Audit Report

# State Department of Assessments and Taxation

August 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


August 4, 2010


**Karl S. Aro**
Executive Director

**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 State Department of Assessments and Taxation (DAT) for the period beginning February 1, 2007 and ending August 20, 2009. DAT is responsible for administering the State's real and personal property tax laws, including various programs that provide property tax credits to homeowners and renters, as well as for various functions applicable to corporations.

Our audit disclosed that DAT did not timely identify and adequately pursue corporations with forfeited corporate charters that appeared to be violating State law by continuing to conduct business in Maryland. With respect to the administration of its property tax programs, DAT did not conduct supervisory reviews to independently verify that homestead tax credits were only granted to qualified property owners for their principal residences. DAT also did not conduct required reviews of homeowners' and renters' tax credits granted to ensure recipients met the eligibility requirements. In addition, as of March 2010, DAT had not reviewed franchise tax returns submitted by public service companies for calendar year 2008 to ensure that the companies had remitted the proper amounts of franchise taxes. Finally, DAT had certain internal control and record keeping deficiencies relating to cash receipts, contractual services, and information systems security and control.

An executive summary of our findings can be found on page 5. The response from DAT to our findings and recommendations is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by DAT.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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* **Denotes item repeated in full or part from preceding audit report**

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# Executive Summary

**Legislative Audit Report on the**
**State Department of Assessments and Taxation (DAT)**
**August 2010**

- **Since April 2008, DAT had not taken steps to identify corporations that were potentially conducting business in Maryland even though they had forfeited their right to do so because they had failed to file required annual personal property tax returns and remit the related fees. Once such corporations were identified, DAT did not always take appropriate action to pursue the corporations.**

  DAT should timely identify corporations that are potentially conducting business in Maryland illegally, and aggressively pursue such corporations to ensure that required annual tax returns are filed and that related fees are remitted.

- **DAT supervisory personnel did not conduct reviews to independently verify that homestead tax credits were only granted to qualified property owners, and DAT did not conduct required reviews of homeowners' and renters' tax credits issued for calendar years 2007, 2008, and 2009.**

  DAT should generate reports of homestead tax credits granted to property owners and such reports should be used by supervisory personnel to verify the propriety of tax credits granted. DAT should also conduct timely reviews of the propriety of homeowners' and renters' tax credits granted, in accordance with its policy.

- **Franchise tax returns submitted by public service companies for calendar year 2008 had not been reviewed by DAT to ensure that the amounts of franchise taxes paid were proper. During fiscal year 2009, franchise tax collections totaled $125 million.**

  DAT should review franchise tax returns timely and pursue payment of any additional taxes owed as a result of the review.

- **Additional internal control and record keeping deficiencies were noted with respect to cash receipts, certain contractual services, and information systems security and control.  For example, adequate controls were not established over a critical database, production files, and the network firewall.**

  DAT should take the recommended actions to improve controls and record keeping deficiencies in these areas.

# Background Information

## Agency Responsibilities

The State Department of Assessments and Taxation (DAT) is responsible for administering the State's real and personal property tax laws as well as for various functions applicable to corporations (for example, issuing corporate charters and collecting certain taxes, such as gross receipts taxes). DAT also administers programs that provide property tax credits primarily to homeowners and renters who meet the related eligibility requirements (such as gross income limitations). DAT's headquarters is located in Baltimore City and it operates assessment and taxation offices in each of the State's 24 local subdivisions. According to the State's accounting records, during fiscal year 2009, DAT's expenditures and revenues totaled approximately $108.5 million and $219.7 million, respectively. The majority of these revenues relate to public service company franchise taxes and corporate personal property filing fees.

## Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the eight findings contained in our preceding audit report dated August 24, 2007. We determined that DAT satisfactorily addressed six of the findings. The remaining two findings are repeated in this report, one of which appears as two findings in this report.

