2017 and audited on an annual basis.

**Recommendation B: Determine whether such coding problems could be affecting distributions in other jurisdictions and, if so, expand the review of subdivision codes and special taxing areas to all relevant jurisdictions and take appropriate action with respect to any local income taxes that were incorrectly distributed.**

RAD concurs with the recommendation.

As previously stated, the Comptroller will conduct a statewide audit to determine if coding errors have resulted in reallocation errors in other jurisdictions. Additionally, in conjunction with the BRE, RAD will continue to analyze the accuracy of the coding process with the purpose of distributing the local income to its respective taxing jurisdictions with a high rate of accuracy. If it is determined that coding errors have affected distributions in other jurisdictions, the agency will determine the appropriate action to take to address the distribution accordingly.

**Recommendation C: Manually review the aforementioned 1,393 returns to ensure that special taxing areas are properly assigned and local income taxes are correctly distributed for these returns**

Respectfully, RAD concurs with the recommendation with minor modification.

As stated previously, reasons for the coding errors were identified, corrections were made to the returns processing work flow, and additional process improvements have been documented to minimize the risk of making coding errors in the future. RAD believes that the implementation of this recommendation should not occur until RAD has completed the following OLA recommendations: analyze the reasons the coding errors occurred; determine whether such coding problems could be affecting distributions in other jurisdictions; ensure that current and complete address data are obtained on a routine basis from all special taxing areas; and consider revising tax forms so that taxpayers are required to submit sufficient address information to facilitate the proper assignment of taxing area subdivision codes.

Since the independent review determined that the revised process was 99.7% accurate for the addresses that met the postal standardization requirements, RAD believes the initial use of resources is better allocated to increase the accuracy of future local income tax distributions and identifying potential fraudulent tax return activity.

## ***OLA Recommendation 2***

**We recommend that RAD**

- a. Establish comprehensive written policies and procedures for employees to follow when identifying special taxing areas and assigning subdivision codes for suspended returns,**
- b. Ensure that current and complete address data are obtained on a routine basis from all special taxing areas,**
- c. Take the necessary steps to ensure that correct subdivision codes have been assigned to all addresses in SMART, and**
- d. Consider revising tax forms so that taxpayers are required to submit sufficient address information to facilitate the proper assignment of taxing area subdivision codes.**

### **RAD Responses to the Recommendations**

**Recommendation A: Establish comprehensive written policies and procedures for employees to follow when identifying special taxing areas and assigning subdivision codes for suspended returns.**

RAD concurs with the recommendation.

RAD has updated its procedures to address the exceptions to the local income tax business rules. Additional training has been provided to applicable staff. These actions will assist in increasing the accuracy rate in the future.

**Recommendation B: Ensure that current and complete address data are obtained on a routine basis from all special taxing areas.**

RAD concurs with this recommendation.

RAD concurs with OLA and understands the need for the taxing jurisdictions to assist the Comptroller of Maryland (“COM”) with executing a viable solution to this complicated issue by requiring that the taxing jurisdictions provide current data on a consistent basis. RAD has and will continue to request yearly updated address information for each taxing jurisdiction in the state.

It is important to note that RAD has no recourse to compel local governments to comply with the request, and many of them fail to do so. Until they are compelled to provide this information each year in a timely fashion, the probability of error may increase.



**Recommendation C: Take the necessary steps to ensure that correct subdivision codes have been assigned to all addresses in SMART.**

RAD concurs with this recommendation.

The agency is committed to taking all necessary steps to prevent this error from occurring in the future. We have either implemented or are in the process of implementing a series of changes resulting from our internal review and a third-party independent audit. Efforts to update and correct coding errors are in progress, and we look forward to strong cooperation from local government entities to ensure that COM has the most up-to-date addresses for taxpayers.

As previously stated in our response to Recommendation B, RAD heavily relies on addresses provided by the taxpayer and makes concerted efforts to obtain updated address records from local government entities to keep our databases accurate. However, RAD and COM do not have legal authority to compel government entities to produce these records, which may increase the probability of error in the future.

