

STATE OF CONNECTICUT



***AUDITORS' REPORT
DEPARTMENT OF REVENUE SERVICES
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2006***

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

Table of Contents

INTRODUCTION	1
COMMENTS	1
FOREWORD	1
Legislative Changes	2
RÉSUMÉ OF OPERATIONS	4
General Fund Revenues and Receipts	4
General Fund Expenditures	5
Special Transportation Fund	6
Audit Assessments	6
Appellate Division.....	7
Accounts Receivable	7
Penalty Waivers.....	8
Collections and Enforcement Division.....	8
CONDITION OF RECORDS	10
Sate Tax Review Commission	10
Administration of the Penalty Review and Abatement Review Committees	10
Statutory Reporting Requirements	13
Equipment Inventory Management	14
Compliance with Policies Regarding Separating Employees	17
Medical Certificates Not on File	18
Monitoring of Dual Employment	19
Policy Regarding Work Schedule of Managers	20
Outdated Position Descriptions	21
Protection of the Identity of Informants and Logging of Complaints	22
Business Continuity/Disaster Recovery Planning.....	24
Administration of Interest Payments on Returns Held for Audit.....	26
Disposition of Seized Property.....	28
RECOMMENDATIONS	30
INDEPENDENT AUDITORS' CERTIFICATION	35
CONCLUSION	37

October 19, 2007

**AUDITORS' REPORT
DEPARTMENT OF REVENUE SERVICES
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2006**

We have examined the financial records of the Department of Revenue Services for the fiscal years ended June 30, 2005 and 2006.

Financial statements pertaining to the operations and activities of the Department of Revenue Services for the above mentioned fiscal years are presented and audited on a Statewide Single Audit basis to include all State agencies and funds. This audit examination has been limited to assessing compliance with several provisions of financial related laws, regulations and contracts, and evaluating internal control structure policies and procedures established to ensure such compliance.

This report on that examination consists of the Comments, Condition of Records, Recommendations and Certification which follow.

COMMENTS

FOREWORD:

The Department of Revenue Services operates principally under the provisions of Title 12 (Taxation), 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 examination of the Department of Motor Vehicles.

Section 12-1a of the General Statutes provides that the Department is under the direction of a Commissioner of Revenue Services. Pamela Law was appointed Commissioner in March 2003, and she served through the audited period.

Legislative Changes:

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

- **Income Tax:**

Public Act 05-251, Section 71, modified the definition of “Connecticut adjusted gross income” for tax years beginning on or after January 1, 2008, to create a subtraction modification for 50 percent of the income received from the U.S. government as retirement pay for a retired member of the armed services.

Public Act 05-251, Sections 74 through 76, delayed by two years the annual increase to the single filer personal exemption, credit, and property tax credit.

Public Act 05-251, Section 77, decreased the maximum income tax credit for property taxes paid to \$350 for tax years beginning on or after January 1, 2005, and \$400 for tax years beginning on or after January 1, 2006.

Public Act 05-260, Section 4, provided for additional exemptions to the general rule that a notice of a proposed deficiency assessment must be mailed to the taxpayer within 3 years after the return is filed.

Public Act 05-260, Section 8, provided that for audits of returns commencing after January 1, 2006, a penalty of 75 percent of the amount of the deficiency may be imposed when it appears that any part of the deficiency is due to a failure to disclose a listed transaction as defined in the Internal Revenue Code.

Public Act 06-186 created a new subtraction modification in computing Connecticut adjusted gross income to subtract contributions to the Connecticut Higher Education Trust.

- **Sales and Use Taxes:**

Public Act 05-251, Section 86 and 87, extended the exemption for college textbooks at private occupational schools and added an exemption for sales of marine brokerage services.

- Corporation Taxes:

Public Act 05-251, Sections 62 and 63, provided that a 20 percent surtax of the tax on net income and the capital base tax will apply for income years commencing on or after January 1, 2006, and prior to January 1, 2007. In addition, a surtax of 15 percent will apply for income years commencing on or after January 1, 2007, to January 1, 2008. The surtax does not apply to the \$250 minimum taxes.

- Alcohol and Cigarette Taxes:

Public Act 05-274 authorized the shipment of wine by farm wineries to State residents and provided for the collection of sales tax and alcoholic beverage tax.

- Gift Taxes:

Public Act 05-251, Section 67, established that the gift tax is now payable only if the aggregate amount of all Connecticut taxable gifts made during all calendar years commencing on or after January 1, 2005 exceeds \$2 million.

PA 06-194 changed the late payment penalty for estate tax purposes to 10 percent of the amount reported on the estate tax return and not paid within nine months after the date of death.

- Other Taxes:

Public Act 05-163, Section 85, made the motor vehicle rental surcharge applicable to the rental of machinery at the rate of 1.5 percent.

Public Act 05-238, Section 14, extended the exemption of subscriber charges received by a health care center from a contract or policy entered into to provide coverage to employees of a municipality. It also exempted subscriber charges received by a health care center for any new or renewal policy entered into after July 1, 2005, to provide coverage to employees of community action agencies or retired State employees.

Public Act 05-251, Section 69, made the estate tax payable based on the value of the decedent's Connecticut taxable estate if the estate exceeds \$2 million.

Public Act 05-251, Section 70, required an estate tax return in the case of every decedent who at the time of death was a resident of Connecticut or if the gross estate includes real property in the State.

Public Act 05-251, Section 78, imposed a resident day user fee on every nursing home in the State. The fee is the product of a nursing home's total resident days during the calendar quarter multiplied by the user fee as determined by the Department of Social Services.

Public Act 05-3, Section 55, of the June Special Session, modified Public Act 05-251 by requiring tax returns for estates valued over \$2,000,000 to be filed with DRS and the probate courts. For estates valued at less than \$2,000,000, tax returns are to be filed with the probate courts. Probate judges are to review each return and issue a written opinion in each case in which the judge determines that the estate is not subject to the estate tax.

- Other Issues:

Public Act 05-145, Sections 1 through 4, authorized the State Comptroller to record as revenue for a fiscal year most taxes received by DRS not later than five business days after the last day of July.

Public Act 05-4, Section 40, of the June Special Session increased the petroleum gross earnings tax from 5 percent for calendar quarters prior to July 1, 2005, to 5.8 percent for calendar quarters prior to July 1, 2006, 6.3 percent for calendar quarters prior to July 1, 2007, 7.0 percent for calendar quarters prior to 2008, and 7.5 percent for calendar quarters prior to 2013, and 8.1 percent after that.

RÉSUMÉ OF OPERATIONS:

General Fund Revenues and Receipts:

General Fund tax revenues, license fees and all other revenues and non-revenue receipts totaled \$10,204,429,260 and \$11,212,283,607, respectively, for the 2004-2005 and 2005-2006 fiscal years. Revenues other than taxes included payments for licenses to collect sales and use taxes and to 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 \$689,209,894 and \$737,502,887 for the fiscal years ended June 30, 2005 and 2006, respectively.

