

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
DEPARTMENT OF REVENUE SERVICES  
FISCAL YEARS ENDED JUNE 30, 2015 AND 2016*

**AUDITORS OF PUBLIC ACCOUNTS**  
JOHN C. GERAGOSIAN ❖ ROBERT J. KANE

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**June 25, 2020**  
**EXECUTIVE SUMMARY**

In accordance with the provisions of Section 2-90 of the Connecticut General Statutes, we have audited certain operations of the Department of Revenue Services (DRS). The objectives of this review were to evaluate the department’s internal controls; compliance with policies and procedures, as well as certain legal provisions; and management practices and operations for the fiscal years ended June 30, 2015 and 2016.

The key findings and recommendations are presented below:

<b>Page 10</b>	DRS does not have procedures to report the status of suspended transactions to upper management. DRS should strengthen internal controls over reporting to ensure management is provided with relevant and accurate information to support the effective and efficient resolution of suspended transactions. (Recommendation 1.)
<b>Page 10</b>	DRS has not adopted formal policies and procedures to identify and retire critical system software that no longer receives manufacturer support and security updates. DRS should adopt policies and procedures to identify end-of-life software, and should retire or upgrade critical software before it loses security updates and manufacturer support. (Recommendation 2.)
<b>Page 12</b>	Our review identified an incorrect configuration of DRS security filters that allowed all devices connected to the state’s secure network to access the DRS intranet site. DRS should regularly monitor its intranet site to ensure that access is limited to authorized users. (Recommendation 3.)
<b>Page 13</b>	DRS made significant year-end payments for prepaid postage, and did not report the year-end balance on its GAAP reporting form. DRS should adhere to its projected budgets and maintain sufficient prepaid account balances to meet the anticipated needs of the department in the fiscal year. (Recommendation 4.)
<b>Page 15</b>	DRS does not have adequate procedures to promptly identify and track all outstanding refund requests held for review. The agency paid significant interest on refunds held for further review. DRS should implement procedures to identify and track all outstanding refund requests held for review. DRS should promptly process refund claims to avoid excess interest payments. (Recommendation 5.)
<b>Page 23</b>	DRS does not adequately complete and document the final disposition of human resource investigations. DRS should adhere to its established Human Resource policies. The use of these formal, written procedures will help to ensure investigative conclusions and actions were reasonable and consistent. (Recommendation 10.)
<b>Page 24</b>	DRS did not perform annual Performance Assessment and Recognition System (PARS) evaluations on its managers for the audited period. DRS should ensure that all managers are evaluated on an annual basis using PARS. (Recommendation 11.)
<b>Page 30</b>	The Business Tax Credit and Tax Policy Review Committee did not meet during the audited period and through July 2018. Furthermore, the committee has not issued the required annual findings and recommendations to the General Assembly. DRS should seek guidance from the General Assembly to assist with coordination of the Business Tax Credit and Tax Policy Review Committee to ensure that the committee fulfills its relevant statutory requirements affecting the department. (Recommendation 16.)

# STATE OF CONNECTICUT



## AUDITORS OF PUBLIC ACCOUNTS

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June 25, 2020

### **AUDITORS' REPORT**

We have audited certain operations of the Department of Revenue Services in fulfillment of our duties under Section 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the years ended June 30, 2015 and 2016. The objectives of our audit were to:

1. Evaluate the department's internal controls over significant management and financial functions;
2. Evaluate the department's compliance with policies and procedures internal to the department or promulgated by other state agencies, as well as certain legal provisions; and
3. Evaluate the effectiveness, economy, and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing written policies and procedures, financial records, minutes of meetings, and other pertinent documents; interviewing various personnel of the department, and testing selected transactions. We obtained an understanding of internal controls that we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contracts, grant agreements, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform our 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 such a basis.

The accompanying Résumé of Operations is presented for informational purposes. This information was obtained from various available sources including, but not limited to, the

department's management and the state's information systems, and was not subjected to the procedures applied in our audit of the department. For the areas audited, we identified:

1. Deficiencies in internal controls;
2. Apparent noncompliance with policies and procedures or legal provisions; and
3. Need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents any findings arising from our audit of the Department of Revenue Services.

## COMMENTS

### FOREWORD

The Department of Revenue Services (DRS) operates primarily under the provisions of Title 12, Chapters 201, 202, and 207 through 229 of the General Statutes. The department is responsible for administering and ensuring compliance with applicable provisions of this title and certain other statutes related to the assessment and collection of taxes. Major functions of the department include collecting and processing tax revenues, developing tax regulations, and providing information and services to taxpayers.

Records pertaining to sales taxes collected by the Department of Motor Vehicles but credited to the Department of Revenue Services are examined as part of our audit of the Department of Motor Vehicles.

Section 12-1a of the General Statutes provides that the department is under the direction of a commissioner. Kevin B. Sullivan was appointed commissioner in January 2011 and served in that capacity throughout the audited period.

### Legislative Changes

Notable legislative changes that took effect during the audited period are summarized by tax type below:

- **Income Tax:**

**Public Act 15-1 (December Special Session)**, Section 26, beginning in the 2016 tax year, excluded compensation for personal services from income rendered by a nonresident domiciled in Connecticut for less than 15 days.

**Public Act 16-3 (May Special Session)**, Sections 200 and 201, beginning in the 2017 tax year, required the portion of nonresident's share of income derived from or connected to

sources in the state to be determined according to statutory apportionment provisions rather than DRS regulations.

- **Sales and Use Tax**

**Public Act 15-244**, Sections 72 and 73, effective on and applicable to sales on or after July 1, 2015, increased the sales and use tax on specified luxury items from 7% to 7.75%.

**Public Act 15-244**, Section 74, effective upon passage and applicable to sales on or after October 1, 2015, required DRS to direct a portion of the 6.35% sales tax revenue to the Municipal Revenue Sharing Account (MRSA) and the Special Transportation Fund (STF).

**Public Act 15-244**, Sections 220 and 223, effective upon passage, repealed the requirement for DRS to deposit \$12.7 million of fiscal year 2014-2015 sales and use tax payments into MRSA and to distribute the funds to municipalities according to a specified formula.

**Public Act 15-5 (June Special Session)**, Section 137, effective October 1, 2015 and applicable to periods ending on or after December 31, 2015, extended the deadline for filing and remitting monthly and quarterly sales and use taxes from the 20<sup>th</sup> day of the month to the last day of the month following the end of the applicable filing period.

**Public Act 15-5 (June Special Session)**, Section 483, effective upon passage, required DRS to transfer the first \$814,891 in sales tax revenue scheduled to be deposited into MRSA to the State Treasurer.

**Public Act 15-1 (December Special Session)**, Sections 31 and 33, effective upon passage, modified the disbursement schedule and established deadlines for specified grant payments to MRSA.

**Public Act 15-1 (December Special Session)**, Section 32, effective upon passage and applicable to sales occurring on or after October 1, 2015, delayed the 4.7% sales tax revenue diversion to the STF by 2 months (December 1, 2015), and to MRSA by 4 months (May 1, 2016).

**Public Act 16-2 (May Special Session)**, Section 40, effective upon passage, eliminated the sales tax revenue diversion to the MRSA, and required DRS to transfer any sales tax revenue that accrued on or after July 1, 2016 (May through June 2016) to MRSA.

**Public Act 16-2 (May Special Session)**, Section 45, effective July 1, 2016, required DRS to reduce the monthly deposit of sales tax revenue to the STF by \$4,166,667.

**Public Act 16-3 (May Special Session)**, Section 183, effective July 1, 2016, beginning in the 2016 tax year, extended the sunset date for angel investor tax credits through July 1, 2019, and allowed taxpayers to sell, assign, or transfer all or part of the credit to other taxpayers.

- **Corporation Business Tax**

**Public Act 15-244**, Section 83 and 84, effective upon passage, beginning in the 2015 tax year, (1) extended the 20% corporation income tax surcharge that was set to expire after the 2015 income year for 2 additional years to 2016 and 2017, and (2) imposed an additional, temporary 10% surcharge for the 2018 income year.

**Public Act 15-244**, Section 87, effective upon passage, limited the amount of net operating loss carryforwards that corporations may deduct.

**Public Act 15-244**, Section 88, effective upon passage, reduced the limit to which corporations can use credits from 70% to 50.01% to reduce the amount of taxes owed.

**Public Act 15-244**, Section 219, effective upon passage, required DRS to (1) review how alternative apportionment and income sourcing methods affect Connecticut businesses and (2) make any recommendations to the Finance, Revenue, and Bonding Committee by February 1, 2016.

**Public Act 15-5 (June Special Session)**, Section 139-141, effective June 30, 2015, delayed the effective date of the provisions of Public Act 15-244, Sections 83 and 84, to January 1, 2016 and made them applicable to subsequent income years. Also, beginning in the 2016 tax year, the act made conforming changes to the provisions imposing the surcharge on companies that file combined or unitary tax returns to reflect the delayed implementation of combined reporting.