**Recommendation D: Consider revising tax forms so that taxpayers are required to submit sufficient address information to facilitate the proper assignment of taxing area subdivision codes**

RAD concurs with this recommendation.

As noted by OLA, RAD is already in the process of implementing this recommended action and the agency will be revising the tax forms to include the address where the taxpayer resided as of the last day of the tax year. This will provide additional information to assist in the proper jurisdictional coding. RAD anticipates this data will be collected beginning with tax year 2016.

## **Out-of-State Tax Credits**

### **RAD Response to OLA Analysis**

RAD wishes to note that in OLA's comprehensive review on this issue, there was no evidence of loss of revenue to the state attributable to this finding.

### ***OLA Recommendation 3***

**We recommend that RAD**

- a. Ensure that all required documentation is submitted and retained to support out-of-state tax credits claimed (repeat);**
- b. Take appropriate action, such as disallowing the claimed credit when the required documentation is not submitted (repeat); and**
- c. Investigate the aforementioned six returns and recover any amounts due (repeat).**

### **RAD Responses to the Recommendations**

**Recommendation A: Ensure that all required documentation is submitted and retained to support out-of-state tax credits claimed (repeat).**

RAD concurs with this recommendation.

This recommendation is consistent with existing procedure within RAD. We will reinforce the use of this procedure and provide additional training to appropriate staff as needed. RAD will also ensure that necessary documents are retained for subsequent verification.

**Recommendation B: Take appropriate action, such as disallowing the claimed credit when the required documentation is not submitted (repeat).**

RAD concurs with this recommendation.

In accordance with existing RAD policy, out of state credits claimed are disallowed when required documentation is not submitted. RAD will review the specific returns noted by OLA for appropriate action as necessary.

**Recommendation C: Investigate the aforementioned six returns and recover any amounts due (repeat).**

RAD concurs with this recommendation.

The agency has initiated the review of the out-of-state credits claimed for the six returns mentioned above and will take the appropriate action to recover any credits claimed that are disallowed as a result of the subsequent review. The anticipated completion date for the review and implementation of Recommendation 3 is December 31, 2016.

## **Adjustments to Taxpayer Accounts**

### **RAD Response to OLA Analysis**

In response to OLA's analysis on this finding, RAD wishes to emphasize that there was no evidence or indication of impropriety pertaining to this finding. All adjustments reviewed by OLA were determined to be proper, and there was no loss of revenue to the state. RAD had already identified this internal weakness in 2015 and initiated corrective action. Since October 2015, the automated reports of adjustments were utilized for reviewing and approving respective adjustments. The supervisor uses the adjustment report to identify those adjustments requiring review and/or approval based upon the written procedures.

### ***OLA Recommendation 4***

**We recommend that RAD**

- a. Ensure that significant financial adjustments to corporate taxpayer accounts are reviewed by supervisory personnel in accordance with its procedures, and that these reviews are documented (repeat); and**
- b. Use automated reports of adjustments processed to identify adjustments for review (repeat).**

### **RAD Responses to the Recommendations**

**Recommendation A: Ensure that significant financial adjustments to corporate taxpayer accounts are reviewed by supervisory personnel in accordance with its procedures, and that these reviews are documented (repeat).**

RAD concurs with the recommendation.

The recommended action is already part of RAD's existing procedures, and RAD will continue to ensure that significant financial adjustments are reviewed and documented by supervisory personnel.

**Recommendation B: Use automated reports of adjustments processed to identify adjustments for review (repeat).**

RAD concurs with the recommendation.

As previously stated, this recommended action is already in place and RAD will continue to utilize the automated reports of adjustments processed to identify and select adjustments for review.

## ***OLA Recommendation 5***

**We recommend that RAD**

- a. Ensure that adjustments to critical taxpayer account information are reviewed by supervisory personnel for propriety by verifying output reports of adjustments processed to supporting documentation, at least on a test basis;**
- b. Ensure that these reviews are documented; and**
- c. Retain supporting documentation for adjustments processed.**

### **RAD Responses to the Recommendations**

**Recommendation A: Ensure that adjustments to critical taxpayer account information are reviewed by supervisory personnel for propriety by verifying output reports of adjustments processed to supporting documentation, at least on a test basis**

RAD concurs with the recommendation.