A summary of tax revenues, net of refunds, for the fiscal years ended June 30, 2005 and 2006, with 2004 figures presented for comparative purposes, is presented below:

(In Millions of Dollars)	<u>2005-2006</u>	<u>2004-2005</u>	<u>2003-2004</u>
Personal income	\$ 5,581	\$ 4,959	\$ 4,721
Sales and use	3,396	3,262	3,529
Corporations	673	564	405
Succession taxes	185	193	153
Public service companies	222	261	281
Insurance companies	208	193	178
Hospital gross earnings	46	45	35
Alcohol/cigarettes/tobacco	318	319	340
Petroleum companies	226	156	149
Real estate/controlling interest	210	206	204
Nursing homes	95	-	-
Admissions, dues and cabaret	35	32	32
All other taxes	<u>17</u>	<u>14</u>	<u>11</u>
Total	<u>\$11,212</u>	<u>\$10,204</u>	<u>\$10,038</u>

As presented in the above analysis, net General Fund tax revenues increased by 11.6 percent during the years under review. The increases were primarily due to rises in personal income, corporate, petroleum company, and nursing home tax revenues. These increases were offset in part by decreases in public service company tax revenue. Revenues from sales and use, and income tax receipts accounted for approximately 80.6 percent and 80 percent of tax revenues in total for the fiscal years ended June 30, 2005 and 2006, respectively.

General Fund Expenditures:

A summary of General Fund expenditures from Department appropriations for the fiscal years ended June 30, 2004, 2005, and 2006, is presented below:

	<u>2005-2006</u>	<u>2004-2005</u>	<u>2003-2004</u>
Personal services	\$51,107,076	\$47,637,922	\$44,734,959
Other expenses	10,344,062	9,068,842	9,060,252
Equipment	94	2,880	269,616
Total Budgeted Accounts	<u>61,451,232</u>	<u>56,709,644</u>	<u>54,064,827</u>
Restricted Appropriations	349,724	343,780	104,684
Totals	<u>\$61,800,956</u>	<u>\$57,053,424</u>	<u>\$54,169,511</u>

As presented above, operating expenditures increased through the audited period. The increase was primarily attributable to an increase in personal service costs.

The number of filled Department positions increased during the audited period, as compared to the previous year. Below is a summary of positions as of June 30, 2004, 2005 and 2006:

	<u>2005-2006</u>	<u>2004-2005</u>	<u>2003-2004</u>
Full-time	756	753	669
Part-time	12	12	20
Temporary or durational	<u>45</u>	<u>23</u>	<u>54</u>
Total	<u>813</u>	<u>788</u>	<u>743</u>

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 to the Special Transportation Fund.

Special Transportation Fund receipts for the Department, totaled \$531,221,167, \$491,356,910 and \$511,923,267 for the fiscal years ended June 30, 2004, 2005, 2006, respectively.

Special Transportation Fund tax refunds, budgeted as reductions of tax revenues, totaled \$8,792,567, \$8,404,500 and \$8,550,305 for the 2003-2004, 2004-2005, 2005-2006 fiscal years, respectively, and were budgeted as reductions in tax revenue.

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

(In Millions of Dollars)	<u>2005-2006</u>	<u>2004-2005</u>	<u>2003-2004</u>
Motor fuel tax	\$385	\$389	\$416
Special motor fuel tax	71	69	66
Petroleum Companies	33	13	10
Motor carrier tax	14	12	13
Total	<u>\$503</u>	<u>\$483</u>	<u>\$505</u>

As noted above, decreases in the motor fuel tax revenues were offset by an increase in the tax on petroleum companies.

Audit Assessments:

Audits were conducted by examiners within the Audit Division to ensure taxpayer compliance, as regards the filing of returns and the remitting of tax payments. Assessments were generated as a result of both office and field audit efforts. Based upon statistics provided by the Audit Division, assessments totaled \$295,415,506, \$370,037,169 and \$522,855,848, respectively, for the fiscal years ended June 30, 2004, 2005 and 2006. A summary of assessments by tax type for the audited period, as provided by the Audit Division, is presented below:

(In Millions of Dollars)	<u>2005-2006</u>	<u>2004-2005</u>	<u>2003-2004</u>
Corporation taxes	\$ 196.1	\$ 125.3	\$ 89.1
Sales and use taxes	168.5	114.1	108.0
Personal income tax	117.9	85.5	51.4
Excise taxes	8.7	11.5	11.1
Public service taxes	19.0	21.6	23.9
All other taxes	12.7	12.0	11.9
Total	<u>\$ 522.9</u>	<u>\$ 370.0</u>	<u>\$ 295.4</u>

Appellate Division:

The Department's Appellate Division administered appeals from taxpayers disputing audit assessments. Following written protests, hearings with taxpayers are held. Based upon information presented, appellate decisions are made concerning the validity of assessments. Further appeal is available to a taxpayer by means of litigation.

Appellate Division activity reports, reflecting resolution activity for the fiscal years ended June 30, 2004, 2005, and 2006 are presented below. Revisions resulted from both court and Appellate Division decisions.

	<u>2005-2006</u>	<u>2004-2005</u>	<u>2003-2004</u>
Cases resolved	1049	1082	1250
Original assessments	\$129,199,730	\$157,534,295	\$162,299,731
Revised assessments	<u>62,090,473</u>	<u>62,521,163</u>	<u>70,120,513</u>
Assessment reductions	<u>\$ 67,109,257</u>	<u>\$ 95,013,132</u>	<u>\$ 92,179,218</u>
Percentage reduction	52%	60 %	57 %

Accounts Receivable:

Accounts receivable of the Department emanate 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, 2004, 2005, and 2006, is presented below:

	<u>June 30, 2006</u>	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Corporation tax	\$135,727,396	\$128,687,131	\$ 161,278,433
Income tax	286,833,413	168,175,642	138,524,003
Sales and use tax	176,330,331	154,363,157	150,844,373
Other taxes	34,980,647	35,495,552	37,713,058
Total	<u>\$633,871,787</u>	<u>\$486,721,482</u>	<u>\$488,359,867</u>
Credits and provisions for uncollectible	<u>(246,062,572)</u>	<u>(145,583,151)</u>	<u>(242,672,391)</u>
Net accounts receivable	<u>\$387,809,215</u>	<u>\$341,138,331</u>	<u>\$245,687,476</u>

The receivable balances presented 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 (refunds payable or deferred revenues.) The provision for the amounts deemed uncollectible is based on estimates of appellate and court reductions, abatements and other cancellations.