# Findings and Recommendations

## Corporate Filing Fees

**Finding 1**
**The State Department of Assessments and Taxation (DAT) did not conduct timely automated matches to identify corporations that were potentially conducting business in Maryland but had failed to file required annual property tax returns and remit related fees. Corporations identified by the matches conducted were not aggressively pursued.**

**Analysis**
DAT did not conduct timely matches of its records with certain records of the State Comptroller to identify corporations that, although had previously forfeited their right to do business in the State because of non-filings, were still potentially conducting business in Maryland. As provided by State law, DAT places corporations in forfeited status when they fail to file at least one annual personal property return, and remit the related fees. DAT uses automated matching procedures to compare its automated file of forfeited corporations with the Comptroller's automated tax system to detect corporations that may be illegally operating in Maryland. Specifically, these corporations have received vendor payments from the State or have an active sales tax account, indicating they may still be operating in the State. However, our review disclosed that, as of February 2010, DAT had not completed any automated matches since April 2008, which used calendar year 2007 data.

Additionally, we noted that DAT was not aggressively pursuing corporations identified by the automated matches as potentially doing business in the State illegally. Specifically, the matches performed in April 2008 identified 500 forfeited foreign corporations (domiciled outside of Maryland) and 293 forfeited domestic corporations that were potentially conducting business in Maryland illegally. Although DAT sent each of these corporations a notice requesting information regarding its operations in Maryland, our review disclosed that DAT's efforts to pursue 501 (353 foreign and 148 domestic) of the 793 corporations were not sufficient. For example, in 222 instances, either notices were returned as undeliverable by the post office, or DAT received no responses from the corporations; however, DAT took no further action (such as to obtain additional information from the State Comptroller) to help determine if these corporations were conducting business in the State. Additionally, 75 of the 501 corporations responded to the notice and admitted to conducting business in the State but had not submitted the required returns and related fees as of February

2010, and DAT had taken no further action to effect submission of the required returns and fees by these corporations.

The aforementioned 501 corporations that were not adequately pursued by DAT potentially owe filing fees and related penalties of up to $220,900 if the corporations failed to file a return for one year. This amount would increase if it were determined that any of the corporations needed to file returns for more than one year. Furthermore, these corporations may also owe personal property taxes to the local subdivisions. Similar conditions were commented upon in our preceding audit report.

**Recommendation 1**
**We recommend that DAT**

a. **conduct timely automated matches to identify corporations that are potentially conducting business in Maryland illegally,**
b. **take appropriate action to obtain any returns and related amounts identified as due (repeat), and**
c. **take appropriate action against forfeited corporations that do not respond to DAT notices (repeat).**

## Homestead Tax Credits

**Finding 2**
**Homestead property tax credits granted to property owners were not independently verified.**

**Analysis**
Procedures to verify the propriety of homestead property tax credits granted to property owners need improvement. By law, prior to December 31, 2007, such credits were generally granted to individuals who owned residential property. However, current State law requires each homeowner to file an application with DAT by December 31, 2012, stating that the property is the homeowner’s principal residence, to continue to qualify for the credit. Individuals purchasing residential property after December 31, 2007 are required to apply for the credit within 180 days of purchase. Homestead tax credit applications submitted by property owners were reviewed by clerical staff using the federal income tax database and Motor Vehicle Administration records to make a determination as to whether the property owners qualified for the credit. However, supervisory personnel did not review the determinations made by the clerical staff to ensure that the tax credits were granted only to qualified property owners. Consequently, tax credits granted to ineligible property owners would not be detected.

For a principal residence, the homestead tax credit limits the annual increase in the owner's State property tax bill resulting from assessment increases to 10 percent, and limits the annual increase in the owner's local property tax bill resulting from assessment increases to 10 percent or less, as determined by each jurisdiction. As of February 22, 2010, DAT had approved 463,772 homestead tax credit applications. The following table summarizes the homestead tax credits issued applicable to the tax year ending June 30, 2010:

**Summary of Homestead Tax Credits for Tax Year 2010**

| Credit Type | Properties Receiving Homestead Credits | Decrease in Assessed Value of Property Due to Homestead Credits (in millions) | Estimated Decrease in Property Tax Revenue Due to Homestead Credits (in millions) |
|---|---|---|---|
| State | 1,292,498 | $ 77,519 | $ 86.8 |
| Local Jurisdictions | 1,354,411 | $ 122,333 | $ 1,313 |

Source: DAT records

**Recommendation 2**
**We recommend that DAT generate output reports of homestead tax credits granted to property owners, and that supervisory personnel verify the propriety of the tax credits granted, at least on a test basis. Such verifications should be documented and retained for audit verification.**