**Public Act 15-1 (December Special Session)**, Section 36, effective on July 1, 2016, beginning in the 2016 tax year, imposed a \$2.5 million cap on the amount that a combined group's corporate income tax liability calculated on a unitary basis can exceed the tax it would have paid on a separate basis.

**Public Act 15-1 (December Special Session)**, Section 40-46, effective July 1, 2016, beginning in the 2016 tax year, required multistate corporations to apportion their Connecticut income based only on unweighted Connecticut sales (i.e. single-factor formula).

- **Cigarette and Tobacco Taxes:**

**Public Act 15-244**, Sections 176 to 180, increased the cigarette tax from (1) \$3.40 to \$3.65 per pack, effective October 1, 2015, and (2) \$3.65 to \$3.90 per pack, effective July 1, 2016. In addition, effective upon passage, the act imposed a 25-cent "floor tax" on each pack of cigarettes that dealers and distributors have in their inventories on September 30, 2015 and June 30, 2016.

- **Estate and Gift Taxes:**

**Public Act 14-155**, Section 11, effective upon passage, changed how taxpayers must calculate the estate tax for deaths on or after January 1, 2015.

- **Gasoline Taxes:**

**Public Act 15-244**, Section 91, effective July 1, 2015 and for calendar quarters ending on or after September 30, 2015, eliminated the requirement for DRS to (a) biennially calculate the amount of taxes paid on gasoline sold in the prior fiscal year as a percentage of total tax revenue and (b) use the calculation to determine the amount of tax revenue transferred to the STF.

- **Other Taxes:**

**Public Act 15-244**, Section 74, effective upon passage and applicable to sales on or after October 1, 2015, eliminated the requirement (for calendar quarters ended July 1, 2016 and prior to July 1, 2017) for DRS to deposit in the Regional Planning Incentive Account (1) 6.7% of revenue from the hotel tax and (2) 10.7% of revenue from the rental car tax. Instead, the revenue generated was redirected to the General Fund in fiscal year 2016-2017.

**Public Act 15-244**, Section 85, effective upon passage and applicable to calendar years on or after January 1, 2015, extended to 2015 and 2016, the temporary cap on the maximum insurance premium tax liability that an insurer may offset through tax credits.

**Public Act 15-5 (June Special Session)**, Section 123, effective upon passage, delayed the deadline for DRS to submit the tax incidence report to the legislature from December 31, 2016 to February 15, 2017.

**Public Act 15-1 (December Special Session)**, Section 30, effective upon passage and applicable to calendar quarters starting on or after January 1, 2016, raised the hospital tax credit cap by 5% per year until it reaches 70% in 2019, and extended the annual cap to ambulatory surgical gross receipts tax.

**Public Act 16-3 (May Special Session)**, Section 192, effective upon passage, delayed the deadline for DRS to submit the tax incidence report to the legislature from February 15, 2017 to February 15, 2018.

**Public Act 16-3 (May Special Session)**, Section 198, effective January 1, 2017, prohibited DRS from issuing or renewing certain permits or licenses for anyone who is determined to have failed to file any required tax returns.

## **RÉSUMÉ OF OPERATIONS**

### **General Fund Revenues and Receipts**

General Fund tax revenues, license fees and all other revenues and non-revenue receipts totaled \$15,168,720,030 and \$15,191,216,373 for the fiscal years ended June 30, 2015 and 2016, respectively. Revenues other than taxes included payments for licenses to collect sales and use



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taxes and sell cigarettes and tobacco products, service-of-process fees and costs related to tax warrants, expenditure refunds and federal funding.

General Fund tax refunds, budgeted as reductions of tax revenues, were \$1,168,857,648 and \$1,240,979,332 for the fiscal years ended June 30, 2015 and 2016, respectively.

A summary of tax revenues, net of refunds, for the fiscal years ended June 30, 2015 and 2016, with 2014 amounts presented for comparative purposes, is presented below:

<b>(In Millions of Dollars)</b>	<b>2013-2014</b>	<b>2014-2015</b>	<b>2015-2016</b>
Personal Income	\$ 7,711	\$ 8,162	\$ 8,187
Sales and Use	4,166	4,199	4,169
Corporations	661	680	743
Public Service Companies	289	297	260
Inheritance Taxes	146	161	195
Insurance Companies	195	182	205
Alcohol/Cigarettes/Tobacco	437	420	436
Real Estate Conveyance Tax	170	185	194
Petroleum Companies	398	345	69
Admissions and Dues	40	38	39
Nursing Homes	149	147	145
Hospital Net Patient Revenue	317	286	482
All other Taxes	63	67	68
Total	<b>\$ 14,742</b>	<b>\$ 15,169</b>	<b>\$ 15,192</b>

The increases in revenues during the audited period were primarily due to personal income and hospital net patient revenue. Revenues from sales and use and personal income tax receipts accounted for approximately 81% of tax revenues in both fiscal years.

### **General Fund Expenditures**

A summary of General Fund expenditures from department appropriations for the fiscal years ended June 30, 2014, 2015, and 2016, is presented below:

	<b>2013-2014</b>	<b>2014-2015</b>	<b>2015-2016</b>
Personal Services	\$ 55,603,677	\$ 57,853,931	\$ 57,801,853
Other Expenses	8,679,502	8,136,912	7,865,293
Total Budgeted Accounts	<b>\$ 64,283,179</b>	<b>\$ 65,990,843</b>	<b>\$ 65,667,146</b>
Restricted Appropriations	8,267	17,077	0
GAAP Appropriations	272,634	530,204	0
Total	<b>\$ 64,564,080</b>	<b>\$ 66,538,124</b>	<b>\$ 65,667,146</b>

Operating expenditures increased slightly over the audited period. Personal services increased partly because of salary increases. Other expenses decreased due to a reduction in advertising and mailing costs related to the tax amnesty program, as well as professional services.

The number of filled positions decreased slightly during the audited period, as compared to the previous year. Below is a summary of positions as of June 30, 2014, 2015, and 2016:

	<b>June 30, 2014</b>	<b>June 30, 2015</b>	<b>June 30, 2016</b>
Full-Time	634	628	599
Part-Time	52	9	9
Temporary or Durational	2	0	0
Total	<b>688</b>	<b>637</b>	<b>608</b>

### **Special Transportation Fund**

In accordance with the provisions of Section 13b-61 of the General Statutes, motor fuel taxes and related fees collected by the department, pursuant to Chapters 221 and 222 of the General Statutes, were deposited into the Special Transportation Fund.

Special Transportation Fund receipts for the department totaled \$515,033,706 and \$780,926,005 for the fiscal years ended June 30, 2015 and 2016, respectively.

Special Transportation Fund tax refunds, budgeted as reductions of tax revenues, totaled \$7,234,079 and \$7,321,017 for the fiscal years ended June 30, 2015 and 2016, respectively.

A summary of Special Transportation tax revenues, net of refunds, for the audited period is presented below:

<b>(In Millions of Dollars)</b>	<b>2013-2014</b>	<b>2014-2015</b>	<b>2015-2016</b>
Motor Fuel Tax	\$ 351	\$ 357	\$ 367
Petroleum Gross Earnings Tax	0	0	186
Sales and use Tax	0	0	76
Total	<b>\$ 501</b>	<b>\$ 508</b>	<b>\$ 774</b>

### **Audit Assessments**

Examiners in the department's Audit Division conducted audits to ensure taxpayer compliance regarding the filing of returns and the remitting of tax payments. These efforts (field and office audits) generated assessments. Based upon statistics provided by the Audit Division, assessments totaled \$416,703,082 and \$349,372,017 for the fiscal years ended June 30, 2015 and 2016, respectively. A summary of assessments by tax type for the audited period, as provided by the Audit Division, is presented below:

<b>(In Millions of Dollars)</b>	<b>2013-2014</b>	<b>2014-2015</b>	<b>2015-2016</b>
Corporation and Other	\$ 163	\$ 193	\$ 186
Sales and Use Taxes	93	93	74

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Personal Income Tax	52	68	63
Excise Taxes	11	42	5
Public Service Taxes	24	21	21
Total	<u>\$ 343</u>	<u>\$ 417</u>	<u>\$ 349</u>

### Appellate Division

The department's Appellate Division administers appeals from taxpayers disputing audit assessments. A hearing is held after a taxpayer files a written protest. Appellate decisions are made concerning the validity of assessments based upon information presented. Further appeals are available to taxpayers by means of litigation.

Appellate Division activity reports, reflecting resolution activity for the fiscal years ended June 30, 2014, 2015, and 2016, are presented below. The division revised the reports as a result of court and Appellate Division decisions.