Penalty Waivers:

Provisions of certain statutes impose penalties for failure to satisfy taxes due within specified times. The Commissioner of Revenue Services is authorized to waive penalties, subject to the provisions of Section 12-3a of the General Statutes, in cases where the failure to pay the tax was due to reasonable cause and was not intentional or due to neglect. Section 12-3a requires approval of a Penalty Review Committee, comprised of the Commissioner of Revenue Services, the Secretary of the Office of Policy and Management and the State Comptroller, for all penalty waivers over \$500.

A summary of penalty waiver activity for the fiscal years ended June 30, 2001 through 2006, 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>
2000-2001	8,003	\$3,576,583	1,498	\$1,781,118	6,505	\$1,795,465
2001-2002	6,400	\$4,294,624	1,541	\$2,638,285	4,859	\$1,656,339
2002-2003	5,238	\$2,829,711	883	\$1,669,602	4,355	\$1,160,109
2003-2004	5,224	\$4,141,590	792	\$1,809,906	4,432	\$2,331,684
2004-2005	4,521	\$2,690,009	775	\$956,956	3,746	\$1,733,053
2005-2006	8,116	\$5,585,757	2,331	\$2,012,022	5,785	\$3,573,735

Collections and Enforcement Division:

The Collections and Enforcement Division 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 cases involving tax evasion. Records of the Collections and Enforcement Division presented revenues collected by the Division to be \$106,659,217, \$197,862,493, and \$142,092,782 during the 2004, 2005 and 2006 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 its suspense tax book for seven years and determined to be uncollectible. During the 2005-2006 fiscal year, abatements were approved totaling \$135,746,000.

In accordance with Section 12-3b of the General Statutes, it is the practice of the Department to remove from its active accounts receivable file accounts considered to be uncollectible but which have yet to be included on abatement approval requests. This is due to the statutorily required seven year waiting period. Accounts totaling \$17,396,240, \$11,388,524, and \$6,975,057 were referred to this status during the 2003-2004, 2004-2005 and 2005-2006 fiscal years, respectively.

CONDITION OF RECORDS

State Tax Review Commission:

Criteria: Section 12-34d of the General Statutes established the State Tax Review Commission in 1991 to study and evaluate the State's entire tax system and make annual reports to the Governor and the General Assembly.

Condition: In a report issued by the Office of Legislative Research dated July 31, 2006, it was noted that the Commission only issued one interim report in January 1994, and its appointed members' terms expired that year without reappointment or replacement. In 1997, the General Assembly passed an Act that included a provision repealing the Commission's authorizing legislation. The Governor vetoed the Act and there has not been any other proposal since to repeal the legislation.

In the Auditors of Public Accounts' 2007 Annual Report to the General Assembly, it was recommended that the Commission's authorizing legislation be repealed.

Effect: Without members, the Commission ceased to operate.

Cause: The General Assembly apparently saw reason to eliminate the Commission, but subsequent efforts were not made after the initial attempt failed by way of the Governor's veto.

Recommendation: The Department of Revenue Services should pursue the elimination of the State Tax Review Commission authorized by Section 12-34d of the General Statutes. (See Recommendation 1.)

Agency Response: "The Department of Revenue Services agrees with this finding and will consider taking the necessary steps to comply with this recommendation."

Administration of the Penalty Review and Abatement Review Committees:

Background: Section 12-3a of the General Statutes created the Penalty Review Committee. Section 12-3b of the General Statutes created the Abatement Review Committee. Each Committee is comprised of the State Comptroller or a designee, the Secretary of the Office of Policy and Management or a designee, and the Commissioner of Revenue Services or a designee. The Committees are to meet monthly or as often as necessary to conduct the necessary business.

The Penalty Review Committee is authorized to approve the waiver of penalties exceeding \$500 that are authorized to be waived by the DRS Commissioner. The Abatement Review Committee is authorized to approve the abatement of taxes, penalties, and interest that are authorized to be waived by the DRS Commissioner. Both Committees are to make available to the public an itemized list of all items approved by a majority vote.

The Committees by their nature discuss confidential taxpayer information during their meetings. As a result, most of the activity of the Committees is carried out in executive session.

Criteria:

Both Committees appear to be “public agencies”, and accordingly are covered by the provisions of the State’s freedom of information laws, most notably Section 1-225 of the General Statutes. Said Section requires that minutes of meetings be maintained and that votes taken at these sessions be reduced to writing and made available for public inspection within 48 hours, as well as be included in the minutes of those sessions.

Section 1-225 of the General Statutes provides that votes of public agencies should be open to the public, thus requiring that the votes not be taken in executive sessions.

Robert’s Rules of Order, which is generally used as conventional guidance for the conduct of meetings, provides that minutes of meetings should be signed by a designated representative to indicate that they have been formally approved.

In order to evaluate whether an organization is performing as intended, guidelines in the form of policies and procedures should be established.

Condition:

We noted that neither Committee documented the votes of the members within the minutes. Minutes of the Abatement Review Committee were not signed to indicate that they were formally approved and accepted by the members.

The Abatement Review Committee only met once in each of the last two years. At those meetings, 17,825 accounts valued at \$135,745,897 and 5,149 accounts valued at \$32,977,284, respectively, were approved for abatement. We were informed that only a small sample of accounts from each year was actually examined.

The Committees had not adopted formal operating procedures. As a result, there are no benchmarks upon which to judge the

sufficiency of the number of files examined or the extent of those reviews by the Committees.

Effect: The failure to properly document the votes of Committee members and the omission of signatures on the formal meeting minutes of the Abatement Committee result in reduced assurance that the minutes are accurate and complete.

The level of review that should be expected from these Committees cannot be sufficiently evaluated if procedures are not in place detailing the numbers and types of cases that should be examined.

Cause: The Committees conduct their business in executive sessions in order to protect taxpayer information from public disclosure. Votes are not recorded in the minutes because they are apparently taken in executive session. The failure of the Abatement Review Committee to meet with sufficient frequency to reasonably accomplish the intended objectives contributed to this condition.

Recommendation: The Department of Revenue Services should encourage the Penalty Review and Abatement Review Committees to adhere to relevant statutory provisions regarding the recording of the activity at meetings and adopt other procedures as necessary to document the number of files expected to be reviewed and increase the level of assurance that can be placed on the minutes of their meetings. In addition, the Abatement Review Committee should attempt to meet more frequently in order to increase the number of accounts that are actually examined prior to approving the entire list of requested abatements. (See Recommendation 2.)

Agency Response: “We agree with this finding, in part. The Department agrees that the minutes taken should be signed by a designated representative. In the future such minutes will be signed.

The DRS does not agree with the comment on the extent of the review performed on the files. As was explained to the Auditors of Public Accounts, since this was the first time that the DRS was allowed to abate any taxes, the number of accounts to be abated was significant. As we go forward in time the DRS believes that the number of accounts to be abated will be reduced significantly and not require more than an annual meeting. Additionally the DRS followed Connecticut Agencies Regulations §12-3b-1 that requires DRS to certify to the Abatement Committee that all taxes presented to them are uncollectible. The DRS has performed due-diligence on

the certified accounts recommended for abatement and follows the published guidelines for the abatement of taxes.”

