

Audit Report

**Comptroller of Maryland
Revenue Administration Division**

April 2010



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

April 5, 2010

Bruce A. Myers, CPA
Legislative Auditor

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Comptroller of Maryland – Revenue Administration Division (RAD) for the period beginning February 1, 2006 and ending March 1, 2009. 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 needs to improve its procedures for verifying certain critical tax data reported and claimed by taxpayers on their individual income tax returns. We found certain irregularities on tax returns that RAD did not detect. For example, we noted several taxpayers who reported invalid social security numbers for dependents, calling into question the validity of those dependents and any related tax benefits. In addition, our testing disclosed taxpayers who claimed the earned income credits on their State tax returns, even though they were not eligible to do so, since they had not claimed the earned income credits on their corresponding federal tax returns. We also found that certain procedures in place for verifying significant tax refunds were not being uniformly applied.

RAD also did not take the necessary steps to ensure that lottery winnings statements were received from the Maryland State Lottery Agency and processed in a timely manner. These statements are necessary to identify taxpayers who failed to report lottery winnings on their tax returns. Finally, we noted certain deficiencies in controls over the disposition of dishonored payments and undeliverable refund checks, and information system security. For example, access controls and monitoring of security-related events were not sufficient over RAD's web-based system for online income tax payments.

An Executive Summary of our findings can be found on page 5. 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 our audit by RAD.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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Executive Summary

Legislative Audit Report on the Comptroller of Maryland Revenue Administration Division (RAD) April 2010

- **Although RAD had implemented certain procedures to ensure the validity of social security numbers reported by taxpayers for dependents, these procedures were not comprehensive. Using other available means, we identified several instances of invalid numbers reported for dependents, calling into question the validity of those dependents for tax reporting purposes and any tax benefits derived.**

RAD should improve its procedures for ensuring that dependent social security numbers reported by taxpayers on their income tax returns are valid.

- **Sufficient procedures were not in place to ensure that taxpayers who claimed the earned income credit on their State income tax returns also claimed the credit on their corresponding federal returns—a requirement for receiving the State credit. Earned income tax credits claimed on State tax returns totaled approximately \$209 million for tax year 2007.**

Procedures should be established to ensure that taxpayers who claim the earned income credit on their State returns have also claimed the credit on their corresponding federal returns.

- **Certain procedures implemented by RAD to help ensure the validity of significant tax refunds (refunds exceeding a specified amount) were not uniformly applied. Specifically, tax overpayments that were applied to a subsequent year's tax liability, rather than refunded to the taxpayer, were not subject to these procedures. During fiscal year 2008, overpayments which exceeded the established threshold, and which were applied to a subsequent year, totaled approximately \$178 million.**

RAD should automatically review significant tax overpayments to be applied to a subsequent year.

- **RAD did not take the necessary steps to ensure that annual lottery winnings statements due from the State Lottery Agency were received within the time frame required by law, and were processed timely when received. In one instance, the statement was processed more than two years after it was due. These statements are necessary to identify taxpayers who fail to report winnings on their tax returns. Lottery winnings reported to RAD for tax year 2008 totaled approximately \$178 million.**

RAD should contact the State Lottery Agency when the statements of lottery winnings are not received within the required time frame, and should process the statements in a timely manner when received.

- **Procedures and controls established to ensure that taxpayer liabilities for dishonored payments were reestablished on the automated tax system, and for verifying the proper disposition of refund checks received as undelivered from the post office, need to be improved. In fiscal year 2008, dishonored payments and undeliverable checks totaled approximately \$32.6 million and \$19.7 million, respectively.**

RAD should take the recommended actions to improve procedures and controls over dishonored payments and undeliverable refund checks.

- **A number of deficiencies were noted with respect to RAD's information system security and control. For example, access controls and monitoring of security-related events were not sufficient over certain computer files and RAD's web-based system for online income tax payments.**

RAD should take the recommended actions to improve its information system security and control.

Background Information

Agency Responsibilities

The Revenue Administration Division's (RAD's) 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. In December 2008, the Board of Public Works approved a multi-year contract for the development and implementation of a new tax system (Modernized Integrated Tax System) to eventually replace the SMART system. RAD has advised that implementation has begun, and will continue through fiscal year 2013.