The recommended action is an existing procedure within RAD. Critical non-financial adjustments will continue to be reviewed by supervisory personnel utilizing automated reports of applicable adjustments in accordance with current RAD procedures.

**Recommendation B: Ensure that these reviews are documented.**

RAD concurs with this recommendation.

The recommended action is an existing procedure within RAD, and division management will continue to ensure that supervisory reviews are documented.

**Recommendation C: Retain supporting documentation for adjustments processed.**

RAD concurs with this recommendation.

Supporting documentation for non-financial adjustments will be retained for audit purposes. Due to the volume of account adjustments, RAD will identify the appropriate content management solution to satisfy the document retention requirements established by OLA in this finding.

# Information Systems Security and Control

## **RAD Response to OLA Analysis**

The Comptroller takes pride in the agency's strong commitment to ensuring that its databases and networks are secure, which was reinforced by the fact that OLA found no security breaches within the agency's IT system. Our IT division continues to prioritize the modernization of our network of firewalls, security appliances, intrusion detection and prevention programs, and Internet access control procedures. Protecting taxpayer data and combatting taxpayer identity fraud are two major goals for the agency. As such, the agency is committed to ensuring that its IT systems are compliant with all federal and state requirements and continues to audit and manage risks associated with threats to its core systems and processes.

### ***OLA Recommendation 6***

**We recommend that RAD implement appropriate database monitoring controls over the SMART, Bill Pay, and iFile tax systems. Specifically, we recommend that RAD**

- a. Log all critical Bill Pay and iFile database security and audit events (repeat);**
- b. Ensure that reviews of the propriety of the critical security system software reports for the SMART system include a review of the supporting detail change reports (repeat);**
- c. Review all significant database (including SMART, Bill Pay, and iFile) security reports for propriety on a timely basis, document these reviews and retain the reviews for future reference.**

## **RAD Responses to the Recommendations**

**Recommendation A: Log all critical Bill Pay and iFile database security and audit events (repeat).**

RAD concurs with this recommendation.

As part of our continued commitment to protecting our networks and security systems, the Comptroller's database security and audit event logging systems will be enhanced to ensure all critical events will be properly logged.

**Recommendation B: Ensure that reviews of the propriety of the critical security system software reports for the SMART system include a review of the supporting detail change reports (repeat).**

RAD concurs with this recommendation.

Reviews of the propriety of critical security system software reports will include a review of supporting detail change reports.

**Recommendation C: Review all significant database (including SMART, Bill Pay, and iFile) security reports for propriety on a timely basis, document these reviews and retain the reviews for future reference.**

RAD concurs with this recommendation.

All significant database security reports will be reviewed for propriety in a timely manner and documentation of these reviews will be retained for audit purposes. The anticipated completion date for implementation of the recommendation is December 31, 2016.

## Cash Receipts

### **RAD Response to OLA Analysis**

RAD wishes to note that in OLA's comprehensive review on this issue, there was no evidence of impropriety or loss of revenue associated with this finding.

#### ***OLA Recommendation 7***

**We recommend that RAD**

- a. Reconcile records of remotely deposited checks that have been destroyed with the record of checks received,**
- b. Ensure that employees who have access to collections do not have the capability to record critical adjustments to taxpayer accounts in SMART,**
- c. Ensure that all adjustments recorded in SMART to reduce check payments to zero are subject to the required supervisory review, and**
- d. Conduct a review of adjustments to check payments recorded in SMART during the aforementioned weeks that the review was not performed.**

### **RAD Responses to the Recommendations**

**Recommendation A: Reconcile records of remotely deposited checks that have been destroyed with the record of checks received.**

RAD concurs with this recommendation.

The agency will ensure that destroyed checks are reconciled with the scanning batch reports.