Auditors’ Concluding

Comment:

We are not trying to suggest that DRS did not perform due diligence, nor did we attempt to review this for ourselves. It appears to be the role of the Abatement Committee to determine whether the DRS staff performed due diligence on those accounts. This would suggest, to some extent, an independent review of the actions taken by DRS. The extent of any reviews performed by the Committee should be based on established standards. Without knowing what those standards will be and the number of accounts that will be abated in coming years, it is difficult to determine how many meetings will be required.

Statutory Reporting Requirements:

Criteria:

Sound internal control suggests that a centralized mechanism should be in place to monitor compliance with a department’s various statutory and regulatory reporting requirements. Agencies should continuously evaluate their various reporting requirements and propose legislation when such requirements become obsolete or duplicative.

Sections 12-240, 12-247 and 12-250 of the General Statutes require the reporting of the amounts of penalties assessed for Corporation Business Taxes, Sales and Use Taxes, and Dividend, Interest and Capital Gains Taxes in the Department’s annual report to the Governor.

Section 12-7a, subsection (b), of the General Statutes provides that the Commissioner of Revenue Services shall annually prepare a list of taxpayers who are delinquent in the payment of corporation business taxes. The list shall be arranged in sequential order by the taxpayer identification number assigned and shall be provided to the Secretary of the Office of Policy and Management not later than July fifteenth annually.

Section 12-315a of the General Statutes provides that the Commissioner of Revenue Services shall prepare a report on enforcement efforts undertaken regarding the sale of cigarette and tobacco products. Such report shall include the number of unannounced inspections conducted by said commissioner and a summary of enforcement actions taken.

Condition:

The Department’s annual report lacked information pertaining to the penalties assessed for the various taxes.

DRS staff informed us that the reporting requirements of Section 12-7a, subsection (b), were deemed by DRS to be obsolete, and such reporting had not been done.

The Department of Revenue Services does not produce the report required by Section 12-315a. The enforcement of laws pertaining to tobacco products is shared between DRS and the Department of Mental Health and Addiction Services (DMHAS) as part of the Tobacco Prevention and Enforcement Program (TPEP). Underage inspections, the focus of the TPEP, are performed by DMHAS under an agreement with DRS.

Effect: In addition to not complying with statutory requirements, the failure to include the required information may hinder effective decision-making by users of those reports.

Cause: The Department regarded some of these reporting requirements to be duplicative or obsolete. We also were informed that despite the lack of formal reports, the same information would be readily shared if using State agencies request it.

Recommendation: The Department should consult with the State agencies that are the primary users of the data included in DRS' reporting requirements and collectively determine whether the reporting is necessary or the statutory requirements should be amended. (See Recommendation 3.)

Agency Response: "The Department agrees with this finding, in part. Some of the reports referred to were put on hold due to the Y2K issue. However, none of the State agencies impacted have asked that we continue to produce these reports, which question their effectiveness. The Agency will take the Auditors of Public Accounts suggestion to pursue legislative changes under advisement."

Equipment Inventory Management:

Criteria: The State Property Control Manual promulgated by the State Comptroller includes certain requirements for maintaining property control records. These include:

- A mechanism should exist to track the movement of equipment from one location to another.
- The official inventory records within Core-CT's Asset Management System should contain all items subject to control.

- Items that are deemed to be lost or unaccounted for upon completion of a physical inventory should be promptly reported and deleted from the inventory database.

Sound internal control dictates that controllable inventory such as computers and accessories with a value of less than \$1,000 and a useful life of one year or more should be tracked and accounted for due to the susceptibility of loss.

When a piece of equipment is disposed of, it should be promptly removed from the inventory record.

Internal control policies recommended by the State Comptroller include separating the custodial duties of inventory control from the recordkeeping duties.

Condition:

Our review of the Department's inventory records revealed the following:

- Inventory with a value of \$554,000 was surplus during the fiscal year ended June 30, 2006 but remained on the inventory record and was included in the annual property report.
- The Department did not maintain any inventory records of "controllable property"-items valued at less than \$1,000.
- The Department did not have an effective process in place to record the movement of assets from one location to another.
- The Information System Division maintains its own inventory records separate from the Department's business office and outside of the State's Core-CT Asset Management System.
- Nine items with a total acquisition cost of \$20,000 were unaccounted for at the time of the June 2006 physical inventory. These items were not reported as lost or stolen, nor were they removed from the inventory record.

Effect:

Inaccuracies in the annual property report can impact the State's balance sheet and result in the State procuring more or less insurance than it optimally needs. Accountability of assets and the ability to detect a loss in a timely fashion is also reduced.

Cause:

Most of these conditions appear to have been caused by the failure to adhere to guidance promulgated by the State Comptroller in the Property Control Manual. The decision to not record any controllable items was a reasonable interpretation of the Comptroller's policies, but did not meet the intent of the provision, which was to allow for Agency discretion to dedicate efforts to the items that are deemed to be more at risk.

Recommendation: The Department should consult with the Comptroller's Property Control Manual and bring its policies and procedures into conformance. (See Recommendation 4.)

Agency Response: "The Department agrees with this finding, in part. This recommendation is based upon several conditions identified during the audit. In order to properly evaluate the effectiveness of the agency's property control procedures, we believe that the following factors need to be taken into consideration.

The Department agrees that the CO-59 was overstated by \$554,000 of surplus equipment. It is important to point out though, that the agency knew the correct value of the assets in its possession. This condition was directly attributable to unfamiliarity with the newly implemented Core-CT Asset Management System. The items were removed from the inventory system in September 2006.

The Department asserts that its decision not to maintain a controllable property inventory is reasonable and in compliance with the guidelines of the State Property Control Manual. The Department's understands that this section of the manual is currently being revised to provide more clarity. DRS will take the necessary steps to fully comply with any new requirements.

The Department's internal procedures require that the movement of information technology equipment, which comprises the vast majority of the agency's capitalized assets, be performed through a work order system administered by its Information Service Division. This work order is then used to update the agency's central inventory system.

In order to facilitate the monitoring of technology usage, the Department's Information Technology Division maintains its own tracking system which has no relationship to the central inventory system used to record the value and location of all agency capitalized assets.

The Department agrees that it had discovered that nine out of approximately 1,500 inventoried items could not be located during its physical inventory process. The agency should have reported the items as missing and removed them from the inventory on a timelier basis."

Compliance with Policies Regarding Separating Employees:

Criteria: The Department's Employee Handbook requires separating employees to have an exit interview and sign an affidavit acknowledging receipt and understanding of the code of ethics and the completion of an exit check list for tracking the return of equipment, IDs and the disabling of access to agency systems.