## Public Service Company Franchise Taxes

**Finding 3**
**DAT had not reviewed any of the 324 franchise tax returns received for calendar year 2008 to ensure that the proper amounts of franchise taxes were paid.**

**Analysis**
As of March 2010, DAT had not reviewed for propriety any of the 324 franchise tax returns received for calendar year 2008, which were due March 15, 2009. State law requires each telephone, electricity, and natural gas provider to file a franchise tax return annually and to pay DAT a franchise tax on gross receipts for the year. To verify the propriety of the tax returns and related fees, DAT reviews

the tax returns for mathematical accuracy and verifies certain information reported on the tax returns (such as the gross operating revenues earned by the companies) to independent sources. Since DAT had not reviewed any of the 324 franchise tax returns received for calendar year 2008, there is no assurance that the franchise tax returns were accurate and that the proper amounts of franchise taxes were paid. According to the State's accounting records, during fiscal year 2009, DAT's franchise tax collections totaled approximately $124.9 million.

**Recommendation 3**
**We recommend that DAT review franchise tax returns timely, including the aforementioned 324 tax returns received for calendar year 2008, and timely resolve any noted tax discrepancies.**

## Homeowners' and Renters' Tax Credits

**Finding 4**
**DAT had not performed reviews of homeowners' and renters' tax credits issued during calendar years 2007 to 2009.**

**Analysis**
As of February 2010, DAT had not performed reviews of homeowners' and renters' tax credits issued during calendar years 2007 to 2009. Homeowners and renters are eligible for tax credits based on meeting certain income eligibility requirements. In addition, eligible renters must be over the age of 60, disabled, or under the age of 60 with dependent children. In that regard, homeowners' and renters' tax credit applications are generally due to DAT by September 1st each year.

DAT processes the applications and, based on the information provided on the applications, approves the tax credits. Subsequently, DAT policy calls for it to perform certain procedures to review the propriety of certain approved tax credit applications. These procedures include (1) a review of applications where a discrepancy exists between adjusted gross income reported on income tax returns to the State Comptroller and income reported on the tax credit applications, (2) a review of applications reflecting a 20 percent change in rent or income from one year to the next, and (3) a random review of 5 percent of approved applications. DAT last performed these procedures for applications received in calendar year 2006. The lack of timely reviews of tax credits issued could result in excessive tax credits being granted to homeowners and renters. During fiscal years 2009 and 2008, homeowners' tax credits totaled approximately $95.6 million and renters' tax credits totaled approximately $4.7 million.

**Recommendation 4**
**We recommend that DAT**

**a. perform timely reviews of approved homeowners' and renters' tax credit applications, and**
**b. take appropriate action to recover any tax credits that are determined to be improperly granted to homeowners and renters.**

## Cash Receipts

**Finding 5**
**Cash receipts were not adequately controlled to ensure that all collections initially received and recorded were subsequently deposited.**

**Analysis**
DAT had not established adequate internal controls over cash and check collections received at DAT's headquarters office (such as filing fees and recoveries of excess tax credits). Cash collections are initially recorded on a cash register and subsequently posted to an automated system, while collections received by check are initially recorded either in the automated system or on a manual check log. Our review disclosed the following control deficiencies:

- Although we were advised by DAT management personnel that independent verifications of recorded collections to deposit were performed, such verifications were not documented. In that regard, our test of 26 collections totaling approximately $1.3 million deposited during fiscal years 2008 to 2010 disclosed that, for the collections tested, there was no documentation that DAT had performed a verification of recorded collections to deposit.

- Since State law prohibits DAT from charging a fee for services provided to certain entities (such as non-profit organizations and local governments), the automated system permits the recording of a "no fee" transaction to account for such services. However, we noted that nine employees who had access to collections could record a "no fee" transaction in DAT's automated system at the time the transaction was initially recorded. Additionally, four employees (including one of these nine) with access to collections had the ability to remove a payment transaction recorded in the automated system and record a "no fee" transaction in its place. This capability is needed, for example, in the case of cashier error. However, output reports of "no fee" transactions recorded in the automated system were not prepared and reviewed by independent supervisory personnel. As a result, any misappropriation of collections may not be readily detected.