RAD is responsible for collecting and processing several types of taxes, surcharges, and fees, the most significant of which are income taxes and sales and use taxes. According to RAD's records, its income tax and sales tax collections and related distributions for fiscal years 2006 through 2009 were as follows:

Table 1				
Tax Collections and Distributions Fiscal Years 2006 - 2009				
	Fiscal Year			
	2006	2007	2008	2009
	(dollars stated in millions)			
Gross income taxes collected	\$13,108	\$13,964	\$14,650	\$13,836
Less:				
Refunds	2,026	2,209	2,491	2,735
Administrative expenses	13	11	12	13
Total refunds and expenses	2,039	2,220	2,503	2,748
Balance available for distribution	\$11,069	\$11,744	\$12,147	\$11,088
Distribution of remaining balance:				
To State's General Fund	\$6,836	\$7,279	\$7,492	\$7,027
To local subdivisions	4,028	4,271	4,470	3,861
To other Funds as provided by State Law (such as Transportation Trust Fund)	205	194	185	200
Total distributions	\$11,069	\$11,744	\$12,147	\$11,088
Gross sales and use tax collections which are primarily credited to the State's General Fund	\$3,393	\$3,456	\$3,759	\$3,874

Organizational Change

Effective July 1, 2009, certain duties and responsibilities within the Comptroller of Maryland were reorganized. Specifically, the Motor-fuel, Alcohol and Tobacco Tax (MATT) Division discontinued functioning as a separate division and became a unit under the Revenue Administration Division. MATT administers laws and regulations pertaining to the manufacturing, storage, transportation, sale, and distribution of alcoholic beverages, tobacco, and motor fuel, and collects the related excise taxes. According to the records of the Comptroller of Maryland, during fiscal year 2009, motor fuel, alcohol, and tobacco tax revenue totaled approximately \$758 million, \$29 million, and \$405 million respectively. The activities of MATT through June 30, 2009 will be included in a separate audit report to be issued this Spring. In the future, MATT will be subject to audit during the audit of the Revenue Administration Division.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the 14 findings contained in our preceding audit report dated December 15, 2006. We determined that RAD satisfactorily addressed 12 of these findings. The remaining 2 findings are repeated in this report.

Findings and Recommendations

Invalid Dependent Social Security Numbers

Finding 1

The Revenue Administration Division's (RAD) procedures for ensuring the validity of social security numbers reported by taxpayers for dependents on certain individual income tax returns were not comprehensive.

Analysis

RAD's procedures for ensuring that taxpayers report valid social security numbers for their dependents need to be improved. Currently, steps are taken to ensure that dependent social security numbers reported on certain individual income tax returns filed do not duplicate other numbers already recorded in the Comptroller of Maryland's automated State of Maryland Tax (SMART) system. However, this action is not performed for certain returns, representing about half of the returns filed, for which dependent social security numbers are not routinely captured in the SMART system. Additionally, other steps available for identifying potential discrepancies—such as comparing dependent numbers to available records of deceased individuals and records of social security numbers issued by the federal government—were not routinely used for any returns filed.

Using the aforementioned available records, we evaluated social security numbers reported for dependents on 45 individual income tax returns, and noted 17 dependents on 8 returns for which the reported social security number was invalid (12 dependents) or for which no number was reported (5 dependents). Although these 45 returns were selected from a population of tax returns which were more likely to include invalid numbers (such as returns in which an unusually high number of dependents was claimed), the results demonstrate that a more comprehensive review of dependent social security numbers may be beneficial. An invalid number calls into question the validity of the reported dependent, as well as any tax benefit derived from reporting the dependent, such as from a claimed exemption. RAD reviewed each of the apparent discrepancies we noted, and advised us that, as a result of its review, six of the taxpayers were billed approximately \$5,000 while the remaining two tax returns did not result in any additional tax liability.

Recommendation 1

We recommend that RAD take steps to improve procedures to ensure that dependent social security numbers reported by taxpayers on their individual income tax returns are valid.

Earned Income Tax Credit

Finding 2

Sufficient procedures were not in place to ensure that taxpayers who claimed the earned income tax credit were eligible to receive it.

Analysis

RAD did not have sufficient procedures to ensure that taxpayers claiming the earned income tax credit on their individual income tax returns were eligible to receive the credit. The earned income tax credit is available to certain individuals who work, but have earned income below a specified level. State law stipulates that a taxpayer is eligible to receive the credit on his or her State return only if the taxpayer was eligible to receive the federal earned income tax credit, and the credit was claimed on the taxpayer's federal tax return.