Based upon a Governor's directive issued by the Special Counsel on Ethics Compliance in 2004, before any State employee leaves State service, an exit interview should be conducted by the agency's Ethics Liaison Officer to remind the individual of potential issues relating to future employment opportunities.

Condition: We noted 15 of 17 terminated employees didn't have an exit checklist on file and seven of the 17 didn't have evidence of an exit interview and ethics affidavit in their files.

We were informed by the Ethics Liaison Officer that he does not conduct any exit interviews with employees.

We noted 10 out of 17 terminated employees were found to still have access rights to the Department's Integrated Tax Administrative System.

Effect: By not conducting the exit interview, the Department loses an opportunity for feedback about the agency's relationship with its employees. Omission of the Ethics Liaison Officer from the exit interview process increases the risk that post-state employment rules may not be met.

The integrity and security of the Department's primary tax information system may be compromised if users' access rights are not disabled promptly.

Cause: Staff informed us that they do not conduct exit interviews for terminated employees and employees who enter into stipulated agreements. In other cases where exit interviews were not done, it was because the employees were not available prior to their termination.

Exit interviews were not conducted by the Ethics Liaison Officer due to a lack of familiarity with the requirements.

The Department did not appear to follow through completely in notifying all required staff regarding employee terminations.

Recommendation: The Department should follow its own procedures and those in the Governor's directive when administering terminated/separated employees. Also, the Department should take more care to ensure that the proper staff are notified of terminations so that access to sensitive data processing systems is promptly disabled. (See Recommendation 5.)

Agency Response: "The Department agrees with this finding, in part. DRS acknowledges that for the audited period, its current Ethics Liaison Officer (ELO) did not participate in the exit interview process. All future exit interviews will now include the ELO. Additionally, the Human Resource Office has adopted and implemented standard procedures for conducting and documenting each exit interview.

However, the recommendation, incorrectly implies that the Department did not have a process in place to ensure that proper staff was notified of separations so that access to sensitive data processing systems could be promptly disabled. The conclusion appears to be based upon the absence of a formal "exit checklist" being on file in the Human Resource Office.

It is important to point out that in May of 2006, the agency adopted its current Human Resource administered "checklist" process for dealing with separating employees. This new process replaced a similar notification process that had been in place for over fifteen years. The agency still maintains the hard copy records associated with this process going back to 1999.

A comparison of these records to actions taken by the agency will reveal that appropriate and timely steps were taken to retrieve agency assets and cancel building and legacy computer system access for separating employees. However, it is acknowledged that during the first two years of the ITAS project, the responsibility for administering authorizations resided with the implementing vendor. This responsibility has subsequently been transferred to DRS. A formal process for administering ITAS system authorizations was developed and implemented by the agency in August of 2006."

Medical Certificates Not on File:

Criteria: Section 5-248-2 of the Regulations of Connecticut State Agencies and various labor contracts require medical certificates to be obtained from employees who utilize more than five consecutive days of sick leave.

Condition: Six of 24 employees with more than five consecutive sick days did not have medical certificates on file.

Effect: The failure to pursue medical certificates increases the risk that abuses of sick leave will not be detected in a timely fashion.

Cause: Supervisors are responsible for keeping track of their employees' attendance and informing DRS' Human Resources Unit about any sick leave patterns. It appears that the supervisors are not informing Human Resources when employees use sick leave for more than five consecutive days.

Recommendation: The Department should enforce the submission of medical certificates in accordance with Section 5-248-2 of the State Regulations and applicable labor agreements. (See Recommendation 6.)

Agency Response: "The Department agrees with this finding. The Core-CT system does not have an automated means of identifying those instances in which an employee has used sick leave for more than five consecutive days. The Department also does not have sufficient resources to manually check on a bi-weekly basis the last 20 daily time entries for all of its 730 plus employees. As such, it relies on supervisory employees to inform the office when their employees use more than five consecutive days of sick leave.

The department has re-emphasized with its supervisory and managerial staff their responsibility to inform the Human Resource Office of those situations where an employee has used more than five consecutive days of sick leave. More importantly, it will continue to pursue an automated Core-CT report that identifies this condition for it. DRS believes that such an electronic reporting capability will have significant statewide benefits."

Monitoring of Dual Employment:

Criteria: Section 5-208a of the General Statutes states that no State employee shall be compensated for services rendered to more than one State agency during a biweekly pay period unless the appointing authority of each agency or his designee certifies that the duties performed are outside of the responsibility of the agency of principal employment, that the hours worked at each agency are documented and reviewed to preclude duplicate payment and that no conflicts of interest exist between services performed.

General Letter Number 204 issued by the Department of Administrative Services states that it is up to the secondary agency to initiate the dual employment process by completing its portion of the dual employment form and forwarding it to the primary agency. However, State agencies are encouraged to institute their own measures in ensuring compliance with Section 5-208a of the General Statutes.

Condition: We noted that two out of four employees with dual employment did not appear to have a proper dual employment approval form on file.

Effect: There is a lack of adherence to the relevant Statutes and reduced assurance that the schedules of the employees don't conflict.

Cause: The Department's Human Resources unit doesn't have a mechanism in place to detect dual employment situations. Reliance is placed upon the secondary employer to notify the Department.

Recommendation: The Department should utilize the reporting capability within Core-CT to evaluate compliance with the dual employment provisions of Section 5-208a of the General Statutes. (See Recommendation 7.)

Agency Response: "The Department agrees with the finding. The Department acknowledges that it has historically relied on the secondary employing agency to notify it of a dual employment situation. While DAS's General Letter 204 states that it is the responsibility of the secondary agency to provide such notification, it is apparent from the audit findings that these required notifications are not necessarily being provided in all cases.

In the future, the agency will utilize the new reporting capability within Core-CT to identify DRS employees who are also employed by other state agencies."

Policy Regarding Work Schedule of Managers:

Criteria: DAS Management Personnel Policy 06-02 indicates that managers generally work forty hours per week. However, managers are expected to work the number of hours necessary to get the job done which would include the extra hour or two a manager might work to complete normal work assignments in a normally scheduled workday. Compensatory time is to be granted by the Agency Head and only in unique situations.

- Condition:* The Department has issued a policy in its Personnel Policy Manual allowing its managers flexibility to manage their individual work schedules, within certain parameters. Managers are expected to maintain regular hours, five days a week and account for forty hours in each week. However, they are allowed to adjust for extra hours worked on one day by coming in late the following day. This requires proper notification to his/her Director or the Commissioner's Office.
- Effect:* The Department's policy appears to contradict DAS's interpretation regarding managers' work schedules and complicates the accountability of time worked.
- Cause:* It appears that the Department sought to recognize the occasional extra hours managers may be required to work without consideration of DAS's Management Personnel Policy regarding compensatory time.
- Recommendation:* The Department should consider revising its flexible work schedule policy for its managers since it appears to contradict DAS's Management Personnel Policy 06-02. (See Recommendation 8.)
- Agency Response:* "The Department agrees with this finding. The DRS Human Resource Office acknowledges that its Managerial Compensatory Time Policy (September 1998) contradicted DAS's Management Personnel Policy 06-02. The DRS policy has been revised to correct the contradiction."