	<u>2013-2014</u>	<u>2014-2015</u>	<u>2015-2016</u>
Cases Resolved	1,448	1,457	1,806
Original Assessments	\$ 48,453,161	\$ 32,773,843	\$ 46,548,866
Revised Assessments	36,226,043	23,300,071	26,890,265
Assessment Reductions	<u>\$ 12,227,118</u>	<u>\$ 9,473,772</u>	<u>\$ 19,658,601</u>
Percentage Reduction	25%	29%	42%

### Accounts Receivable

The department's accounts receivable are derived from various sources, including audit assessments, delinquency assessments, penalty and interest charges, and returns filed without remittances or filed with an underpayment of tax liability. A summary of accounts receivable as of June 30, 2014, 2015, and 2016, is presented below:

	<u>June 30, 2014</u>	<u>June 30, 2015</u>	<u>June 30, 2016</u>
<b>Taxes Receivable:</b>	\$	\$	\$
Corporation Tax	26,570,909	22,285,051	51,454,199
Income Tax	207,368,426	231,567,926	271,883,383
Sales and Use Tax	189,721,107	207,076,477	243,860,548
Other Taxes	<u>29,662,172</u>	<u>31,357,050</u>	<u>37,955,105</u>
Total Taxes Receivable	<u>\$453,322,614</u>	<u>\$492,286,504</u>	<u>\$605,153,235</u>
<b>Reductions:</b>			
Credits	(129,936,411)	(129,393,135)	(142,955,762)
Appellate and Court			
Estimated Uncollectible	<u>(117,048,404)</u>	<u>(129,027,706)</u>	<u>(156,520,020)</u>
Total Reductions	<u>(273,892,105)</u>	<u>(299,088,857)</u>	<u>(350,277,866)</u>
Net Taxes Receivable	<u>\$179,430,509</u>	<u>\$193,197,647</u>	<u>\$254,875,368</u>

The receivable balances reflect reductions for payments that were made on account by taxpayers to avoid the continued accrual of interest on assessments under protest and credits due taxpayers.

**Penalty Waivers**

Certain statutes impose penalties for failure to pay taxes within specified deadlines. Section 12-3a of the General Statutes authorizes the commissioner of Revenue Services to waive penalties for cases in which the taxpayer failed to pay the tax due to reasonable cause. Section 12-3a requires the Penalty Review Committee to approve all penalty waivers over \$1,000. The committee is comprised of the commissioner, the Secretary of the Office of Policy and Management, and the State Comptroller.

A summary of the penalty waiver activity for the fiscal years ended June 30, 2014 through 2016, as provided by the department, follows:

	<u>Requests</u>		<u>Denied</u>		<u>Approved Waivers</u>	
	<u>Cases</u>	<u>Penalties</u>	<u>Cases</u>	<u>Penalties</u>	<u>Cases</u>	<u>Penalties</u>
2013-2014	3,179	\$3,914,942	1,644	2,546,536	1,535	\$1,368,407
2014-2015	3,542	\$4,347,568	2,482	3,604,064	1,060	\$743,504
2015-2016	3,794	\$4,234,464	2,897	3,259,225	897	\$975,239

**Audit and Compliance Bureau**

The Audit and Compliance Bureau is comprised of revenue agents who pursue collections through direct contact with taxpayers, field agents who issue tax warrants to delinquent taxpayers, hearing officers who provide an initial hearing process for delinquent taxpayers, and enforcement agents who investigate tax evasion cases. Audit and Compliance Bureau records indicated revenues collected by the division were \$185,091,733 and \$166,433,243 during the 2014-2015 and 2015-2016 fiscal years, respectively

The commissioner, upon the approval of an Abatement Review Committee, may abate any tax payable to the state that has been present on department’s suspense tax book for seven years and determined to be uncollectible. The Abatement Review Committee did not hold a meeting during the audited period.

In accordance with Section 12-3b of the General Statutes, the department removes accounts considered to be uncollectible from its active accounts receivable file and transfers those amounts to the tax suspense book. The department eventually considers these transferred amounts for inclusion on abatement approval requests, after the statutorily required 7-year waiting period. The department referred accounts totaling \$34,392,487 and \$36,886,313 to this status during the 2014-2015 and 2015-2016 fiscal years, respectively.

## STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Our examination of the records of the Department of Revenue Services disclosed the following 16 findings and recommendations, of which 9 have been repeated from the previous audit:

### **Internal Control Weaknesses with Suspended Transactions**

*Background:*

The department sometimes cannot process tax returns and payments entered into its tax administration system. The unprocessed returns and subsequent payments go into suspended status. There are many different reasons transactions go into suspense, including a payment that does not match the submitted coupon, or a taxpayer's name that does not match the social security number on file. The system assigns most suspended transactions a severity code, based on the potential impact on a taxpayer's account.

The system should be able to resolve suspended transactions as part of routine procedures in any data processing environment. This should occur on an ongoing basis or through special projects designed to eliminate these transactions. It is DRS policy to resolve all suspended transactions within 5 months of the transaction suspension date, or contact the taxpayer when additional information is required. Suspended transactions requiring additional information remain in suspense until the department receives the information, regardless of how often DRS employees attempt to contact the taxpayer.

*Criteria:*

The Committee of Sponsoring Organizations' Integrated Framework for Internal Controls states that an effective system of internal controls provides reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance. Information and communication are integral components of the internal control system which provide management with relevant, quality information to sustain and improve performance and support the effective and efficient achievement of objectives.

*Condition:*

DRS does not have procedures to aggregate and report the status of suspended transactions to upper management. The current reporting system makes it difficult for management to determine whether DRS personnel made prompt and sufficient efforts to resolve the remaining suspended transactions awaiting additional taxpayer information.

*Context:*

A December 2018 DRS report indicated there were over 19,000 suspended transactions compared to the approximately 38,000 transactions suspended in the report provided by DRS in November 2015. Our review also found that each unit's reporting system to

document the status and progress of work on suspended transactions varies between supervisors.

*Effect:* A lack of reporting of relevant, quality information to upper management may result in decreased efficiency or effectiveness in the use of resources and resolution of suspended transactions.

*Cause:* The department's current internal controls for suspended transactions do not require the reporting of information to upper management regarding DRS efforts to resolve remaining suspended transactions.

*Prior Audit Finding:* This finding has been previously reported in a modified form in the last 2 audit reports covering the fiscal years ended June 30, 2011 to 2014.

*Recommendation:* The Department of Revenue Services should strengthen its internal controls over reporting to ensure management is provided with relevant and accurate information to support the effective and efficient resolution of suspended transactions. (See Recommendation 1.)

*Agency Response:* "While the Agency recognizes our current system (ITAS) lacks the ability to aggregate reporting to upper management of relevant information on the current status of suspended items, we are confident our new modernized system (CTax) will contain robust reporting capabilities for suspended transactions including documentation of efforts made by employees to resolve transactions that remain in suspense when additional information is required from the taxpayer. CTax is in the first of four phases of implementation; full implementation is expected by fiscal year ending 2024."

## **Software Lifecycle Management**

*Criteria:* All software products have a life cycle during which the manufacturer will provide security, compatibility and functional updates, and technical assistance.

The Internal Revenue Service Publication 1075, Tax Information Security Guidelines for Federal, State and Local Agencies, stipulates that agencies must replace information system components when support for the components is no longer available from the developer, vendor, or manufacturer. Federal reviews conducted in accordance with Publication 1075 consider unsupported systems to be a critical finding.

Sound business practice dictates that keeping software up-to-date protects against current threats.

<i>Condition:</i>	<p>The department has not adopted formal policies and procedures to identify and retire critical system software that no longer receives manufacturer support and security updates. That software is deemed end-of-life.</p> <p>We identified that DRS used certain critical system software beyond its stated end-of-life. Therefore, the software no longer receives manufacturer support and security updates.</p>
<i>Effect:</i>	<p>Computer systems operating with unsupported software are more vulnerable to ransomware attacks, malware, and data breaches. Users may also encounter problems with software and hardware compatibility.</p>
<i>Cause:</i>	<p>The department has not implemented policies and procedures to identify and retire critical software before the products exceed their intended end-of-life and are unsupported by the manufacturer. Additionally, the agency indicated that the recent relocation caused a delay in the upgrade process.</p>
<i>Prior Audit Finding:</i>	<p>This finding has not been previously reported.</p>
<i>Recommendation:</i>	<p>The Department of Revenue Services should adopt policies and procedures to identify end-of-life software. The department should retire or upgrade critical software before it loses security updates and manufacturer support. (See Recommendation 2.)</p>
<i>Agency Response:</i>	<p>“The Agency agrees with the recommendation and will implement a Software Lifecycle policy to ensure that unsupported software products are upgraded or retired prior to the products end-of-life.”</p>

### **Improper Intranet Security**

<i>Criteria:</i>	<p>The National Institute of Standards and Technology recommends various access controls in its Special Publication 800-53 (SP 800-53). Control AC-6, Least Privilege, requires that the organization employ the principle of least privilege, "allowing only authorized accesses for users which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions."</p>
<i>Condition:</i>	<p>The DRS intranet site contains sensitive, operational information intended only for DRS staff. Our review identified an incorrect configuration of security filters that allowed all devices connected to the state's secure network to access the DRS intranet site.</p>

When our auditors informed DRS about this issue, the department reconfigured the security filters to limit access to authorized users.