During fiscal year 2009, collections received via cash and checks at DAT's headquarters location totaled approximately $38.2 million. A total of 1,210 "no fee" transactions were recorded in DAT's automated system during fiscal year 2009, and 184 payments totaling $30,698 were removed from the system during that year, while 130 payments totaling $14,401 were removed in fiscal year 2008.

**Recommendation 5**
**We recommend that DAT**

a. **document the independent verifications of recorded collections to deposit; and**
b. **generate output reports of "no fee" transactions recorded in the automated system, and ensure that supervisory personnel independent of the cash receipts functions review these transactions for propriety.**

**We advised DAT on accomplishing the necessary separation of duties using existing personnel.**

## Contractual Services

**Finding 6**
**DAT did not adequately verify the propriety of invoices submitted for payment by a contractor.**

**Analysis**
DAT did not review invoices submitted by the lockbox contractor to ensure that the amounts billed were in accordance with the related contract. In that regard, DAT uses a lockbox account to process annual personal property filing fees paid by entities conducting business in the State. Although DAT reviewed invoices received from the lockbox contractor to ensure that payment had not previously been made for the services billed, DAT did not verify that the rates charged for lockbox processing services agreed with the rates stipulated in the related contract, which had been procured by the State Treasurer's Office (STO). Furthermore, DAT did not have a copy of the lockbox service contract.

We obtained a copy of the lockbox contract from the STO and compared the rates specified in the contract to the rates charged by the contractor on three invoices paid by DAT during fiscal year 2009. These three invoices contained charges totaling approximately $108,400 for 23 services. However, for 18 of the charges totaling approximately $92,700, the description of the services provided and the corresponding service charges per the invoices did not correspond to any service description or rate specified in the lockbox contract. Consequently, we were unable to determine the propriety of the payments made to the contractor for these 18 services. During the period from February 2007 through May 2009, DAT made payments to the lockbox contractor totaling approximately $489,500.

**Recommendation 6**
**We recommend that DAT**

a. **obtain and maintain a current copy of the STO-procured lockbox contract;**
b. **compare lockbox service charges previously paid to the contractor to the related lockbox contract;**
c. **obtain clarification from the contractor and the STO, as needed, for any services or rates billed that do not correspond to services or rates specified in the lockbox contract;**
d. **seek reimbursement from the contractor for any overpayments identified; and**
e. **in the future, ensure that charges billed by the lockbox contractor are in accordance with the related contract prior to paying the invoices.**

## Information Systems Security and Control

**Background**
DAT operates several critical computer applications and databases on its internal network and on the Comptroller of Maryland's Annapolis Data Center (ADC). These include property assessment databases; property tax credit databases; and the Maryland Business Entity System, which contains registrations of business entities and related filings and assessments. DAT also operates a statewide network that connects its local offices and the DAT headquarters internal network. DAT's statewide network offers users access to various information technology services including ADC mainframe computer-based applications, a database management system, network services, email services, and Internet access.

**Finding 7**
**Adequate monitoring controls over a critical mainframe database and production files were not implemented.**

**Analysis**
Monitoring controls over a critical mainframe database and production files were not adequate. Specifically, we noted the following conditions:

- The review of file accesses against critical production files, as recorded on an important daily security report, was not comprehensive. Specifically, reviews were only performed for access violations, and direct file accesses against critical files were not reviewed for propriety.

- Mainframe security reports, which identify changes to security software userids and changes to critical access rules, were reviewed by the same individual who was responsible for making these changes. Furthermore, we were advised that the reviews of the security reports did not include a review of the documentation supporting the entries (for example, approved access forms).

- The database administrator for the Maryland Business Entity System database was also responsible for reviewing the related database security reports. Furthermore, while we were advised that reviews of the reports were performed, these reviews were not documented. As a result, there was a lack of assurance that adequate and independent reviews of the database security reports were performed.