**Recommendation B: Ensure that employees who have access to collections do not have the capability to record critical adjustments to taxpayer accounts in SMART.**

RAD concurs with this recommendation.

In concurrence with this recommendation, RAD will limit access where practical. It must be noted that in order to process tax forms, certain employees may have access to collections, as well as the ability to post critical adjustments to taxpayer accounts. However, these employees do not have access to taxpayer addresses. Therefore, they do not have the ability to alter the delivery of a refund check.

In addition, RAD policy requires supervisory review of financial adjustments recorded in SMART which therefore limits the exposure to potential misappropriation and corresponding adjustment to a taxpayer's account. Accordingly, we believe that there is adequate control.

In order to strengthen our processing and adherence to this recommendation, RAD will limit the access of certain employees to actual collections. A payment voucher form is being designed so that upon mail opening, the payment will be routed for immediate deposit while the tax form will be processed via the current process. This will further limit access to ensure proper segregation of duties.

**Recommendation C: Ensure that all adjustments recorded in SMART to reduce check payments to zero are subject to the required supervisory review.**

RAD concurs with this recommendation.

RAD believes the agency is already in compliance with the recommendation. Additional information that supports our position appears below.

Annually, the Payment Processing (PP) section adjusts less than 100 checks (of a total of approximately 1.3 million checks received) to a zero dollar status; we consider this immaterial and a true and proper exception to the normal processing. OLA noted only 39 such adjustments during the major filing season, and these exceptions are generally a result of the foreign checks, damaged checks, or improper formatting or sizing of checks.

The Returns Processing (RP) section receives the zero dollar report identifying the checks to be removed (not to use to reconcile or otherwise balance to) for manual deposit. Additionally, all zero dollar adjustment checks remain in the automated TRIP21 check queue until such time as the zero dollar adjustment has been manually deposited. A supervisor reviews the applicable queue. Procedures will be implemented to ensure the propriety of these transactions utilizing the respective weekly output report which will be retained as documentation of review.

**Recommendation D: Conduct a review of adjustments to check payments recorded in SMART during the aforementioned weeks that the review was not performed.**

RAD concurs with this recommendation.

While we concur with the recommended action, RAD will comply by using alternative procedures. As noted by OLA, RAD was unable to recreate certain applicable SMART reports dated prior to August 2014; however, all reports from August 17, 2014 through June 27, 2015 were available for review. As described in the comment for recommendation, RAD also utilizes reports to review these adjustments. A review of the applicable adjustments during the period for which the SMART reports were not available will be completed by December 31, 2016.



## **Replacement Checks**

### **RAD Response to OLA Analysis**

RAD wishes to note that in OLA's comprehensive review on this issue, there was no evidence of impropriety or loss of revenue associated with this finding.

### ***OLA Recommendation 8***

**We recommend that RAD**

- a. Ensure that output reports used to select replacement checks for review include all replacement checks generated;**
- b. Ensure that replacement checks on output reports are reviewed according to its policy; and**
- c. Review for propriety, at least on a test basis, the aforementioned 750 checks not included in output reports.**

### **RAD Responses to the Recommendations**

**Recommendation A: Ensure that output reports used to select replacement checks for review include all replacement checks generated.**

RAD concurs with this recommendation.

RAD will ensure that the output reports are complete. RAD, in consultation with the Comptroller's Information Technology Division, is identifying the root cause of the incompleteness of the replacement check output reports noted by OLA.

**Recommendation B: Ensure that replacement checks on output reports are reviewed according to its policy.**

RAD concurs with this recommendation.

As OLA noted, a supervisory review was performed to ensure the propriety of replacement checks; however, documentation of the review was not indicated on the respective automated report. RAD will ensure the written policy regarding replacement checks is adhered to utilizing the aforementioned report.

**Recommendation C: Review for propriety, at least on a test basis, the aforementioned 750 checks not included in output reports.**

RAD concurs with this recommendation. RAD will review those checks noted for propriety. The anticipated completion date of the review will be December 31, 2016.

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