*Effect:* The department’s intranet site was exposed to an increased risk of unauthorized access.

*Cause:* DRS was not aware that the configuration of security filters was incorrect, and does not regularly monitor access to its intranet site.

*Prior Audit Finding:* This finding has not been previously reported.

*Recommendation:* The Department of Revenue Services should regularly monitor its intranet site to ensure that access is limited to authorized users. (See Recommendation 3.)

*Agency Response:* “The Agency adopted a formal “Least Privilege” policy in 2015 that was re-authorized in March 2019. The conditions that allowed other State agencies access to the DRS Intranet site was an oversight and was corrected immediately upon discovery. The Agency will periodically monitor access to the DRS intranet site to ensure that proper access controls remain in place.”

### **Use of Prepaid Accounts to Prevent the Lapsing of Appropriations**

*Background:* In conjunction with our audit of the state’s Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2018, we analyzed the Department of Revenue Services expenditures during the period.

According to the Office of the State Comptroller’s GAAP reporting package instructions, agencies must report prepaid account balances of at least \$300,000. Training materials on the Comptroller’s website use prepaid postage as an example of a type of asset balance that state agencies should report.

*Criteria:* Sections 4-89(a) and 4-89(b) of the General Statutes require budgeted appropriations to be used during the authorized period. All unexpended balances must revert to the fund they were initiated from.

Section 4-98(a) of the General Statutes provides that current expenditures must be made in the appropriated fiscal year.

The submission of complete and accurate information required for reporting in accordance with Generally Accepted Accounting Principles (GAAP) is instrumental in producing a fairly stated Comprehensive Annual Financial Report (CAFR). Reports should be submitted in



compliance with the Office of the State Comptroller's (OSC) requirements as set forth in the State Accounting Manual and other related instructions.

*Condition:*

DRS made substantial payments to the prepaid postage account at the end of fiscal years 2015-2016, 2016-2017, and 2017-2018. This prevented the lapsing of General Fund appropriations and accumulated funds in accounts already containing sufficient balances to meet the department's needs.

DRS did not report the year-end balance of prepaid postage on its GAAP reporting packages for the 2015-2016 and 2016-2017 fiscal years as required by the Comptroller. DRS reported its prepaid postage balance in fiscal year 2017-2018 after our office informed the department of the reporting requirement.

*Context:*

There was over \$1.2 million in the prepaid postage account at the end of fiscal year 2017-2018, which is approximately 75% of DRS' projected postage expenditures for fiscal year 2018-2019. DRS approved and paid \$640,000 of the aforementioned balance during the final week of the fiscal year. The chart below demonstrates the escalating payments and balances at fiscal year-end as compared to DRS' appropriations for Other Expenses, which include prepaid postage:

	<b>Fiscal Year</b>		
	<b>2016-2017</b>	<b>2017-2018</b>	<b>2018-2019</b>
<b>Payments to Postage Account in May &amp; June</b>	\$464,375	\$924,695	\$969,105
<b>Postage Account Balances at Fiscal Year End (approximate)</b>	\$725,000	\$915,000	\$1,265,00
<b>Expenditures from Postage Account (approximate)</b>	\$1,355,259	\$1,764,20	\$1,940,25
<b>Appropriations DRS – Other Expenses for the Subsequent Fiscal Year</b>	\$6,776,492	\$7,961,11	\$6,433,06

*Effect:*

When prepaid account balances are maintained in excess of reasonable immediate needs, the state loses the ability to use the funds for other purposes and the potential to earn interest.

Inaccurate GAAP reporting misrepresents the state's financial position as reported in the CAFR and prevents financial statement users from accurately understanding the financial position of the reporting agency.

*Cause:* DRS prepares annual budgets for prepaid postage, which include reasonable quarterly expenditures based on prior period actuals. However, DRS did not make payments to prepaid postage in accordance with budgeted projections or actual needs.

DRS did not include the prepaid postage account balances in its GAAP reporting packages because of an oversight.

*Prior Audit Finding:* This finding has not been previously reported.

*Recommendation:* The Department of Revenue Services should adhere to its projected budgets and maintain sufficient prepaid account balances to meet the anticipated needs of the department in the fiscal year. (See Recommendation 4.)

*Agency Response:* “The Agency agrees with this finding regarding the postage account balance not being included initially in the GAAP reports. Upon notification by the APA, the GAAP reports were revised to include the transaction. The postage account balance at the end of the fiscal year is usually depleted to a level that will hinder DRS from implementing and informing taxpayers of any legislative tax changes and incentive programs. In order to meet the increasing number of accelerated tax changes, the agency will continue to prefund its postage account to meet the tight deadlines imposed in accordance with OPM guidance and Comptroller requirements on reporting.”

### **Interest Payments on Returns Held for Review**

*Criteria:* Prior to issuing tax refunds, DRS procedures require the review of tax refund claims over a fixed threshold to help deter erroneous or fraudulent returns. The Operations Division compares initial returns with refund claims and the Audit Division reviews amended returns. Statutory provisions generally require DRS to pay interest on refund requests held for more than 90 days. The payment of interest on these returns should incentivize DRS to promptly handle these claims.

The Committee of Sponsoring Organizations’ Integrated Framework for Internal Controls published provides that an effective system of internal controls include a reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance. Information and communication are integral components of the internal control system that provide management with relevant and accurate information in a timely manner.

*Condition:* We judgmentally selected 6 taxpayer accounts based on the amount of the interest payment and the period that interest accrued. The interest totaled \$2,767,778 on \$11,630,768 in refunds. Our review disclosed the following:

- 1) DRS paid \$1,120,031 in interest on an \$8,979,748 tax refund. The taxpayer filed an initial return in September of 2015 requesting an \$8,841,910 refund, and an amended return in March of 2017 requesting an additional \$137,838 refund. DRS held both returns for review, and discovered that the initial return was still outstanding while it was examining the amended return. DRS completed both reviews concurrently and issued the entire refund plus interest in May of 2017. DRS did not identify why it held the initial return for more than a year and a half.
- 2) DRS paid \$1,346,382 in interest on \$1,270,969 in tax refunds for 3 taxpayer accounts. DRS identified these refund requests in fiscal year 2014-2015, which the department held for review since its conversion to the current system in fiscal year 2006-2007. DRS conducted the reviews and issued the payments after identifying the outstanding refunds.
- 3) DRS paid \$176,110 in interest on a \$1,056,134 tax refund amount. DRS held the refund during a 15-month review of the tax return. The review took a long time due to the complexity of the return. DRS has since implemented procedures to minimize the interest due when conducting reviews for this tax type.
- 4) DRS paid \$125,254 in interest in July of 2014 on a \$323,917 tax refund. The taxpayer filed an amended return in June of 2009 and DRS held the return to conduct a fraud review. DRS completed the fraud review in May of 2014.

*Context:* Total refunds issued and interest paid during the period for illustration are as follows:

<b>Fiscal Year</b>	<b>Refunds</b>	<b>Interest</b>
2014-2015	\$1,176,091,727	\$ 5,140,712
2015-2016	1,248,300,349	2,613,376
2016-2017	1,282,732,496	3,799,139
2017-2018	1,285,527,300	844,951
<b>Total</b>	<b>\$4,992,651,871</b>	<b>\$12,398,178</b>

In addition, our review noted that DRS implemented procedures in fiscal year 2017-2018 to reduce interest payments when returns are held

for review. However, we requested a report of all outstanding refund requests currently held for review, but DRS has not provided it .

*Effect:* The state continues to incur unnecessary interest expenses when the department does not identify and track returns held for review.

*Cause:* DRS does not have adequate procedures in place to track refund requests held for review.

*Prior Audit Finding:* This finding has been previously reported in a modified form in the last audit report covering the fiscal years ended June 30, 2013 and 2014.

*Recommendation:* The Department of Revenue Services should implement procedures to adequately identify and track all outstanding refund requests held for review. The department should promptly process refund claims to avoid excess interest payments. (See Recommendation 5.)

*Agency Response:* “The Agency is in the process of standardizing a report to monitor all User Requested General PRIs. The Agency would like to emphasize that review item number 1 was an isolated incident and in no way reflects the general practice of Audit refund claim reviews. This return did not have a system generated Audit PRI. A User Requested General PRI was placed on the account as a result of a referral from the Operations Bureau. At the time the taxpayer was under audit for prior periods and the Audit Division did not want to issue the refund until the result of the prior period audit could be determined. To add complexity to the situation, the taxpayer was also changing their filing to a combined unitary basis.”

### **No Evidence of a Cost-Benefit Analysis for a Significant Policy**

*Background:* The Department of Revenue Services allows a 3 to 5-day grace period when determining the timeliness of receipt of mailed tax returns or payments when DRS receives them after the deadline. For individual income tax returns, DRS generally accepts any return or payment received within the grace period as filed timely without consideration of the postmark.