However, our test of 50 tax year 2007 returns, with earned income tax credits totaling approximately \$202,000, disclosed 7 returns with credits totaling \$28,000 for which the taxpayers did not claim a corresponding federal earned income tax credit for the year. In these instances, the taxpayer either did not claim a credit on his or her federal return, or did not file a federal return for the year, according to federal records obtained by RAD at our request. RAD advised that, as a result of our inquiries, the returns in question were investigated and billings totaling \$7,250 were sent to the applicable taxpayers for disallowed credits. According to RAD's records, taxpayers collectively claimed earned income tax credits on their State tax returns totaling approximately \$209 million for tax year 2007.

A similar condition was commented upon in our preceding audit report.

Recommendation 2

We recommend that RAD establish sufficient procedures to ensure that taxpayers claiming earned income tax credits on their State tax returns are eligible to receive the credits by verifying, at least on a test basis, that taxpayers who claim the credit also claimed the credit for federal tax purposes (repeat).

Review of Significant Tax Refunds

Finding 3

Certain procedures implemented by RAD to ensure the validity of significant tax refunds were not uniformly applied.

Analysis

RAD did not uniformly apply certain review procedures designed to ensure the validity of significant tax refunds. Specifically, individual income tax returns that claimed refunds exceeding a specified dollar amount were automatically suspended from processing, for manual review and evaluation, prior to payment of any refund. However, this control was not extended to tax returns for which the taxpayer applied the tax overpayment to his or her subsequent year's estimated tax liability rather than request a cash refund. According to RAD's records, during fiscal year 2008, overpayments which exceeded the specified threshold and which were applied by taxpayers to a subsequent year totaled approximately \$178 million. Although no cash payment is made when overpayments are applied in this manner, the taxpayer still receives the corresponding benefit as a reduction in the next year's tax liability.

Recommendation 3

We recommend that significant tax overpayments applied by taxpayers to a subsequent year be automatically reviewed for propriety prior to final processing of the related tax returns.

Lottery Winnings Statements

Finding 4

RAD did not take the necessary follow-up steps to obtain required statements of lottery winnings from the State Lottery Agency. Furthermore, when the statements were received, RAD did not always process them in a timely manner.

Analysis

RAD did not ensure that it received required statements of lottery winnings from the Maryland State Lottery Agency within the time frame required by State law, and did not process these data in a timely manner. The law requires that the statements, which include specific data regarding taxpayer winnings, be sent to RAD by February 28 following each tax year. The data are recorded in the SMART system and used to identify lottery game winners who did not file income tax returns or who failed to claim lottery winnings on their returns.

Our review disclosed that, although the electronic statement file for tax year 2005 was received on time, it was not processed in the SMART system until 17 months later. Additionally, the tax year 2006 file initially received was damaged and could not be processed; a revised 2006 file was received and processed in August 2009, more than two years after it was due, and subsequent to our inquiries. The 2007 tax year file was received and processed in September 2008, more than six months after the February due date. Lastly, although the 2008 file was received timely, it was not processed until four months later. For all these years when the reports were not received timely, RAD did not follow-up with the State Lottery Agency to obtain the reports.

For tax year 2008, the State Lottery Agency reported lottery winnings to RAD totaling approximately \$178 million.

Recommendation 4

We recommend that RAD

- a. follow up with the Maryland State Lottery Agency when the statements of winnings are not received within the time frame required by law, and**
- b. process the applicable data in a timely manner (for example, within two months).**

Reestablishing Taxpayer Liabilities for Dishonored Payments

Finding 5

Procedures for ensuring that taxpayer liabilities were reestablished in the SMART system for all dishonored payments should be improved.

Analysis

Procedures for ensuring that taxpayer liabilities were reestablished in the SMART system for all dishonored payments (payments rejected by the bank for reasons such as insufficient funds) should be improved. Since a taxpayer's liability is originally satisfied by the payment, the liability must be reestablished on the system when the payment is dishonored by the bank. Although certain procedures had been implemented, these procedures were not sufficient. Specifically, there was no procedure to ensure that the record used to verify that the dishonored payments were recorded in the SMART system agreed with the original source documentation of dishonored payments received from the State Treasurer's Office and the bank. According to RAD's records, dishonored payments totaled approximately \$32.6 million during fiscal year 2008.

Recommendation 5

We recommend that RAD establish sufficient procedures to ensure that dishonored payments posted in the SMART system agree to independent source documentation received from the State Treasurer’s Office and the bank. We advised RAD of the necessary revisions to its current procedures in order to accomplish this verification.