**Recommendation 7**
**We recommend that the DAT implement appropriate monitoring controls over critical mainframe databases and production files. Accordingly, we made detailed recommendations to DAT, which if implemented, should provide the necessary monitoring controls.**

**Finding 8**
**The DAT network was not properly secured.**

**Analysis**
Sufficient controls were not established over the DAT network. Specifically, we noted the following conditions:

- Firewall rules allowed numerous unnecessary connections to the DAT network, placing various network devices at risk. For example, a contractor's network was allowed network level access to the entire DAT internal network over all ports. Proper firewall rules should utilize a "least privilege" security strategy, which only grants network access privileges needed to perform assigned tasks.

- Firewall logs were not reviewed and the firewall was not configured to send alerts to network administrators advising them of serious issues detected by the device. These two conditions were commented upon in our preceding audit report. Furthermore, the firewall's logs were stored on the device itself and were not recorded on a separate logging server. These logs were overwritten when filled, resulting in lost logging information.

- Three user accounts, formerly used by contractors, were no longer needed but continued to have modification access to the firewall. In addition, one of these accounts did not require the use of a password.

- Remote administrative access to the firewall was not adequately restricted to only those users who required such access. For example, users and devices on the Internet could make a remote management connection to the firewall.

**Recommendation 8**
**We recommend that DAT**
**a. configure the firewall to adequately secure its network,**
**b. perform documented reviews of the firewall logs as least weekly (repeat),**
**c. configure the firewall to send alerts to network administrators advising them of serious issues detected by the firewall (repeat),**
**d. store the firewall logs on a separate logging server, and**
**e. delete all unnecessary firewall accounts and restrict remote access to the firewall to only those users requiring such access.**

**Finding 9**
**The intrusion prevention system (IPS) was not properly configured, and log review procedures were inadequate.**

**Analysis**
DAT did not configure its IPS to send alerts to network administrators advising them of serious issues detected by the IPS, which gathers and analyzes network traffic to identify and block attacks. In addition, although DAT advised us that the IPS logs were reviewed on a weekly basis, documentation did not exist to substantiate these reviews. These two conditions were commented upon in our preceding audit report. Furthermore, the IPS was configured to only review and inspect traffic from one segment of the DAT network to the internal network. All other traffic (including traffic from the Internet) was not subject to review. Finally, IPS signatures (used to detect malicious traffic) had not been updated in more than 22 months and, during that time, the IPS vendor had issued numerous signature updates.

**Recommendation 9**

**We recommend that DAT**

a. **configure the IPS to send alerts to network administrators advising them of serious issues detected by the IPS (repeat),**
b. **perform documented reviews of the IPS logs at least weekly (repeat),**
c. **configure the IPS to provide coverage for all critical network traffic, and**
d. **update the IPS signatures on a timely basis.**

# Audit Scope, Objectives, and Methodology

We have audited the State Department of Assessments and Taxation (DAT) for the period beginning February 1, 2007 and ending August 20, 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 DAT's financial transactions, records and internal controls, 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 corporate fees and taxes, tax credits, real property assessments, procurements and disbursements, information systems, cash receipts, and payroll. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observations of DAT'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.

DAT provides certain support services (such as payroll, invoice processing, maintenance of accounting records and related fiscal functions) to the Property Tax Assessment Appeals Board. These support services are included within the scope of our audits of DAT.

DAT'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 DAT'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 DAT that did not warrant inclusion in this report.

DAT's response 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 DAT regarding the results of our review of its response.

# APPENDIX

State of Maryland

**DEPARTMENT OF ASSESSMENTS AND TAXATION**

Office of the Director

**MARTIN O'MALLEY**
**Governor**

**C. JOHN SULLIVAN, JR.**
**Director**

August 2, 2010

Mr. Bruce A. Myers, CPA
Legislative Auditor
Office of Legislative Audits of
the Maryland General Assembly
301 West Preston Street
Baltimore, Maryland 21201

Dear Mr. Myers:

Enclosed you will find the Responses of the Department of Assessments and Taxation (DAT) to your Audit Report Comments and Recommendations for the agency for the period beginning February 1, 2007 and ending August 20, 2009. Our Response also has been sent electronically.

Per the directive of the General Assembly's Joint Audit Committee and your highlighted reference to the Committee's Policy, please be advised that DAT has included in each Response a specific implementation date for the Recommendations.

If the Department or I can provide any further information or be of other assistance, please let me know.