DRS believes that the grace period allows for the more effective and efficient use of its limited resources, and therefore enhances its staff’s productivity during tax deadlines, when the demands on its resources are the greatest due to the large volume. DRS also indicated that the use of the grace period is a common business practice in most states it contacted.

<i>Criteria:</i>	<p>Section 12-39aa(a) of the General Statutes provides that if any document or payment required to be made to DRS is delivered by an authorized mail delivery service and received after the statutorily required period or due date, then the date postmarked on the envelope will be deemed the date of delivery or payment.</p> <p>Most tax types included under Title 12 of the General Statutes impose a penalty for not submitting a return or payment by the statutorily prescribed period or due date.</p> <p>Sound business practices dictate that an analysis should be used to anticipate and evaluate the likely consequences of significant policies. Cost-benefit and cost-effectiveness analyses provide a systematic framework to identify and evaluate the likely outcomes of alternative policy choices to determine if the benefits of an action likely justify the costs. They also help to discover which of the various possible alternatives would be most cost-effective.</p>
<i>Condition:</i>	<p>There is no evidence that the DRS use of grace periods is the most effective and efficient solution to handle a large volume of filings immediately following tax deadline. DRS has not evaluated the amount of forfeited penalties as a result of this policy decision.</p>
<i>Context:</i>	<p>Penalties are statutorily required when DRS receives a payment after the deadline, and are based on a percentage of the unpaid tax due for most tax types. For example, the penalty for late payments of individual income tax is 10% of the unpaid tax.</p>
<i>Effect:</i>	<p>Without a properly documented analysis of its significant policies and possible alternatives, DRS management may not be implementing the most effective and efficient use of its resources.</p>
<i>Cause:</i>	<p>DRS believes that the use of a grace period allows for the most effective and efficient use of its resources. However, the department has not documented how it arrived at that conclusion or whether it evaluated any alternatives.</p>
<i>Prior Audit Finding:</i>	<p>This finding has been previously reported in a modified form in the last 2 audit reports covering the fiscal years ended June 30, 2011 to 2014.</p>
<i>Recommendation:</i>	<p>Prior to instituting or modifying significant policies, the Department of Revenue Services should perform and document cost-benefit and cost-effectiveness analyses. These reviews would evaluate whether the benefits of the policy are likely to justify the costs and identify possible alternatives to assist in the selection of the most effective and efficient method. (See Recommendation 6.)</p>

*Agency Response:*

“To provide context to this recommendation, during the first several days after the Individual Income Tax due date, the Agency historically receives over 26,000 payment envelopes. Due to the requirement to have these payments processed and deposited in a timely manner, a business decision was made to process all mail received by DRS within a specified timeframe after the due date as “timely”. This decision eliminates the need for employees to manually view and sort over 26,000 pieces of mail. The grace period timeframe is assessed each year, based on the volume of mail received. Several years ago, the Internal Audit Unit performed an analysis of the actual postmark dates contained in the mail received during the grace period timeframe and determined this business decision appeared appropriate. The business decision is based on billing thresholds, the cost associated to mailing bills to taxpayers for nominal amounts due, especially when the bill is based only on this late penalty amount, and the resource drain of employee resources to facilitate taxpayer calls on the billing notices, penalty waiver requests and process any nominal payments received. It is important to note that any taxpayer with an underpayment of estimated tax liability would still be assessed the amount due for that associated penalty.”

## **Maintenance and Disposition of Seized Property Cases**

*Background:*

The Department of Revenue Services, Special Investigation Section (SIS), is primarily responsible for the investigation of statutory civil and criminal violations pertaining to illegal importation of untaxed cigarettes and other suspected violations. In accordance with Section 12-330(g) of the General Statutes, the DRS Commissioner is authorized to seize untaxed tobacco products as contraband.

Property seized under the above provisions may, after a hearing if one is requested, be offered for sale at auction or be disposed of in a manner deemed to be in the best interest of the state. The accused cannot request a hearing after the expiration of the statute of limitations. At that point, the department should close the case. Proceeds from sales of such items are to be deposited with the State Treasurer.

During our review, DRS used two separate inventory systems for tracking the inventory of SIS property, the official “Integrated Tax Accounting Software (ITAS) Contraband Inventory Report” and the “SIS Excel Contraband Inventory Report (maintained by custodian)”. DRS must perpetually reconcile updates in the Excel file to ITAS.

In prior audits, we obtained and reviewed operating policies and procedures. We expected that the department would retain these policies

and make them available to current custodians to ensure proper and consistent internal controls.

*Criteria:* The department's Special Investigation Section policy states that the property agent and/or SIS supervisor, and DRS Public Tax Service Unit (PSU) personnel should conduct a biannual audit of all property in the seized property evidence room to ensure compliance and accuracy. On a quarterly basis, the property agent should request an inventory list of all currently seized property, promptly review it for accuracy, and follow accepted procedures regarding the disposal of seized property that is no longer required to be in the SIS inventory.

*Condition:* During our review of the operation of the SIS inventory, we noted that the established policies and procedures were not available to the current SIS inventory staff. As a result, the current custodians were not operating the SIS inventory under established procedures.

We also noted various discrepancies between the official ITAS record and Excel report used to track the SIS inventory, as follows:

- DRS listed several cases on the SIS Excel report, but did not enter them into ITAS after they were placed in the evidence room.
- DRS listed cases as closed, donated, and destroyed in ITAS, but still listed them as on hand in the SIS Excel report.
- During our physical inventory walkthrough, we noted various discrepancies in units of measurement between both reports and actual physical counts on hand.
- There was no evidence that DRS performed a reconciliation of actual amounts on hand to both inventory records in the department's physical inventories for fiscal years 2014-2015 and 2015-2016.

*Effect:* There is less assurance that the department secured, preserved, and maintained seized property and promptly disposed of it properly.

*Cause:* The transition in custodians did not include the transfer of established policies and procedures.

*Prior Audit Finding:* This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2013 and 2014.

*Recommendation:* The Department of Revenue Services should comply with its policies and procedures regarding the maintenance of seized property and promptly update its inventory records after cases are closed. (See Recommendation 7.)

*Agency Response:* “The Agency agrees with this finding.”

**Inventory and Property Control Management Exceptions**

*Criteria:* Section 4-36 of the Connecticut General Statutes requires each agency to establish and maintain an inventory record as prescribed by the State Comptroller. The State Property Control Manual establishes the standards, which include tagging property and recording of inventory in Core-CT. Agencies are to annual submit to the Comptroller, via the CO-59 property control report, a detailed inventory of all of the following property owned by the state and in the custody of such agency: (1) real property, and (2) personal property having a value of \$1,000 or more. The manual also requires agencies to differentiate licensed software (LSOFT) and software state-owned (SOFT) be capitalize and report them on the CO-59. The CO-59 instructions require that the report balances agree with the balances in Core-CT, the state’s official accounting system.

*Condition:* From a selection of 20 items listed on the department’s capitalized equipment inventory, we noted the following:

- One computer was listed as active in August 2018 but documentation indicates that it was disposed of in August 2014.
- Two servers were located in Springfield, Massachusetts, but were listed as being in Groton, Connecticut in Core-CT.

In addition, we noted differences between Core-CT asset balances and amounts DRS reported on its CO-59 reports, as follows:

**Fiscal Year 2014-2015**

	<b>CO-59</b>	<b>Core-CT</b>	<b>Variance</b>
<b>SOFT</b>	\$3,858,102	\$300,798	\$3,557,304
<b>LSOFT</b>	\$0	\$3,556,128	\$(3,556,128)

**Fiscal Year 2015-2016**

	<b>CO-59</b>	<b>Core-CT</b>	<b>Variance</b>
<b>Capitalized Equipment</b>	\$9,015,669	\$8,509,627	\$506,042
<b>SOFT</b>	\$0	\$416,077	\$(416,077)
<b>LSOFT</b>	\$4,861,014	\$4,170,857	\$690,157



<i>Effect:</i>	The property inventory records were not accurate. The department has less assurance that its capital assets are properly maintained and reported.
<i>Cause:</i>	It appears that the department did not strictly adhere to the State Property Control Manual. In addition, weaknesses in managerial oversight contributed to the conditions.
<i>Prior Audit Finding:</i>	This finding has been previously reported in the last audit covering the fiscal years ended June 30, 2013 and 2014.
<i>Recommendation:</i>	The Department of Revenue Services should improve internal controls over its property inventory reporting in order to comply with the State Property Control Manual. (See Recommendation 8.)
<i>Agency Response:</i>	“The Agency agrees with this finding. Due to staffing changes in the oversight of asset/inventory management, DRS did have to overcome challenges reconciling Core-CT and CO-59 for these fiscal years. However, in fiscal years 2018 and 2019, the CO-59 report reconciled with Core-CT and all assets were properly tagged and identified. This finding should be resolved.”

### **Disposition of Funds Awaiting Distribution**

<i>Background:</i>	Any receipt of funds that cannot be posted to the correct funding source must be coded to Funds Awaiting Distribution. This fund was established by the Office of the State Comptroller (OSC) to enable agencies to comply with statutory depositing requirements. It is incumbent on the agency to determine the correct coding for these funds and disburse them in order to clear this fund.
<i>Criteria:</i>	<p>The DRS Funds Awaiting Distribution Fund accounts should be supported by detailed accounting records. Proper internal control calls for the reconciliation of control totals to subsidiary records.</p> <p>Section 3-112 of the General Statutes requires the Office of the State Comptroller to prescribe the mode of keeping and rendering all public accounts of the state. The State Accounting Manual (SAM) year-end closing process requires each state agency with a balance in the Funds Awaiting Distribution Fund at June 30th, to submit by July 31st of each year, a report to OSC that the agency has reconciled its Funds Awaiting Distribution Fund account activity. The report requires the agency to inform OSC of any errors and request required corrections.</p>

*Condition:* We identified an account within the Funds Awaiting Distribution with an ending balance that DRS did not reconcile and could not explain the activity. There were recent reconciliation issues and items as far back as 2008 that the department continuously carried forward into the current period.

In addition, DRS did not submit a report to the Comptroller in accordance with State Accounting Manual. The fund's balance totaled \$16,599,582 and \$18,560,820 as of June 30, 2015 and 2016, respectively.

*Effect:* The lack of timely identification and reconciliation of the Funds Awaiting Distribution Fund activity could result in the improper use and recording of cash receipts.

*Cause:* The agency did not ensure that it promptly identified the activity properly subsequent to posting it to the temporary account. It appears that some of the activity may be from the department's transition to ITAS.

*Prior Audit Finding:* This finding has not been previously reported.

*Recommendation:* The Department of Revenue Services should consult with the Office of the State Comptroller and investigate, identify, and promptly reconcile the balance in its Funds Awaiting Distribution Fund account. (See Recommendation 9.)

*Agency Response:* "The Agency agrees with the finding. The issue relates to the SID the funds are deposited into differing from the SID used when the funds are allocated to other agencies. DRS has been in contact with the Office of the State Comptroller and is working toward resolving the issue and preventing future reconciling items."

## **Investigations Log**

*Criteria:* The Human Resources Unit should conduct investigations using formal, written procedures to ensure their investigative conclusions and actions are reasonable and consistent. These procedures should include documentation to substantiate the administrator's review of the complaints, a determination of whether the complaint requires further investigation, the proper preparation of case files, and support of the investigation's conclusions.

DRS' Human Resource Investigation Procedure requires that an investigation summary form must accompany any investigation.

<i>Condition:</i>	<p>A review of 12 cases judgmentally selected during our audited period noted the following exceptions:</p> <ul style="list-style-type: none"><li>• In 6 instances, the unit did not close investigations or promptly resolve them. These cases were filed in fiscal year 2015-2016, but still listed as pending as of November 2018.</li><li>• In 7 instances, the unit did not complete investigation summary forms.</li><li>• In one instance, the investigation summary form was not signed.</li><li>• In 4 instances, there was no documentation in employee files to show whether DRS implemented the recommended disciplinary action or followed up on the progress of stipulated agreements.</li></ul>
<i>Effect:</i>	<p>There is increased risk of inconsistencies in investigation conclusions and actions without a well-documented review with standardized forms.</p>
<i>Cause:</i>	<p>The agency did not utilize the investigations summary form to detail pertinent investigative information and substantiate that it performed a formal review.</p>
<i>Prior Audit Finding:</i>	<p>This finding has not been previously reported.</p>
<i>Recommendation:</i>	<p>The Department of Revenue Services should adhere to its established Human Resources policies. The use of these formal, written procedures will help to ensure investigative conclusions and actions were reasonable and consistent. (See Recommendation 10.)</p>
<i>Agency Response:</i>	<p>“HR Administration changed personnel in May of 2018. Therefore, the current HR Administration cannot speak to the violation cited. However, the current HR Administration has created and utilizes a case management system to maintain all aspects of investigations. In addition, the prior investigation policy has been enhanced into a standard operating procedure.”</p>

### **Lack of Performance Assessment and Recognition System Annual Evaluations**

<i>Criteria:</i>	<p>The Performance Assessment and Recognition System (PARS) is a program developed by the Department of Administrative Services (DAS) to support additional incentive compensation for managerial and confidential employees who work in agencies that use a prescribed PARS plan. Basic features of the program include developing results-</p>
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oriented, measurable performance objectives and goals for each manager and confidential employee, regular communication between such employees and their supervisors on meeting goals, performance assessments, and providing a basis for differentiating among performance levels and thus serving as a basis for annual salary increases.

*Condition:* The Department of Revenue Services participates in PARS, but was unable to provide us with records to document that it performed PARS reviews on all of its managers and confidential employees during our audited period.

*Effect:* There is less formal feedback to management about performance goals, the attainment of such goals, and productivity expectations when performance evaluations are not prepared.

*Cause:* The department has inadequate administrative controls to ensure the completion of PARS managerial performance evaluations.

*Prior Audit Finding:* This finding has not been previously reported.

*Recommendation:* The Department of Revenue Services should ensure that all managers are evaluated on an annual basis using the Performance Assessment and Recognition System. (See Recommendation 11.)

*Agency Response:* “HR Administration changed personnel in May of 2018. Therefore, the current HR Administration cannot speak to the violation cited. However, the current HR Administration encourages and tracks collective bargaining agreements service ratings and Performance Assessment and Recognition System evaluations in accordance with the established guidelines.”

## **Compensatory Time and Overtime**

*Criteria:* Section 5-245 of the General Statutes provides that employees receive overtime pay hours exceeding the employee’s regular workweek, when the appointing authority authorizes the additional work.

Good business practice dictates that agencies establish formal written procedures for the approval of overtime.

Collective bargaining agreements and agency policies permit employees to earn compensatory time, with prior approval, for time worked in excess of their normal work schedule. Employees must submit a compensatory time request form that documents the dates and approximate hours requested, and the reason for the request. The

agency has an official compensatory time form that the manager must approve prior to employee being allowed to earn the compensatory time.

*Condition:*

**Overtime**

We reviewed 20 staff overtime records during the audited period. In 16 cases, the department was unable to provide evidence to substantiate the proper approval of overtime.

In addition, the department does not have written overtime approval procedures in place.

**Compensatory Time**

We reviewed 20 staff compensatory time records during the audited period. None of the 20 employees obtained prior management approval for their earned compensatory time.

*Context:*

DRS adopted an informal policy allowing supervisors to approve overtime using email. DRS does not have an official approval form, but makes employees aware that they must receive prior approval, except in the case of an emergency or unforeseen circumstance.

In situations in which agencies adopted formal approval forms to manage the use and approval of compensatory time, it is expected that they will use these documentary records.

*Effect:*

A lack of proper documentation indicating the approval of compensatory and overtime reduces assurance that such time was earned and necessary.

*Cause:*

DRS does not have established overtime authorization procedures. The department relied on informal email acknowledgement, which does not always occur or often occurs after the fact. DRS did not follow its compensatory time procedures.

*Prior Audit Finding:*

Elements of this finding have been previously reported in the last audit covering the fiscal years ended June 30, 2013 and 2014.

*Recommendation:*

The Department of Revenue Services should establish procedures for the authorization of overtime to comply with Section 5-245 of the General Statutes. In addition, the department should adhere to internal procedures that require prior approval of compensatory time. (See Recommendation 12.)

*Agency Response:*

“HR Administration changed personnel in May of 2018. Therefore, the current HR Administration cannot speak to the violation cited. However, the current HR Administration works with the Fiscal Office

and follows collective bargaining contracts when guiding on overtime and compensatory time approvals. DRS will establish procedures for authorization of overtime and compensatory time approval prior to accruing in accordance with statutory compliance and DAS guidelines.”

### **Untimely Access Termination to Core-CT for Terminated Employees**

- Criteria:* The Core-CT Security Liaison Guide states that each agency is responsible for assigning a Core-CT Security Liaison as the primary contact for the Statewide Core-CT Applications Security Administrator. The agency liaisons are responsible for requesting the deletion of access immediately upon notice of an employee’s termination, retirement, or transfer.
- Condition:* Our review of 9 terminated employees’ access to the Core-CT system disclosed that the department did not immediately deactivate 5 employees’ system access. It took the department 7 to 51 days to deactivate the employees’ access.
- Effect:* There is an increased risk of unauthorized access to the Core-CT system and possible manipulation of data.
- Cause:* The department does not have appropriate controls in place to ensure that it immediately deactivates employee access to Core-CT upon termination.
- Prior Audit Finding:* This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2013 and 2014.
- Recommendation:* The Department of Revenue Services should establish controls to ensure that it immediately deactivates employee access to the Core-CT system upon termination. (See Recommendation 13.)
- Agency Response:* “HR Administration changed personnel in May of 2018. Therefore, the current HR Administration cannot speak to the violation cited. However, the current HR Administration has adopted a lockout standard operating procedure in December of 2019.”

### **Outdated Penalty Waivers Regulation**

- Criteria:* The department should update its regulations related to the Penalty Review Committee to comply with Section 12-3a(c) of the General Statutes.

Section 4-168(h) of the General Statutes allows the agency to amend or repeal a regulation in accordance with the requirements of subsection (a) of this section, or may proceed without prior notice, public comment period or hearing, provided the agency has posted such amendments to or repeal of the regulation on the eRegulations System. Any regulation amendment or repeal must be submitted in the form and manner prescribed in Section 4-170(b), to the Attorney General, as provided in Section 4-169, and to the standing legislative regulation review committee, as provided in Section 4-170, for approval. If approved, the change shall be submitted to the office of the Secretary of the State for posting on the eRegulations System with, in the case of transferred or renumbered sections only, a correlated table of the former and new section numbers.

*Condition:* Sections 12-3a-1 and 12-2-11 of the current DRS penalty waiver regulations are outdated. As far back as 2013, the agency proposed the repeal of the two regulations and drafted new Sections 12-3a-1a and 12-3a-2. However, as of 2018, the department had not submitted the draft regulations to all of the regulatory committees for review.

*Context:* On October 25, 2012, Governor Dannel P. Malloy sent a letter to the DRS Commissioner notifying him of the approval of proposed changes to existing regulation and the need to proceed with the regulation-making process set forth in Chapter 54 of the General Statutes. DRS currently has Policy Statement 2018(3) which governs the waiver process. This policy statement is detailed, provides clear guidance, and is listed on the department's website. However, DRS recognized that the original regulation provided limited guidance and needed to be replaced. The formal regulation process which involves additional levels of review by regulatory committees and public comment ensures that enacted regulations are not unduly burdensome to taxpayers or the state.

*Effect:* The processing of waivers is not clear when regulations are not updated.

*Cause:* DRS has considered its policy statement sufficient for compliance in the absence of amendments to existing regulations.

*Prior Audit Finding:* This finding has been previously reported in the last audit report covering the fiscal years ended June 30, 2013 and 2014.

*Recommendation:* The Department of Revenue Services should perform the necessary steps to promptly update its penalty waiver regulations or adopt new regulations. (See Recommendation 14.)

*Agency Response:* “The Agency disagrees with this recommendation. The agency’s existing regulation, supplemented by published guidance (including instructions with each application form) provide very clear standards for the penalty waiver review process.”

*Auditors’ Concluding Comment* The fact that the agency drafted a new regulation appears to acknowledge the need to revise the existing regulation.

### **Administration of Internal Audit Unit**

*Background:* The DRS Internal Audit Unit has 3 employees – a director, a tax supervisor, and an accounts examiner. The unit is utilized in accordance with the department’s mission to protect taxpayer information by monitoring employee system access activities and the Data Loss Prevention (DLP) program. The unit also conducts reviews based on requests from upper management, various compliance reviews for DRS employees, and acts as audit liaison for external auditors.

*Criteria:* Professional internal auditing standards are recommended guidelines that an internal audit organization should follow to achieve quality and consistency in the performance of its work. These guidelines address the concepts of organizational independence, objectivity, proficiency, due professional care, continuing education, and the planning, performance, reporting and follow-up of engagements. In order to promote compliance with such standards, they should be in written form and formally adopted by the organization.

*Condition:* The Internal Audit Unit has not adopted professional standards to guide the performance of its duties. The unit and DRS management have not produced a risk assessment to help justify the timing and frequency audits.

We also noted that some of the Internal Audit Unit’s monitoring responsibilities appear to conflict with its independence.

*Effect:* The lack of adherence to professional standards impedes the ability of the Internal Audit Unit to achieve the highest level of consistency and effectiveness. The failure of the unit to use documented risk assessments can impact the allocation of resources and prevent them from being used in the most beneficial way.

*Cause:* The department indicated that this condition is caused by a lack of resources.



## ***Auditors of Public Accounts***

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- Prior Audit Finding:*** This finding has been previously reported in the last 2 audits covering the fiscal years ended June 30, 2011 to 2014.
- Recommendation:*** The Department of Revenue Services should adopt professional internal auditing standards to facilitate the operation of the Internal Audit Unit. The adoption of these standards will ensure the department addresses proper audit risk assessment and independence. (See Recommendation 15.)
- Agency Response:*** “The Agency disagrees with the analysis resulting in this recommendation. The Agency’s Internal Audit Unit, while small, adheres to established procedures and acts effectively to serve the agency with respect to risk prevention and correction.”
- Auditors’ Concluding Comment:*** We would note that DRS responded to a prior audit stating, “The department agrees with this finding. The department will develop a plan of action to adopt professional standards for the internal audit activities. The department is in the process of increasing the staff within the Internal Audit Unit, which currently consists of the director and one other employee. Full implementation of the action plan will be dependent upon staffing and available resources.”

### **Other Matters - Business Tax Credit and Tax Review Committee Not Functioning**

- Criteria:*** Section 12-217z(a) of the General Statutes established a Business Tax Credit and Tax Policy Review Committee comprised of: (1) chairpersons and ranking members of the joint standing committee of the General Assembly having cognizance of matters relating to finance, revenue and bonding, or their designees; (2) one member appointed by each of the following: Governor, president pro tempore of the Senate, the speaker of the House of Representatives, majority leader of the Senate, majority leader of the House of Representatives, minority leader of the House of Representatives and minority leader of the Senate; and (3) the commissioners of Revenue Services, Economic and Community Development, and Labor, or their designees.
- Section 12-217z(c) provides that the chairpersons of the joint standing committee of the General Assembly having cognizance of matters relating to finance, revenue and bonding are the chairpersons of the committee, which must meet not less than twice a year, and at such other times as the chairpersons deem necessary.
- Section 12-217(d) provides that the committee will study and evaluate all existing credits against the corporation business tax, evaluate

changes or modifications made to such tax, and consider further changes in policy regarding the taxation of businesses. The committee will also engage in an analysis of the history, rationale and estimated revenue loss as a result of each tax credit or policy change, and will recommend revisions necessary to change the tax by eliminating or changing any redundant, obsolete or unnecessary tax credit or any credit or tax policy that is not providing a measurable benefit sufficient to justify any revenue loss to the state.

Section 12-217(f) requires the committee to report its findings and recommendations to the joint standing committee of the General Assembly having cognizance of matters relating to finance, revenue and bonding annually by January 1 in accordance with Section 11-4a.

*Condition:*

The Business Tax Credit and Tax Policy Review Committee did not meet during our audited period and through July 2018. Furthermore, the committee has not issued the required annual findings and recommendations to the General Assembly.

We observed that there does not appear to be an adequately established process and responsibility of organizing the committee's schedule and agenda.

*Context:*

It is not our intent to convey that DRS is responsible for the committee's failure to meet, since it does not chair the committee. Rather, we seek to ensure the establishment of a process and understanding by all key members to ensure compliance with the committee's statutory responsibilities. This is a very important committee tasked with evaluating the benefit of business tax policy. The committee should meet at least twice a year to assess whether policies need revisions based on various agreements with corporations. Discussions between the relevant committee members is necessary to analyze the performance of tax credits and their benefits to the state. Although some of the DRS reports are available online, the committee has not met to review and discuss the data and reports.

*Effect:*

There is increased risk that current business tax policy is not meeting the intended needs of taxpayers and the state. Furthermore, various tax credits may not provide their intended benefit or justify the loss of state revenue.

*Cause:*

It is not clear if the current committee members are fully aware of this statute and the committee's responsibilities and impact. Although the statute is listed under the General Statutes pertaining to taxation (Title 12), it is not chaired by DRS.

*Prior Audit Finding:*

This finding has not been previously reported.

*Recommendation:* The Department of Revenue Services should seek guidance from the General Assembly to assist with coordination of the Business Tax Credit and Tax Policy Review Committee to ensure that the committee fulfills its relevant statutory requirements affecting the department. (See Recommendation 16.)

*Agency Response:* “Although DRS is not responsible for convening the meetings, the Agency will seek to discuss and formalize the operation and requirements of the Business Tax Credit and Tax Review Committee with the key members.”

## RECOMMENDATIONS

### Status of Prior Audit Recommendations:

Our prior audit report on the Department of Revenue Services contained 19 recommendations. Nine have been implemented or otherwise resolved and 10 have been repeated or restated with modifications during the current audit.

- The Department of Revenue Services should address the perceived obsolescence of Section 12-7a subsection (b) of the General Statutes by seeking a legislative change to either repeal or otherwise amend the current language to reflect the current practice, or adhere to the statute. **The statute was amended and this recommendation has been resolved.**
- The Department of Revenue Services should comply with its policies and procedures regarding the maintenance of seized property and update its inventory records in a timely manner after cases are closed. **This recommendation is being repeated. (See Recommendation 7.)**
- The Department of Revenue Services should ensure that refund requests are processed in a timely manner to avoid the payment of interest. **This recommendation is being repeated. (See Recommendation 5.)**
- The Department of Revenue Services should analyze manual refund data to determine the refund review threshold accordingly and implement effective controls to ensure issuance of correct manually processed tax refunds. **This recommendation has been resolved.**
- The Department of Revenue Services should establish procedures for the authorization of overtime to comply with Section 5-245 of the General Statutes. **This recommendation is being repeated. (See Recommendation 12.)**
- The Department of Revenue Services should ensure that alternative work schedules are reviewed and approved. **We noted significant improvement in this area and will not be repeating the recommendation.**
- The Department of Revenue Services should ensure that supervisors properly review employee timesheets prior to approval. **This recommendation has been resolved.**
- The Department of Revenue Services should establish controls to ensure that access to the Core-CT system is deactivated immediately upon termination of an employee. **This recommendation is being repeated. (See Recommendation 13.)**
- The Department of Revenue Services should ensure that the LILA time reporting code is adjusted in accordance with Core-CT Job Aid procedures. **This recommendation has been resolved.**

- The Department of Revenue Services should comply with the State Accounting Manual petty cash fund requirements. **This recommendation has been resolved.**
- The Department of Revenue Services should establish a consistent standard for defining the postmark date to apply to the payments mailed directly to DRS to ensure they are deposited in accordance with Section 4-32 of the General Statutes. **This recommendation is being repeated in a modified form. (See Recommendation 6.)**
- The Department of Revenue Services should strengthen its internal control procedures to ensure the timely resolution of suspended transactions, with emphasis on those transactions considered either high priority or identified as having a potential financial impact for the state. **This recommendation is being repeated in a modified form. (See Recommendation 1.)**
- The Department of Revenue Services should improve internal controls over its property inventory to comply with the State Property Control Manual. **This recommendation is being repeated in a modified form. (See Recommendation 8.)**
- The Department of Revenue Services should consider adopting professional internal auditing standards to facilitate the operation of the Internal Audit Unit. **This recommendation is being repeated. (See Recommendation 15.)**
- The Department of Revenue Services should establish the procedures necessary to ensure that it is in compliance with Section 12-39aa subsection (a) of the General Statutes. **This recommendation is being repeated in modified form. (See Recommendation 6.)**
- The Department of Revenue Services should ensure that tax amnesty recipients meet the requirements set forth in the General Statutes in order to be in compliance. **This recommendation has been resolved.**
- The Department of Revenue Services should comply with the State Accounting Manual and ensure that tax refunds are recorded correctly to enhance the accuracy of GAAP reporting. **This recommendation has been resolved.**
- The Department of Revenue Services should ensure that a new system is properly tested before it is implemented to identify possible defects. The department should also make every effort to recover lost revenue and properly track and document its efforts. **We noted significant improvement in this area and will not be repeating the recommendation.**
- The Department of Revenue Services should properly process and document penalty waiver requests in accordance with sections 12-3a and 1-225 of the General Statutes. **This recommendation is being repeated in modified form. (See Recommendation 14.)**

**Current Audit Recommendations:**

- 1. The Department of Revenue Services should strengthen its internal controls over reporting to ensure management is provided with relevant and accurate information to support the effective and efficient resolution of suspended transactions.**

Comment:

DRS does not have procedures to aggregate and report the status of suspended transactions to upper management.

- 2. The Department of Revenue Services should adopt policies and procedures to identify end-of-life software. The department should retire or upgrade critical software before it loses security updates and manufacturer support.**

Comment:

The department has not adopted formal policies and procedures to identify and retire critical system software that no longer receives manufacturer support and security updates.

- 3. The Department of Revenue Services should regularly monitor its intranet site to ensure that access is limited to authorized users.**

Comment:

Our review identified an incorrect configuration of DRS security filters that allowed all devices connected to the state's secure network to access the DRS intranet site.

- 4. The Department of Revenue Services should adhere to its projected budgets and maintain sufficient prepaid account balances to meet the anticipated needs of the department in the fiscal year.**

Comment:

DRS made significant year-end payments for prepaid postage, and did not report the year-end balance on its GAAP reporting form.

5. **The Department of Revenue Services should implement procedures to adequately identify and track all outstanding refund requests held for review. The department should promptly process refund claims to avoid excess interest payments.**

Comment:

DRS does not have adequate procedures to promptly identify and track all outstanding refund requests held for review. The agency paid significant interest on refunds held for further review.

6. **Prior to instituting or modifying significant policies, the Department of Revenue Services should perform and document cost-benefit and cost-effectiveness analyses. These reviews would evaluate whether the benefits of the policy are likely to justify the costs and identify possible alternatives to assist in the selection of the most effective and efficient method.**

Comment:

DRS did not conduct a cost-benefit analysis of its grace period policy to determine whether it is the most effective and efficient solution to handle the large volume of filings immediately following tax deadlines. DRS did not estimate the amount of forfeited penalties as a result of this policy decision.

7. **The Department of Revenue Services should comply with its policies and procedures regarding the maintenance of seized property and promptly update its inventory records after cases are closed.**

Comment:

The current custodian of seized inventory did not have access to DRS procedures for the operation of Special Investigations Section inventory. There were various inconsistencies in the reporting and disposition of inventory items between the two inventory data systems. There was no evidence that DRS performed a reconciliation of actual amounts on hand to both inventory records in the department's physical inventories for fiscal years 2014-2015 and 2015-2016.

8. **The Department of Revenue Services should improve internal controls over its property inventory reporting in order to comply with the State Property Control Manual.**

Comment:

We noted various inconsistencies in the DRS Core-CT inventory records and incorrect software amounts on the CO-59 reports for fiscal years ended June 30, 2015 and 2016.

- 9. The Department of Revenue Services should consult with the Office of the State Comptroller and investigate, identify, and promptly reconcile the balance in its Funds Awaiting Distribution Fund account.**

Comment:

DRS did not reconcile and could not explain the activity. There were recent reconciliation issues and items as far back as 2008 that the department continuously carried forward into the current period.

- 10. The Department of Revenue Services should adhere to its established Human Resources policies. The use of these formal, written procedures will help to ensure investigative conclusions and actions were reasonable and consistent.**

Comment:

Our review of DRS personnel investigations noted that DRS did not promptly close or resolve cases, complete investigation summary forms, and follow-up on or document Human Resources suggested recommendations.

- 11. The Department of Revenue Services should ensure that all managers are evaluated on an annual basis using the Performance Assessment and Recognition System.**

Comment:

DRS was not able to provide us with records to document that it performed PARS reviews on all managers and confidential employees during the audited period.

- 12. The Department of Revenue Services should establish procedures for the authorization of overtime to comply with Section 5-245 of the General Statutes. In addition, the department should adhere to internal procedures that require prior approval of compensatory time.**

Comment:

The department does not have written procedures in place for the approval of overtime. We noted that 16 of 20 employees reviewed who did not receive prior approval of overtime. In addition, all 20 employees reviewed did not receive prior approval for their earned compensatory.



- 13. The Department of Revenue Services should establish controls to ensure that it immediately deactivates employee access to the Core-CT system upon termination.**

Comment:

Our review of 9 terminated employees' access to the Core-CT system disclosed that the department did not immediately deactivate 5 employees' system access. It took the department 7 to 51 days to deactivate the employees' access.

- 14. The Department of Revenue Services should perform the necessary steps to promptly update its penalty waiver regulations or adopt new regulations.**

Comment:

The current regulations Section 12-3a-1 and 12-2-11 governing penalty waivers are outdated. The agency drafted two new regulations in 2013, which it has not submitted for final approval through the relevant regulatory bodies.

- 15. The Department of Revenue Services should adopt professional internal auditing standards to facilitate the operation of the Internal Audit Unit. The adoption of these standards will ensure the department addresses proper audit risk assessment and independence.**

Comment:

The Internal Audit Unit has not adopted professional standards to guide in the performance of its duties. The unit and DRS management have not produced a risk assessment to help justify the timing and frequency of audits. Some of the Internal Audit Unit's monitoring responsibilities appear to conflict with its independence.

- 16. The Department of Revenue Services should seek guidance from the General Assembly to assist with coordination of the Business Tax Credit and Tax Policy Review Committee to ensure that the committee fulfills its relevant statutory requirements affecting the department.**

Comment:

The Business Tax Credit and Tax Policy Review Committee did not meet during the audited period and through July 2018. Furthermore, the committee has not issued the required annual findings and recommendations to the General Assembly.

**ACKNOWLEDGMENTS**

The Auditors of Public Accounts would like to recognize the auditors who contributed to this report:

Frederick K.P. Armour  
Christopher DiDomizio  
Brianna Passero  
Roberto Sanchez

**CONCLUSION**

In conclusion, we wish to express our appreciation for the courtesies and cooperation extended to our representatives by the personnel of the Department of Revenue Services during the course of our examination.



Frederick K.P. Armour  
Principal Auditor

Approved:



John C. Geragosian  
State Auditor



Robert J. Kane  
State Auditor