Outdated Position Descriptions:

- Criteria:* In accordance with Section 5-206 of the General Statutes, the Department of Administrative Services (DAS) has established position descriptions that include a title and code, pay grade, a statement of duties and responsibilities and the minimum desirable qualifications required by the incumbent for each class. These job descriptions are used by human resource personnel to help manage the assignment and utilization of staff in an effective and consistent manner.
- Condition:* We noted numerous instances in which the duties and description of positions in the respective job specifications did not appear to match the responsibilities of the employees filling such positions at the Department.
- The Agency initiated communication with DAS in 2002 requesting to expand the use of five classes and asking for the job

specifications to be updated. At the time of the request, 19 positions were impacted by this condition.

Effect: The use of these Agency-specific classes does not appear to conform to published job specifications. The ability to manage positions is hampered if specifications are not accurate.

Cause: While DAS approved the proposed use of the classes, the specifications were never updated.

Recommendation: The Agency should request that the Department of Administrative Services modify the job specifications that do not conform to the titles as they are being utilized within the Agency. (See Recommendation 9.)

Agency Response: “The Department agrees with this finding. The Department has previously recommended and submitted job specification revisions to the Department of Administrative Services. In addition, the DRS has been continually following up with the Department of Administrative Services over the past several years on this matter and will continue to do so until it is resolved.”

Protection of the Identity of Informants and Logging of Complaints:

Criteria: In order to encourage citizens to come forward with information that they believe indicates wrongdoing, entities create processes to provide for the confidential reporting of such matters. Informants can be anonymous or may choose to provide their identity in order to facilitate the ability to obtain additional information. In either scenario, the source of the information has the right to expect that their anonymity be maintained to the highest degree possible unless it is specifically waived.

Section 12-15(h)(2) of the General Statutes provides that no provision of law shall be construed to require the disclosure of the identity of a confidential informant.

The Department has an Internal Audit function that is organizationally independent and capable of investigating complaints related to the administration of the tax laws and the operation of the Department.

Condition: The relevant Statute permits the Department to maintain the confidentiality of an informant, but does not require it. Under the current law, disclosure of an informant’s identity would not

constitute a statutory violation and would not necessarily subject a DRS employee to penalties.

Complaints can come to the Agency through a few different routes. The majority are received by the Commissioner's Office and then routed to the Special Investigations Unit, but other units may receive complaints directly. The Special Investigation Unit does not maintain a log of the complaints that it receives. Agency procedures conveyed to us provide that after 15 months, unfounded or unassigned complaints are redacted from the files.

Effect: The absence of the statutory protection does little to put an informant at ease that their identity will not be divulged.

The lack of a log of complaints received by the Department makes it difficult for an independent review of how the complaint was handled. In addition, the lack of historical data beyond the 15-month retention period prevents the documentation of trends or patterns. The existence of such cumulative information could impact the assessments made by DRS of the information contained in individual complaints.

Cause: It appears that the Department had not seen the need to provide statutory protection to whistleblowers, and had not contemplated the need for accountability over the process used to review complaints.

Recommendation: The Department of Revenue Services should seek a statutory revision that specifically grants anonymity to those that supply the Department with information about the potential wrongdoing of taxpayers. In addition, the Department should put a process in place that will provide for the recording and independent review of complaints that are made to the Agency. (See Recommendation 10.)

Agency Response: "The Department disagrees with the recommendation. The Department believes that the current law appropriately balances the interests of a taxpayer and the interests of a confidential informant. The Department does not intend to seek the passage of legislation that would specifically grant anonymity to informants.

The Department has a process in place that it believes effectively and efficiently reviews and addresses taxpayer complaints. We do not believe that hiring additional staff to number and record complaints will add any significant value compared to what is currently in place. An independent review of how a complaint was satisfied is not necessary since the process has checks and balances

in place. In addition, the 15 month maximum for retaining unsubstantiated complaints is required to comply with C.G.S. § 1-216.”

*Auditors’ Concluding
Comment:*

Similar to the State’s Whistleblower laws, the availability of the statutory protection of the identity of an informant is oftentimes the basis of successful complaint processes, and theoretically should be part of any effective tax administration program. Accordingly, the Auditors of Public Accounts will consider recommending such legislation in its next Annual Report to the Legislature.

References to Section 1-216 of the General Statutes may be misguided, as said Section refers only to uncorroborated criminal activity and does not appear to prevent the cataloging of complaints for historical purposes if the identity of the subject is redacted.

Business Continuity/Disaster Recovery Planning:

Background:

Security over the data processing functions includes provisions for disaster recovery to enable critical operations to resume within a reasonable period of time after a disaster. The Department of Information Technology (DOIT) provides guidance and a basic template for agencies to create a proper business continuity plan within which a disaster recovery plan is a key component. Disaster recovery strategies include the use of alternate “hot” or “cold” sites. Hot sites are equipped with hardware and connectivity, cold sites are unequipped.

Criteria:

DOIT maintains a contract for a hot site to recover data and applications that reside at its East Hartford facility. With regard to applications that reside at the local agencies, it appears to be incumbent upon the agencies to pursue protection of these mid-range systems and other enterprise systems that each agency deems to be critical. The designation of these systems should be part of the business continuity plan.

Due to the sensitive nature of the data held by DRS, and the emerging technological initiatives that enable DRS to collect increasing amounts of confidential information, there appears to be the need for a current plan that will enable the Agency to continue to operate under difficult circumstances and still maintain the integrity of the information.

Condition: The Department's Business Continuity Plan had not been updated since 1999 and the latest available version of the Disaster Recovery Plan was a draft last revised in September 2004 but never formally accepted, adopted, or implemented. We were informed that there have been no arrangements made for the utilization of a hot or cold site in the event of a disaster. Both of the existing plans precede the implementation of the ITAS system, which has dramatically impacted the processes in place within the Department.

We were informed that DRS intends to have these plans updated by the end of the 2007 calendar year.

Effect: The absence of current plans increases the risk that a timely response to a disaster would be impeded. The usability of the current plans is greatly reduced if they aren't written to conform with the system(s) that are currently in place. The lack of current procedures covering the usage and security of confidential data increases the risk of a breach when DRS is operating under difficult circumstances.

Cause: The focus of the Department has understandably been the implementation of the new ITAS system.

Recommendation: The Department should take steps to ensure that the planned updates to the disaster recovery and business continuity plans occur in a timely fashion. (See Recommendation 11.)