Undelivered Refund Checks

Finding 6

Controls over refund checks returned from the post office as undeliverable were not sufficient.

Analysis

RAD did not adequately account for all refund checks returned to it by the post office as undeliverable, since the original log of returned checks was not used in this process. After the returned checks were recorded on the log, the Taxpayer Investigation Unit determined whether the checks should be voided (because the correct address could not be located) or forwarded to another employee for re-mailing. The Refund Unit used records prepared by the Taxpayer Investigation Unit to help verify the proper disposition of returned checks without comparing those records to the original log of returned checks. In addition, the Unit’s verification of re-mailed checks did not include an examination of the actual log of checks mailed prepared by the employee who mailed them. According to RAD’s records, refund checks returned by the post office totaled approximately \$19.7 million in fiscal year 2008.

Recommendation 6

We recommend that RAD

- a. verify the proper disposition of checks returned from the post office by agreeing the original log of returned checks to the record it uses to verify the disposition of those checks, and**
- b. use the log prepared by the employee responsible for re-mailing return checks to verify the proper disposition of those checks.**

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 tax and the sales and use tax (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 includes web-based access through the iFile system for personal income tax returns and through the bFile system for employer withholding and sales and use taxes. The iFile and bFile systems allow users to make online payments of taxes due to the State. Based on the records of the Comptroller of Maryland, the following amounts were paid using the online filing services during fiscal year 2009:

Tax Type	Approximate Amounts Paid
Individual Income Taxes (iFile)	\$79 million
Employer Withholding Taxes (bFile)	\$1.7 billion
Sales and Use Tax (bFile)	\$1.4 billion

The iFile and bFile are server-based systems secured using operating system and database security, in addition to other utilities. These server-based systems are also administered by ITD support personnel.

Sensitive and personal information pertaining to taxpayers, as well as tax payment information, is processed through the iFile and bFile systems. According to ITD's records, 151,808 individual income tax returns were submitted using the iFile service for calendar year 2008.

Finding 7

Security reporting, monitoring, and access controls over critical components of the iFile system were not adequate.

Analysis

Security reporting, monitoring, and access controls were not adequate over critical components of the iFile system. Specifically, we noted the following deficiencies:

- Security reports for an important iFile server did not include certain critical security-related events. Although security reports, which listed certain types of security events, were generated and reviewed, these reports did not include critical security events related to changes to audit policies, changes to user rights, and clearing of audit logs. As a result, certain significant system activities were not properly monitored.
- A default administrative database account unnecessarily had full access to the iFile database. Since this account includes local server administrators by default, all local administrators on the database server had full administrative access to this database. Also, anyone able to achieve local administrator privileges (such as by exploiting a potential vulnerability) would automatically have full administrative access to this database and could perform unauthorized retrieval of or modifications to critical data.
- Certain iFile database security and audit events (for example, grant privileges and stop audit) which should have been logged were not logged. Furthermore, although all failed logon attempts were logged, reviews of these logs were limited to just one account. Accordingly, significant database security violations could go undetected.

Recommendation 7

We recommend that RAD

- a. include all critical security events in the security reports for this critical server; and**
- b. limit access to all critical databases to personnel whose job duties require such access; and**
- c. log all critical database security and audit events, and review the reports of all failed logon attempts.**

Finding 8

Access and monitoring controls over certain mainframe files were not adequate.

Analysis

Access and monitoring controls over certain mainframe files were not adequate. Specifically, we noted the following conditions:

- The security software access rules for certain critical motor fuel tax files did not adequately restrict and/or log direct access to these files. Specifically, 14 employees had unnecessary and unlogged direct file modification access to certain critical motor vehicle fuel tax files, which allowed these files to be changed or copied without detection.
- An important security software report, which shows modifications of security software rules governing the SMART and motor vehicle fuel tax data and program files, was not reviewed. Security event review is integral to an organization's information systems control environment. A similar condition regarding SMART 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 system were not reviewed to ensure that the activity recorded on the security system software report was proper. A similar condition was commented upon in our preceding audit report.

Recommendation 8

We recommend that RAD

- a. restrict direct access to critical tax files to only those personnel who require such access for their job duties, and log all such accesses;**
- b. review all important security software reports generated for the SMART system (repeat); and**
- c. review the detailed change reports supporting the items on the aforementioned critical security system software report to ensure that activity on the report was proper (repeat).**

Finding 9

Controls over a publicly accessible iFile web server were not adequate, and sensitive personal information was unnecessarily stored in plain text on this server.

Analysis

Controls over a publicly accessible iFile web server were not adequate, and sensitive personal information was unnecessarily stored in plain text on this server. Specifically, we noted the following conditions:

- A critical iFile web server's file access was not properly restricted. This web server provided unnecessary access to a critical editor program on the host computer which allowed viewing and changing settings that affect the host computer's operating system and applications running on this computer. As a result of this condition, the host computer was unnecessarily exposed to excessive risk.
- iFile users' sensitive personal information was unnecessarily stored, in plain text, on the aforementioned iFile web server. We identified 325,613 records on this web server which disclosed this sensitive information. Such information would be accessible to unauthorized individuals if the related server were compromised. This sensitive personal information is commonly sought for use in identity theft. Accordingly, appropriate information system security controls need to exist to ensure that this information is safeguarded and is not improperly disclosed.

Recommendation 9

We recommend that RAD

- a. properly restrict all critical publicly accessible web servers' file access to sensitive system resources; and**
- b. remove the described sensitive personal information from the publicly accessible server. If the information must be retained, it should be stored on an internal server that is not publicly accessible, and should be encrypted.**

Audit Scope, Objectives, and Methodology

We have audited the Comptroller of Maryland – Revenue Administration Division (RAD) for the period beginning February 1, 2006 and ending March 1, 2009. 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 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. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included primarily 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. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of RAD's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include certain support services provided to RAD by the Comptroller of Maryland – Office of the Comptroller. These support services (such as processing of invoices, maintenance of accounting records, and related fiscal functions) are included in the scope of our audits of the Office of the Comptroller. Our audit also 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. These support services are included in the scope of our audits of the Information Technology Division.

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 relating 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 Comptroller of Maryland's response, 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.

APPENDIX



Peter Franchot
Comptroller

Linda L. Tanton
Deputy Comptroller

April 1, 2010

Bruce A. Myers, CPA, Legislative Auditor
301 West Preston Street, Room 1202
Baltimore, MD 21201

Dear Mr. Myers:

Thank you for the opportunity to respond to your audit report on the Comptroller of the Treasury – Revenue Administration Division (RAD) for the period beginning February 1, 2006 and ending March 1, 2009.

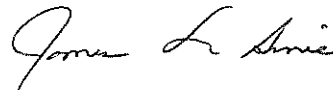
Enclosed are our responses to the recommendations contained in the audit report. We thank you and your staff for providing suggestions and recommendations, most of which have already been implemented, that will enable the Division to improve fiscal operations and strengthen internal controls.

If you desire any additional information, we will be happy to respond to your request.

Very truly yours,



Linda L. Tanton, Deputy Comptroller



James M. Arnie, Director
Revenue Administration Division

LLT

Enclosure

cc: The Honorable Peter Franchot

Responses to Findings and Recommendations

Invalid Dependent Social Security Numbers

Recommendation 1

We recommend that RAD take steps to improve procedures to ensure that dependent social security numbers reported by taxpayers on their individual income tax returns are valid.

Division Response

Since the last legislative audit, we have partnered with the IRS to validate taxpayer identification numbers (TINs) of both primary and secondary (spouse) taxpayers. We have been capturing dependent TINs beginning with returns filed for TY 2007 for DHMH use (SCHIP program), and we are now exploring the possibility of pre-processing validation of dependent TINs through IRS. While it may not be feasible to make the required programming changes and forms modifications to implement this capability in the legacy system, we will add dependent TINs to the deceased file match that is currently run against primary and secondary TINs. Finally, we are developing business rules for validation of dependent TINs in MITS.

We have reviewed each of the apparent discrepancies identified by the auditors and have taken appropriate action.

Earned Income Tax Credit

Recommendation 2

We recommend that RAD establish sufficient procedures to ensure that taxpayers claiming earned income tax credits on their State tax returns are eligible to receive the credits by verifying, at least on a test basis, that taxpayers who claim the credit also claimed the credit for federal tax purposes (repeat).

Division Response

As the auditors noted in their analysis, federal data is not available at the time the State returns are being processed, and post-processing matches are all that we can do unless these returns suspend for other review criteria. We will develop a procedure to verify these credits, on a test basis, on returns that have suspended for other review criteria.

The auditors referred to a QRDT procedure to compare earned income credits greater than \$10 to IRS (federal) data. This procedure, which was implemented in response to the previous audit, entailed requesting taxpayers to provide their federal return information (forms and schedules). We were finding significant percentages of the

taxpayers provided information showing income from self-employment in landscaping, construction, daycare, etc., and we were unable to confirm the information. Based on results, we could not justify continuation of this particular project. The newly enacted Workplace Fraud Act of 2009, Senate Bill 909, which was strongly supported by the Comptroller, addresses this issue, as it specifically prohibits employers in the construction and landscaping services from improperly and/or knowingly misclassifying employees as independent contractors.

Review of Significant Tax Refunds

Recommendation 3

We recommend that significant tax overpayments applied by taxpayers to a subsequent year be automatically reviewed for propriety prior to final processing of the related tax returns.

Division Response

We do not disagree with the auditors' recommendation to review overpayments to be applied to subsequent tax years, although we feel the risk of fraud in such cases is quite low. Rather than diverting programming resources to implement this programming change in our legacy system, we will establish a review process for high-dollar value overpayments in MITS.

Lottery Winnings Statements

Recommendation 4

We recommend that RAD

- a. follow up with the Maryland State Lottery Agency when the statements of winnings are not received within the time frame required by law, and**
- b. process the applicable data in a timely manner (for example, within two months).**

Division Response

We agree that the State Lottery Agency should send W-2G statements for gambling winnings within the timeframe required by statute. We will follow-up when this information is late and ensure that it is processed timely when received.

Reestablishing Taxpayer Liabilities for Dishonored Payments

Recommendation 5

We recommend that RAD establish sufficient procedures to ensure that dishonored payments posted in the SMART system agree to independent source documentation received from the State Treasurer's Office and the bank. We advised RAD of the necessary revisions to its current procedures in order to accomplish this verification.

Division Response

We do not agree with the auditors' conclusion that there is a lack of assurance that all dishonored payments were properly processed and the taxpayer's liabilities were reestablished. However, we do agree that the auditors' recommendations will further strengthen existing controls, and thus we have modified our procedures accordingly.

Undelivered Refund Checks

Recommendation 6

We recommend that RAD

- a. verify the proper disposition of checks returned from the post office by agreeing the original log of returned checks to the record it uses to verify the disposition of those checks, and**
- b. use the log prepared by the employee responsible for re-mailing return checks to verify the proper disposition of those checks.**

Division Response

We have strengthened existing controls over undeliverable refund checks as recommended by the auditors in the first part of the recommendation. This review will be documented by the initials of the reviewer and date of review.

We believe we were already performing the second part of the recommendation, although the procedures were performed by several different individuals during the audit period due to retirements, reassignment, illnesses, etc. Nonetheless, we confirm that our controls over returned refund checks are consistent with the recommendations of the auditors.

Information Systems Security and Control

Recommendation 7

We recommend that RAD

- a. include all critical security events in the security reports for this critical server; and**
- b. limit access to all critical databases to personnel whose job duties require such access; and**

- c. log all critical database security and audit events, and review the reports of all failed logon attempts.**

Division Response:

We agree with the recommendation and

- a. have included all critical security events in the security reports for the critical server; and
- b. will by the end of FY2010 limit access to all critical databases to personnel whose job duties require such access; and
- c. will begin implementation of logging all critical database security and auditing events, and reviewing the reports of all failed logon attempts by the end of FY2010 with completion by January 15, 2011.

Recommendation 8

We recommend that RAD

- a. restrict direct access to critical tax files to only those personnel who require such access for their job duties, and log all such accesses;**
- b. review all important security software reports generated for the SMART system (repeat); and**
- c. review the detailed change reports supporting the items on the aforementioned critical security system software report to ensure that activity on the report was proper (repeat).**

Division Response:

We agree with the recommendation and

- a. will restrict direct access to critical tax files to only those personnel who require such access for their job duties, and log all such accesses (to be completed by end of FY2010);
- b. have implemented an improved procedure for reviewing all important security software reports generated for the SMART system; and
- c. have developed an improved procedure for reviewing the detailed change reports supporting the items on the aforementioned critical security system software report to ensure that activity on the report was proper and will implement the improved procedure by end of FY2010.

Recommendation 9

We recommend that RAD

- a. properly restrict all critical publicly accessible web servers' file access to sensitive system resources; and**
- b. remove the described sensitive personal information from the publicly accessible server. If the information must be retained, it should be stored on an internal**

server that is not publicly accessible, and should be encrypted.

Division Response:

We agree with the recommendation and

- a. have properly restricted all critical publicly accessible web servers' file access to sensitive system resources; and
- b. have removed the described sensitive personal information from the publicly accessible server.

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