Sincerely,

C. John Sullivan, Jr.
Director

CJS:hhr

Enclosures

300 West Preston Street – Room 605 – Baltimore, Maryland 21201
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# State Department of Assessments and Taxation
# Audit Report Responses
# July 2010

## FINDING 1: DEPARTMENT'S RESPONSE ON CORPORATE FILING FEES

The Department (DAT) substantially agrees with the Audit Finding but must note that a significant percentage of the forfeited "foreign" (out of state) and domestic corporations in the audit may not be required to file an Annual Report and pay the filing fee because these business entities do not have sufficient business activity or "legal nexus" to the State. Therefore, in the discussions with the Auditors, DAT proposed that it will refine for the current year the automated audit programs that prepare the lists of these entities contacted to establish a threshold on the amount of the vendor payments or sales tax reported and not just the fact that any payment was received or sales tax reported. The additions to the automated programs will be implemented within 180 days of the August 2, 2010 date of this Response. This way DAT can have more employee time to devote to attempt to track down (as the Auditors recommend) business entities where the Postal Service has returned as undeliverable letters sent by DAT. Subsequent inquiries have found some forfeited entities as now operating under a new entity name that is in good standing with the Department with all annual filing fees paid. Similarly, DAT can better refute claims by out of state business entities with no physical address in Maryland that they have been advised by their attorneys and accountants as to their not having sufficient nexus in Maryland to be required to file when responding to our contact letters. Finally, the Department will maintain its existing procedure of forwarding to the State's Central Collection Unit any forfeited business entity showing up two years in a row on either the vendor payment or sales tax list. This year the Department forwarded 229 business entities to Central Collections for further action. DAT can only forward to Central Collections entities where the agency can certify the debt as validly owed.

## FINDING 2: DEPARTMENT'S RESPONSE ON HOMESTEAD TAX CREDITS

The Department agrees with the Audit Finding and will add the additional audit on a test basis as suggested within 60 days of the date of this Response. DAT created a Homestead Tax Credit data processing system in 2007 that does not allow any Homestead application to be approved without a standardized match being performed that compares the address of the residential property with the address shown in the federal income tax database for the filing of the homeowner's federal income tax return. This matching also utilizes a second verification method relying on the homeowner's Social Security number reported on the Homestead Tax Credit application. Whenever there is a discrepancy between the property address and the address location in the federal income tax database, the Department's Homestead Tax Credit processing employees next look to the address used for the Maryland driver's license and registration of motor vehicles in the Motor Vehicle Administration (MVA) database, which the Department also has in its system. The employees make an individual determination on these exception cases for approving the Homestead Tax Credit eligibility.

The additional audit proposed in the Recommendation here would require a supervisory level employee to generate an output report of approved Homestead Tax Credit applications and to have the supervisor verify on a test basis the propriety of the tax credit eligibility granted on the accounts randomly selected. The supervisor will document the verification with the date of the review and that employee's initials. These records will be retained for future audit verification.

## FINDING 3: DEPARTMENT'S RESPONSE ON PUBLIC SERVICE COMPANY FRANCHISE TAX AUDIT

The Department agrees with the Audit Finding. The one remaining employee in the Franchise Tax Unit (the Program Manager and Secretary unexpectedly retired) was unable to perform a detailed audit in 2009 of the 324 franchise tax returns received for calendar year 2008. A general review of the top 30 return filers who reported and paid 97% of the franchise tax collected showed no underpayments in the amounts of taxes paid. Once the Department is able to fill the Program Manager position, then it will direct that employee to audit the 2008 returns and recover any additional taxes owed as a result of that audit within 180 days of the date of this Response.

## FINDING 4: DEPARTMENT'S RESPONSE ON HOMEOWNERS' AND RENTERS' TAX CREDIT AUDITS

The Department agrees with the Audit Finding and has already begun the use of its standardized audit programs to review these tax credits for the 2007 and 2008 application years on July 1, 2010. As is the customary procedure, DAT will recover any improperly granted or overpaid credits received by homeowners or renters in each year. DAT will timely perform all of its standardized audits each year.

## FINDING 5: DEPARTMENT'S RESPONSE ON CASH RECEIPTS

The Department agrees with the Audit Finding and the two separate recommendations here. DAT does perform a verification of deposits both to the reports from the automated system and to the State's accounting records but acknowledges that staff had not been making notations to show this process was performed. To be in compliance with internal controls, staff not involved with the preparation of the check deposit are performing the verifications to the State's Treasurer Reports that become the basis for the State's accounting records. Prior to the completion of the Audit fieldwork, DAT's chief Fiscal Administrator implemented a procedure whereby Accounting staff now place their initials next to each amount that is traced from support documents, cash receipt logs, and revenue reports to the bank deposit ticket to verify that the amount is correct.

With regards to the second Audit Recommendation that the Department generate an output report on "no fee transactions" recorded in the automated system, it should be noted that this is a first time request by the Auditors to conduct a review of this particular type of transaction. DAT has directed its chief Fiscal Administrator, who is independent of the processing and collections functions of the Charter Unit, to prepare the report, review support documents and necessary approvals, perform random checks on a test basis, and make appropriate initialed notations when the review is conducted. This report will be generated and reviewed within 90 days of the date of this Response.

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**FINDING 6: DEPARTMENT'S RESPONSE ON CONTRACTUAL SERVICES**

The Department agrees with the Audit Finding and is implementing the six parts of the Auditor's Recommendation here. First, DAT has already obtained and is maintaining a current copy [annually updated on July 1 for CPI increases] of the lockbox contract procured by the State Treasurer's Office (STO). Second, DAT's chief Fiscal Administrator will conduct an audit of the lockbox service charges previously paid to the contractor pursuant to the related lockbox contract within 120 days of the date of this Response. Third, DAT will obtain from the contractor and the STO a clarification of any charges and rates that do not correspond to the lockbox contract. In this regard, DAT's chief Fiscal Administrator has proposed to the STO and the contractor that they develop a numerically coded list of the applicable charges and rates to be used on the invoice submitted by the contractor with the corresponding charges. DAT will make further inquiry to the STO that has responsibility for administering the statewide master lockbox contract for all agencies as to the status of DAT's request for the vendor to use the coded billing list. Fourth, DAT will seek reimbursement from the contractor for any overpayments identified or shall deduct any overpayments from the amount due on the next month's billing statement. Finally, DAT will ensure that the charges billed are in accordance with the contract prior to issuing payment of the invoices.

**FINDING 7: DEPARTMENT'S RESPONSE ON MONITORING DATABASES AND PRODUCTION FILES**

The Department agrees with the Audit Finding and has implemented the following new procedures. DAT has created an Excel spreadsheet to record all critical production file access by users and has begun to document all violations with follow-up actions taken. DAT has separated the implementation and review of access forms. All worked is now performed by the Assistant Security Officer and reviewed by the Security Officer. DAT has now implemented detailed procedures for monitoring the databases consistent with the Auditors' Recommendation, and these procedures are documented in writing and available for audit verification.

**FINDING 8: DEPARTMENT'S RESPONSE ON NETWORK SECURITY**

The Department agrees with the Audit Finding and has implemented the five parts of the Recommendation. DAT has reconfigured its firewall based on the suggestions from the Auditors. The specific changes that have been made in this regard are documented in writing and are available for audit verification. The Network Manager performs weekly reviews of the firewall logs. Weekly reviews are documented in an Excel spreadsheet. The firewall has configured to send alerts on serious issues to the Network Manager e-mail. The firewall logs are stored on a network security monitoring device. DAT submits that it is unnecessary to store the logs on another server given the use capacity of the network security monitoring device. DAT purchased the network security monitoring device for this purpose in response to a Recommendation in the Auditors' Prior Report. All unnecessary firewall accounts have been deleted and remote access has been limited to only required users.

**FINDING 9: DEPARTMENT'S RESPONSE ON IPS SYSTEM AND LOG REVIEW PROCEDURES**

The Department agrees with the Audit Finding and has already taken corrective actions to implement the four part Recommendation. DAT has configured the IPS to send critical alerts to the Network Manager. The Network Manager performs weekly reviews of the IPS logs. Weekly reviews are documented in an Excel spreadsheet. The IPS has been configured to provide coverage for all critical network traffic. IPS signature updates will be applied when made available by the vendor. Weekly inquiries to the vendor's website are done by the Network Manager and documented in an Excel spreadsheet.

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