Agency Response: "The Department agrees with this finding, in part. DRS has always recognized its mission critical role in State government. As such, it has historically placed great emphasis on planning for unexpected service disruptions. Unfortunately a 25 percent staffing reduction in 2003 combined with the initiation of a five year \$70 million operating system (ITAS) replacement project has forced the agency to focus its available resources on meeting its core operating requirements.

While the agency did not formally update its (IT) disaster recovery and business continuity documents during this period, it has continued the planning process necessary to sustain essential operations during a disaster situation. The agency will have its information technology disaster recovery plan documentation fully updated by December 2007. Additionally, it is expected that the DRS business contingency and continuity plan (BCCP) will be formally updated within 12 months after full implementation of its new ITAS operating system."

Administration of Interest Payments on Returns Held for Audit:

Criteria: Procedures in place within DRS require that claims for tax refunds over a certain threshold be audited prior to issuance of the refund in order to help deter fraudulent returns. Statutory provisions generally require DRS to pay interest on refund requests held for more than 90 days. The requirement that interest be paid on these returns should ensure that they receive expedited handling in order to avoid or minimize the expense to the State.

The State has a budget process in place to help manage operating expenses of most agencies. Requiring budgets for various line items improves accountability for such expenses through the budget reporting process.

Internal Revenue Service guidelines indicate that the interest in excess of \$600 paid as a result of delays in paying refunds is reportable to the taxpayers as interest income on Form 1099-INT. These amounts would also likely be reportable as income on the taxpayers State income tax return.

Condition: During a sample of 150 tax refund payments made during the 2006 fiscal year, we noted that five payments included interest on the refund because the returns were held for more than 90 days. The combined interest on these five returns exceeded \$90,000, with the smallest amount being \$9,000. The periods for which interest was paid ranged from five months to 21 months.

The interest was treated as a regular refund of income tax and deducted from amounts received by the State to arrive at a net amount of income tax collected.

DRS did not have a procedure in place to capture the information necessary to comply with Internal Revenue Service requirements for the reporting of this interest as taxable income.

Effect: The State incurred the expense of interest payments without evidence that all reasonable steps were taken to minimize the expense, including adherence to a budgeted amount. Internal Revenue Service reporting requirements were not being adhered to. Opportunities for the State to recoup some of the interest paid by taxing those same amounts may have been missed, but those opportunities were few due to the fact that non-resident returns were the ones most frequently held up.

Cause: Non-resident returns were judged to be higher risk because the taxpayer is more difficult to locate in the event of an overpayment. The Department did not have a process in place to effectively prioritize the processing of those returns that appeared to lend themselves to an interest obligation. In addition, response times from taxpayers and accountants were out of the Department's control.

Historical data on the amounts and frequency of interest paid on tax refunds is not readily available due to the budgetary process of netting these amounts against payments collected.

Internal Revenue Service reporting requirements were not complied with because a process was not in place to capture the necessary data.

Recommendation: The Department of Revenue Services should consider steps to improve or expedite the handling of those refund requests that appear to be candidates for the payment of interest. Budgetary control over such payments should be enhanced by establishing a line item for that expense. (See Recommendation 12.)

Agency Response: "The Department agrees with this finding, in part. The Department acknowledges that the interest paid to a taxpayer was not separately stated in all cases when it was associated with an audit. The computer system that was in place did not have the capability to properly track and report out this information. Rather than expend the limited staffing resources on a system that has since been replaced the Department determined that it was more prudent to program this functionality into the new system.

The Department does not agree with the comment that steps were not taken to minimize the interest that was paid on refund requests. The Department implemented a fast-track process in addition to other procedures specifically to limit the amount of interest paid on these types of refund requests. It should be noted that the overwhelming majority of interest paid on these accounts was to Non-Resident taxpayers and therefore would not be subject to income tax in Connecticut. Additionally, of the 119 audit cases requesting refunds totaling in excess of \$6.2 million for the period ended June 30, 2006, the Department denied or reduced the amount of the refund request by more than \$2.7 million. As it was pointed out to the Auditors of Public Accounts the benefits of this procedure far outweighs the interest being paid."

Auditors' Concluding

Comment: The current method of accounting for the interest paid on these returns needs to be modified so that the amount can be identified and monitored for budgetary purposes.

Disposition of Seized Property:

Background: The Department's Special Investigation Section (SIS) is primarily responsible for the investigation of civil and criminal violations of the Connecticut General Statutes which pertain to criminal tax fraud, sales, corporation, withholding, and personal income taxes, illegal importation of untaxed alcoholic beverages, cigarettes and motor fuels, as well as other suspected violations of Connecticut tax statutes. In accordance with Section 12-330, subsection (g), of the General Statutes, the DRS Commissioner is authorized to seize untaxed tobacco products as contraband. In addition, vehicles used to store and transport the tobacco products and cash deemed to be from the sale of those tobacco products may also be seized 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. Proceeds from the sales of such items are to be deposited with the State Treasurer.

Criteria: In order to maximize the amount received by the State for contraband that is offered at auction and the investment income from cash that is confiscated and turned over to the State, procedures should provide for the timely transaction of such items.

Condition: During our examination of the seized property in March 2007, we noted a vehicle and approximately \$2,700 cash on hand. A review of the corresponding case files found that the cases were deemed to have been closed in November 2006, and at that time all that was necessary for turning the property over to State surplus for disposition was a declaration from the Commissioner.

Effect: Delays in transacting items such as motor vehicles results in reduced values at the time of auction due to additional depreciation. Delays transacting cash postpones the revenue recognition and increases the risk of loss.

Cause: Special Investigation Section staff attributed the delays to a lack of personnel to prepare the correspondence for the Commissioner's signature.

Recommendation: The Department of Revenue Services should consider implementing procedures that will avoid unnecessary delays in the

transacting of seized property after it is deemed to belong to the State. (See Recommendation 13.)

Agency Response: “The Department disagrees with this finding. The case in question is still open, additionally the delay stated as the Cause is incorrect. The Bureau of State Surplus delayed acceptance of the seized vehicles and can not sell them without clear title. The Connecticut Department of Motor Vehicle can not provide a clean title for a vehicle that was registered out of state or that has a lien on it. The Department of Revenue Services Legal Division is currently working on this issue, and the Bureau of State Surplus may refuse to accept these vehicles in the future.

To say that the delay which will reduce the value of the vehicle was caused by the Department of Revenue Services is misleading since the vehicles are still at State Surplus and are not yet for sale. Additionally one of the vehicles was not drivable and had to be towed to State Surplus. The Department has been working with the various State Agencies in order to dispose of the property.”

*Auditors’ Concluding
Comment:*

DRS can only be responsible for the timely transfer of seized property to State Surplus or the timely deposit of cash. The intricacies associated with the seizure and sale of vehicles with liens and/or out-of-state titles serves to illustrate the need for procedures designating the role of the various State agencies in this process.

RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 2001, 2002, 2003 and 2004, contained a total of six recommendations. Of those recommendations, three have been implemented or otherwise resolved. The status of recommendations contained in the prior report is presented below.

Prior Audit Recommendations:

- The controls over the receipt of checks should be improved to ensure the prompt deposit of receipts in accordance with statutory requirements and the Agency should verify the deposit of all checks received. Nothing came to our attention to indicate that deposit delays were continuing.
- DRS should implement procedures to monitor and ensure compliance with State of Connecticut petty cash employee travel advance requirements. We are not repeating this recommendation because DRS has increased the rate of compliance to a reasonable level.
- DRS should take whatever measures necessary to comply with Section 12-7b of the General Statutes to compile an Annual Report and provide other required specific tax information. This recommendation has been modified to reflect current conditions. (See Recommendation 3.)
- The Department should develop and implement additional procedures to examine and verify personal income tax information supporting taxes withheld prior to the issuance of tax refund payments. This recommendation is not being repeated.
- The Department of Revenue Services should implement the internal controls necessary to ensure that its computer software inventory is maintained in accordance with the software inventory policy and procedures as set forth in the *State of Connecticut's Property Control Manual*. This recommendation is being repeated. (See Recommendation 4.)
- The Department of Revenue Services should take whatever measures necessary to comply with Section 12-3a, subsection (b), of the General Statutes and produce a complete statement of all penalty waivers approved by the Penalty Review Committee. This recommendation has been modified to reflect current conditions. (See Recommendation 2.)

Current Audit Recommendations:

- 1. The Department of Revenue Services should pursue the elimination of the State Tax Review Commission authorized by Section 12-34d of the General Statutes.**

Comment:

The Commission has not meet since 1994 and a 1997 legislative attempt to eliminate it was not successful.

- 2. The Department of Revenue Services should encourage the Penalty Review and Abatement Review Committees to adhere to relevant statutory provisions regarding the recording of the activity at meetings and adopt other procedures as necessary to document the number of files that are expected to be reviewed and increase the level of assurance that can be placed on the minutes of their meetings. In addition, the Abatement Review Committee should attempt to meet more frequently in order to increase the number of accounts that are actually examined prior to approving the entire list of requested abatements.**

Comment:

Minutes were not signed to indicate that they were approved and the votes of the members were not specified. The Abatement Review Committee approved approximately 22,000 accounts at two separate meetings.

- 3. The Department should consult with the State agencies that are the primary users of the data included in DRS' reporting requirements and collectively determine whether the reporting is necessary or the statutory requirements should be amended.**

Comment:

The Department's annual report failed to include the necessary information. Reports required by Sections 12-7a and 12-315a of the General Statutes were not formally prepared.

- 4. The Department should consult with the Comptroller's Property Control Manual and bring its policies and procedures into conformance.**

Comment:

Surplused items were not removed from the inventory records in a timely manner, and the Department did not maintain any records of controllable property.

5. **The Department should follow its own procedures and those in the Governor’s directive when administering terminated/separated employees. Also, the Department should take more care to ensure that the proper staff are notified of terminations so that access to sensitive data processing systems is promptly disabled.**

Comment:

Evidence that employees went through an exit interview process was missing in 15 of 17 instances we examined. Interviews with the Ethics Liaison Officer were not conducted. Ten of 17 employees did not have their access to one or more critical systems removed.

6. **The Department should enforce the submission of medical certificates in accordance with Section 5-248-2 of the State Regulations and applicable labor agreements.**

Comment:

Six of 24 employees with more than five consecutive sick days did not have medical certificates on file.

7. **The Department should utilize the reporting capability within Core-CT to evaluate compliance with the dual employment provisions of Section 5-208a of the General Statutes.**

Comment:

Two of four staff with dual employment arrangements did not have the required documentation on file.

8. **The Department should consider revising its flexible work schedule policy for its managers since it appears to contradict DAS’s Management Personnel Policy 06-02.**

Comment:

The DRS policy essentially grants compensatory time to managers that may work only an occasional hour or two, contrary to DAS policy.

- 9. The Agency should request that the Department of Administrative Services modify the job specifications that do not conform with the titles as they are being utilized within the Agency.**

Comment:

The Department received permission to utilize certain titles in a manner outside of the official job specifications. The specifications were never rewritten to accommodate these revised uses.

- 10. The Department of Revenue Services should seek a statutory revision that specifically grants anonymity to those that supply the Department with information about the potential wrongdoing of taxpayers. In addition, the Department should put a process in place that will provide for the recording and independent review of complaints that are made to the Agency.**

Comment:

DRS informants are not provided statutory protection as most whistleblowers would be. The lack of a log of complaints received by the Department makes it difficult to independently assess the resolution of those complaints.

- 11. The Department should take steps to ensure that the planned updates to the disaster recovery and business continuity plans occur in a timely fashion.**

Comment:

The Business Continuity Plan had not been updated since 1999, and the disaster recovery plan had not been updated since 2004. Both of these plans preceded the implementation of the major ITAS system.

- 12. The Department of Revenue Services should consider steps to improve or expedite the handling of those refund requests that appear to be candidates for the payment of interest. Budgetary control over such payments should be enhanced by establishing a line item for that expense.**

Comment:

Interest payments are recorded in the accounting records as additional tax refunds rather than as an expense. Internal Revenue Service reporting requirements were not being adhered to.

- 13. The Department of Revenue Services should consider implementing procedures that will avoid unnecessary delays in the transacting of seized property after it is deemed to belong to the State.**

Comment:

During March 2007, cash and a vehicle associated with a case that was closed in November 2006 were not yet ordered by the Commissioner to be turned over to the State for disposition.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Department of Revenue Services for the fiscal years ended June 30, 2005 and 2006. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grants, and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Department of Revenue Services for the fiscal years ended June 30, 2005 and 2006 are included as a part of our Statewide Single Audit of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Department of Revenue Services complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of the internal controls to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the Department of Revenue Services is the responsibility of the Department of Revenue Services' management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations, contracts, and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations for the fiscal years ended June 30, 2005 and 2006, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial or less than significant instances of noncompliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

The management of the Department of Revenue Services is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants applicable to the Agency. In planning and performing our audit, we considered the Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Department of Revenue Services' financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Agency's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts and grants. We believe the following finding represents a reportable condition: the failure to report interest earned on tax refunds that are delayed due to the audit process.

A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants or the requirements to safeguard assets that would be material in relation to the Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal controls over the Agency's financial operations and over compliance would not necessarily disclose all matters in the internal controls that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or significant weaknesses. However, we believe that the reportable condition described above is not a material or significant weakness.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the officials and staff of the Department of Revenues Services during the course of our examination.

Kenneth Post
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts