

STATE OF CONNECTICUT



*AUDITORS' REPORT
DEPARTMENT OF REVENUE SERVICES
FOR THE FISCAL YEARS ENDED JUNE 30, 2007 AND 2008*

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	3
General Fund Revenues and Receipts.....	3
General Fund Expenditures.....	4
Special Transportation Fund.....	5
Audit Assessments	6
Appellate Division	6
Accounts Receivable.....	6
Penalty Waivers	7
Collections and Enforcement Division	8
CONDITION OF RECORDS	9
State Tax Review Commission.....	9
Administration of the Penalty Review and Abatement Review Committees	9
Small and Medium-Sized Business Users Committee.....	11
Failure to Adopt Regulations as Required by Statute	11
Statutory Reporting Requirements.....	12
Attendance Records for Suspended Employees	14
Review of Sick Leave Records for Medical Certificate Requirements	15
Investigation by Human Resources Unit of Alleged Improprieties.....	16
Proper Recording of Receipt Dates for Expenditures.....	19
Insufficient Commitment Amounts on Purchase Orders	20
Recording of Actual Receipt Dates to Verify Timely Deposit	21
Documentation and Review of Sales and Use Tax Audit Procedures	22
Processing of Suspended Transactions	24
Unauthorized Inspection of Tax Return Information.....	25
Maintenance and Disposition of Seized Property Cases.....	26
Management of Equipment Inventory	27
Comparison of Job Descriptions to Assigned Duties	29
Clarification of Confidentiality Provisions of Section 12-15 of the General Statutes.....	30
RECOMMENDATIONS	33
INDEPENDENT AUDITORS' CERTIFICATION	39
CONCLUSION	41

December 4, 2009

**AUDITORS' REPORT
DEPARTMENT OF REVENUE SERVICES
FOR THE FISCAL YEARS ENDED JUNE 30, 2007 AND 2008**

We have examined the financial records of the Department of Revenue Services for the fiscal years ended June 30, 2007 and 2008.

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:**

Section 4 of Public Act 07-108 provided for the offset of any Connecticut income tax refund to persons in default of student loans made or guaranteed by the Connecticut Higher Education Supplemental Loan Authority (CHESLA), effective July 1, 2007.

Section 133 of Public Act 07-1 required the Office of Legislative Research to conduct a feasibility study of a state earned income tax credit and report the conclusion to the Governor and the Committees on Finance, Revenue, and Bonding, Appropriations, and Human Services, no later the February 1, 2008.

- **Sales and Use Tax**

Section 20 of Public Act 07-242 reinstated the sales tax exemption for sales of passenger motor vehicles, as defined in Section 14-1 of the General Statutes, with an EPA estimated city or highway gasoline mileage rating of at least 40 miles per gallon (formerly 50 mpg highway), effective January 1, 2008; sunsets June 30, 2010.

- **Corporation Business Tax**

Section 18 of Public Act 07-250, effective January 1, 2007, expanded the job creation tax credit provided for in Section 12-217ii of the General Statutes by allowing firms in Connecticut to qualify and reducing the required number of new jobs from 50 to 10 and increasing the credit from 25 percent to 60 percent of the amount of Connecticut income tax deducted and withheld from the wages of the new employees.

- **Cigarette and Tobacco Taxes:**

Section 124 of Public Act 07-01 of the June 2007 Special Session increased the cigarette tax from \$1.51 to \$2 per pack, effective for sales occurring on or after July 1, 2007.

- Gift and Estate Taxes:

Section 132 of Public Act 07-1 of the June 2007 Special Session required the Department of Revenue Services and Office of Policy and Management to conduct a study of the estate tax and submit its findings to the Governor and the General Assembly's Finance, Revenue, and Bonding Committee no later than February 1, 2008.

- Other Taxes:

Section 127 of Public Act 07-01 of the June 2007 Special Session exempts events held at the Connecticut Convention Center from the admission tax for admissions charged on or after July 1, 2007.

Section 135 of Public Act 07-01 of June Special Session increased the Motor Fuel Tax rate on diesel from 26 cents to 37 cents, effective July 1, 2007.

Section 137 of Public Act 07-01 of the June Special Session exempted the first sale within Connecticut of diesel fuel from the petroleum products gross earnings tax.

Section 8 of Public Act 08-1 of the November 24, 2008 Special Session established a tax amnesty program that ran from May 1 through June 25, 2009. In this amnesty program if a taxpayer paid the taxes due by June 25, 2009 under amnesty their interest will be reduced from 1 percent to 0.75 percent from the tax due date to the payment date or June 25, 2009, whichever is earlier.

Section 1 of Public Act 08-2 of the June 2008 Special Session eliminated the increase in the petroleum products gross earnings tax from 7 to 7.5 percent that was to take effect July 1, 2008. The next scheduled increase to 8.1 percent will be effective on or after July 1, 2013.

RÉSUMÉ OF OPERATIONS:

General Fund Revenues and Receipts:

General Fund tax revenues, license fees and all other revenues and non-revenue receipts totaled \$12,641,563,000 and \$13,522,813,000 for the fiscal years ended June 30, 2007 and 2008, respectively. 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 \$752,535,357 and \$863,546,653 for the fiscal years ended June 30, 2007 and 2008, respectively.

A summary of tax revenues, net of refunds, for the fiscal years ended June 30, 2007 and 2008, with 2006 figures presented for comparative purposes, is presented below:

(In Millions of Dollars)	<u>2007-2008</u>	<u>2006-2007</u>	<u>2005-2006</u>
Personal income	\$ 6,757	\$ 6,118	\$ 5,581
Sales and use	3,634	3,369	3,396
Corporations	615	778	673
Inheritance taxes	162	173	185
Public service companies	227	233	222
Insurance companies	170	189	208
Hospital gross	29	45	46
Alcohol/cigarettes/tobacco	379	314	318
Petroleum companies	344	288	226
Real estate/controlling interest	163	208	210
Nursing homes	124	127	95
Admissions, dues and cabaret	37	33	35
All other taxes	<u>15</u>	<u>17</u>	<u>17</u>
Total	<u>\$12,656</u>	<u>\$11,892</u>	<u>\$11,212</u>

As presented in the above analysis, net General Fund tax revenues increased by 6.1 percent and 6.4 percent during the years under review. The increases were primarily due to rises in personal income tax revenues. Revenues from sales and use and personal income tax receipts accounted for approximately 79.8 percent and 82.1 percent of tax revenues in total for the fiscal years ended June 30, 2007 and 2008, respectively. The increase in tax revenue from petroleum companies is the result of the passage of Public Act 06-136, which required that such revenue be deposited into the General Fund rather than the Special Transportation Fund.

General Fund Expenditures:

A summary of General Fund expenditures from Department appropriations for the fiscal years ended June 30, 2006, 2007, and 2008, is presented below:

	<u>2007-2008</u>	<u>2006-2007</u>	<u>2005-2006</u>
Personal services	\$57,151,966	\$53,990,780	\$51,107,076
Other expenses	10,668,283	10,351,565	10,344,062
Equipment	-	-	94
Total Budgeted Accounts	<u>\$67,820,249</u>	<u>\$64,342,345</u>	<u>\$61,451,232</u>
Restricted Appropriations	<u>18,723</u>	<u>8,873</u>	<u>349,724</u>
Totals	<u>\$67,838,972</u>	<u>\$64,351,218</u>	<u>\$61,800,956</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 positions changed during the audited period, as compared to the previous year. Below is a summary of positions as of June 30, 2006, 2007, and 2008:

	<u>As of June 30,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Full-time	740	688	756
Part-time	13	77	12
Temporary or durational	<u>44</u>	<u>66</u>	<u>45</u>
Total	<u>797</u>	<u>831</u>	<u>813</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 \$475,331,743 and \$493,848,242 for the fiscal years ended June 30, 2007 and 2008, respectively.

Special Transportation Fund tax refunds, budgeted as reductions of tax revenues, totaled \$8,020,996 and \$6,999,188 for the fiscal years ended June 30, 2007 and 2008, respectively.

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

(In Millions of Dollars)	<u>2007-2008</u>	<u>2006-2007</u>	<u>2005-2006</u>
Motor fuel tax	\$ 375	\$387	\$385
Special motor fuel tax	96	67	71
Petroleum Companies	-	-	33
Motor carrier tax	<u>15</u>	<u>13</u>	<u>14</u>
Total	<u>\$486</u>	<u>\$467</u>	<u>\$503</u>

As noted above, the elimination of the tax revenue from petroleum companies is attributable to the passage of Public Act 06-136, which directed the tax revenue from the Special Transportation Fund to the General Fund.

Special Transportation Fund expenditures from Department appropriations for the fiscal years ended June 30, 2006, 2007, and 2008, is presented below:

	<u>2007-2008</u>	<u>2006-2007</u>	<u>2005-2006</u>
Highway Planning and Construction	\$ 96,690	\$77,838	\$11,392
Tax Refund Check Box Administration	<u>23,165</u>	<u>11,419</u>	<u>18,500</u>
Total	<u>\$119,855</u>	<u>\$89,257</u>	<u>\$29,892</u>

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 \$522,855,848, \$371,514,391, and \$474,930,475 respectively, for the fiscal years ended June 30, 2006, 2007 and 2008. 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>2007-2008</u>	<u>2006-2007</u>	<u>2005-2006</u>
Corporation taxes	\$ 227	\$ 166	\$ 196
Sales and use taxes	114	118	169
Personal income tax	95	39	118
Excise taxes	14	12	9
Public service taxes	12	25	19
All other taxes	<u>13</u>	<u>11</u>	<u>12</u>
Total	<u>\$ 475</u>	<u>\$ 371</u>	<u>\$ 523</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, 2006, 2007, and 2008, are presented below. Revisions resulted from both court and Appellate Division decisions.

	<u>2007-2008</u>	<u>2006-2007</u>	<u>2005-2006</u>
Cases resolved	1,526	1,134	1,049
Original assessments	\$162,495,352	\$237,787,928	\$ 129,199,730
Revised assessments	<u>83,377,722</u>	<u>109,576,857</u>	<u>62,090,473</u>
Assessment reductions	<u>\$ 79,117,630</u>	<u>\$128,211,071</u>	<u>\$ 67,109,257</u>
Percentage reduction	49%	54%	52%

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, 2006, 2007, and 2008, is presented below:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Taxes Receivable:	\$	\$	\$
Corporation tax	130,376,520	161,415,889	135,727,396
Income tax	222,671,397	324,991,283	286,833,413
Sales and use tax	186,093,892	148,330,409	176,330,331
Other taxes	<u>31,893,301</u>	<u>26,455,073</u>	<u>34,980,647</u>
Total Taxes Receivable	<u>\$571,035,110</u>	<u>\$661,192,654</u>	<u>\$633,871,787</u>
Reductions:			
Credits	(89,297,577)	(67,077,784)	(59,974,154)
Appellate reductions	(89,916,078)	(158,587,350)	(186,088,417)
Estimated uncollectible	<u>(147,150,465)</u>	<u>(79,506,960)</u>	<u>(93,729,036)</u>
Total Reductions	<u>(326,364,120)</u>	<u>(305,172,094)</u>	<u>(339,791,607)</u>
Net taxes Receivable	<u>\$244,670,990</u>	<u>\$356,020,560</u>	<u>\$294,080,180</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 reductions from the tax receivable include the credits, appellate and court reductions, and aged tax receivable estimated to be uncollectible.

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 the penalty waiver activity for the fiscal years ended June 30, 2001 through 2008, 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
2006-2007	7,275	\$6,976,806	2,925	\$3,092,373	4,350	\$3,884,433
2007-2008	7,563	\$9,240,227	2,189	\$1,997,736	5,374	\$7,242,491

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 indicated revenues collected by the Division to be \$142,092,782, \$104,532,427, and \$113,626,358 during the 2006, 2007, and 2008 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 2007-2008 fiscal year, abatements were approved totaling \$11,399,405. The Committee did not hold a meeting during the 2006-2007 fiscal year.

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 \$6,975,057, \$17,446,254, and \$8,956,780 were referred to this status during the 2005-2006, 2006-2007, and 2007-2008 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: As noted in our prior audit, a report issued by the Office of Legislative Research dated July 31, 2006, found 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. The Department has initiated legislation in the June 2009 legislative session to repeal the Statute.

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 continue to 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 submitted legislation to repeal the State Tax Review Commission. The legislation was not adopted by the General Assembly."

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 Abatement Review Committee did not meet in 2007 and met once in 2008. At the June 2008 meeting, 841 accounts valued at approximately \$11,399,000 were approved for abatement.

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. DRS staff review the cases submitted to those Committees to determine if they are appropriately documented.

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

In order to be most effective, such oversight committees should be independent of the associated State agency.

Condition: Neither Committee had 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.

The inclusion of a representative from DRS on these committees creates an apparent conflict of interest, as they may be asked to opine on an action that is being recommended by their own colleagues. This may offset the value of having the DRS representative on the Committees for technical advice.

Effect: The extent 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 are expected to be examined. The amount of oversight that is achieved may be questioned when one of the Committee members is not independent of the process.

Cause: A lack of administrative oversight contributed to this condition. The makeup of the Committees is dictated by Statute.

Recommendation: The Department of Revenue Services should encourage the Penalty Review and Abatement Review Committees to adopt formal procedures detailing the process by which cases will be reviewed. Consideration should also be given to amending the relevant legislation in order to replace the DRS representatives and/or make the representatives' roles only advisory in nature. (See Recommendation 2.)

Agency Response: "The Department agrees with this finding in part. The regulations for the Penalty Waiver Committee were adopted on August 26, 1988 and for the Abatement Review Committee April 28, 2005. The Commissioner has recently initiated a review of the penalty waiver process in order to incorporate the concerns raised by Auditors of Public Accounts. Regarding the composition of the Committees, the Department is following what is required in the Statute."

Small and Medium-Sized Business Users Committee:

Criteria: Section 12-3f of the General Statutes established the Small and Medium-Sized Business Users Committee to advise and make recommendations to the Commissioner of Revenue Services concerning measures to improve the Department's "user friendliness".

Condition: The Committee has been inactive since 1995.

Effect: The failure of the Committee to hold meetings renders it ineffective.

Cause: The Department regarded the Committee as having served its purpose and no longer necessary.

Recommendation: The Department should consider seeking legislation repealing the Small and Medium-Sized Business Users Committee authorized by Section 12-3f of the General Statutes. (See Recommendation 3.)

Agency Response: "The Department submitted legislation to repeal the Small and Medium-Sized Business Users Committee. The legislation was not adopted by the General Assembly."

Failure to Adopt Regulations as Required by Statute:

Criteria: Subparagraph (B) of subdivision (40) of Section 12-412 of the General Statutes states that the Commissioner of Revenue Services

shall adopt regulations requiring the periodic registration for purposes of the issuance of fisherman tax exemption permits.

Condition: The Department has not established the required regulations.

Effect: There were no regulations in place to carry out the legislative mandate.

Cause: This condition appears to have been an oversight.

Recommendation: The Department of Revenue Services should implement regulations requiring periodic registration for the issuance of fisherman tax-exempt permits in accordance with Section 12-412 of the General Statutes. (See Recommendation 4.)

Agency Response: “The Department agrees with this finding. The Department intends to adopt regulations pertaining to Conn. Gen. Stat. 12-412(40). However, the fact that regulations have not yet been adopted has not adversely affected commercial fishermen because the Department has, in fact, periodically registered commercial fishermen in order to issue fisherman tax exemption permits.”

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.

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 12-7b, subsection (d), of the General Statutes requires the Commissioner of Revenue Services to submit to the Office of Fiscal Analysis a monthly report on certain data concerning sales and use taxes.

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: DRS staff informed us that the reporting requirements of Section 12-7a, subsection (b), and Section 12-7b, subsection (d), were not being done as specified in the Statutes. Instead, the data was supplied as requested.

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. However, the Department has asserted that it has met the requests of the user agencies by supplying these reports as requested rather than adhering to the statutory schedule.

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. The Department has initiated legislation in the 2009 session attempting to repeal Section 12-315a of the General Statutes.

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 5.)

Agency Response: "The Department disagrees with this finding. Because of limited resources, the Department reached an agreement with the Office of Fiscal Analysis and the Secretary of the Office of Policy and Management to issue the reports pursuant to Section 12-7a, subsection (b), and Section 12-7b, subsection (d), on demand. The

Department submitted legislation to repeal Section 12-315a. The legislation was not adopted by the General Assembly.”

Attendance Records for Suspended Employees:

Criteria: Attendance records should present an accurate historical record of an employee’s status, whether at work or on leave. Unpaid leave of more than five days in a month can impact the employees’ leave accruals. The annual attendance report is designed to provide at-a-glance summaries of employees’ attendance.

Condition: A review of annual attendance records of employees that had been suspended without pay revealed two employees whose records did not indicate that they were suspended. Instead, there were no entries at all made for those days.

Effect: The attendance records did not reflect the true status of these employees for those specific days. In the instances noted, the leave accruals appeared to have been properly adjusted to reflect the suspensions. However, the omission of unpaid suspensions from the attendance record increases the risk that leave accruals may not be properly calculated.

Cause: The Department’s payroll staff were not familiar with the promulgated procedures for adjusting the Core-CT system to accommodate these scenarios. Since the accrual balances and other attendance modules within Core-CT were correct, the Department had no apparent need to ensure that the attendance calendar reflected the unpaid leave.

Recommendation: The Department of Revenue Services should implement procedures to ensure that the attendance records of employees suspended without pay accurately reflect the status of those employees. (See Recommendation 6.)

Agency Response: “The Department of Revenue Services agrees with this finding, but disagrees with the Cause statement that “the department’s payroll staff were not familiar with the promulgated procedures for adjusting the Core-CT system to accommodate these scenarios.”

The disagreement stems from the fact that the Core-CT job aids for Unpaid Leave of Absences (May 2006) were only updated to include instructions on how to provide an attendance record for unpaid leave (via the Adjust Paid Time page) **on April 24, 2009**. Prior to the April 2009 update, the only reference in the job aid to

unpaid leave stated that “No time should be entered on the timesheet page when an employee is on an unpaid leave of absence”.

With the updated instructions in place, DRS has begun to utilize the Adjust Paid Time page of the Core-CT Time and Labor section. However, it maintains that it was properly recording unpaid leave prior to the April 24, 2009 update.

*Auditors’ Concluding
Comment:*

The use of the Adjust Paid Time process for employees on unpaid leave was discussed at a **March 2005** Core-CT Users Group meeting.

Review of Sick Leave Records for Medical Certificate Requirements:

Criteria: State Personnel Regulations and most collective bargaining contracts require that employees provide medical certificates to substantiate the use of more than five consecutive sick days. Such certificates should be presented to the agency upon the employees’ return to work.

Condition: The Department’s Human Resources Unit has a procedure in place to review quarterly reports of employees’ sick leave usage in order to determine which staff are subject to the medical certificate requirement.

Effect: While the process in place was generally successful in ultimately obtaining the required certificates, the timeliness of the receipt of these documents could be delayed when these reviews are only done quarterly. Reviews should be done on a biweekly basis in order to promptly document the propriety of the sick leave usage and provide assurance to the Department that a physician has authorized the employee to return to duty.

Cause: The Department had apparently determined that a quarterly review was sufficient.

Recommendation: The Department of Revenue Services should consider increasing the frequency of its reviews of sick leave usage for purposes of determining which employees are required to provide medical certificates. (See Recommendation 7.)

Agency Response: “The Department of Revenue Services agrees with this finding. The Human Resources office has implemented the Auditors of Public Accounts’ recommendation and is now reviewing sick leave usage

on a biweekly basis. It is important, however, to recognize that this is a time consuming process and a drain on already limited resources.

While the recommended action will help to identify any missing medical certificates sooner, it will not achieve the overall goal of preventing an employee who has five consecutive days of medical leave from returning to work without a properly completed medical certificate. In order to achieve such, the frequency of the Human Resource reviews would have to be increased to a daily basis which is not feasible. Accordingly, as it did with its quarterly Human Resource review, the agency will rely on the diligence and tracking of its supervisory employees to enforce the medical certificate requirement until the biweekly review has been completed.”

Investigation by Human Resources Unit of Alleged Improprieties:

Background:

Most agencies have a human resources and/or affirmative action unit(s) to manage most facets of the personnel function. Oftentimes these units become involved in investigations related to accusations of discrimination, harassment, and violations of certain workplace rules. Due to a perception of independence, these units are commonly asked to look at matters that extend into other issues that may involve identifying and assessing breaches in the internal control structure of an agency. This is often beyond the skill sets of human resource professionals.

For those agencies that are large enough to have an internal audit function, the primary focus of internal auditors is to evaluate and monitor the role of internal controls within an organization, as well as perform objective reviews of sensitive matters in order to determine corrective actions.

There is sometimes a need for internal audit and human resource units to work together in order to build sufficient cases against employees in the event that personnel actions are contemplated, as well as to address any internal control weaknesses that may have permitted any undesirable outcomes. However, the roles need to be distinct in order to provide independence, both in appearance and in fact.

Criteria:

Section 4-33a of the General Statutes requires that agencies report to the Auditors of Public Accounts and the State Comptroller any unauthorized or irregular use of State resources.

Agencies such as the Department of Revenue Services that have the benefit of Internal Audit Units should use those units to investigate any allegations of impropriety outside of the realm of the Human Resources Unit in order to provide the highest degree of independence possible. The involvement of the Internal Audit Unit can assist the agency in identifying internal control weaknesses that need to be corrected in order to deter or prevent future occurrences. Internal Audit Units are typically assigned the duty of initiating the reports necessary to comply with Section 4-33a.

In order to provide assurance that the conclusions reached and actions taken as a result of investigations are reasonable and consistent, the Human Resources director should document the review and concurrence with the reports prepared by staff.

Condition:

Our review of a whistleblower complaint alleging the misuse of Department resources found that the Human Resources Unit performed a review of the same matter, which alleged illegal activity in addition to misuse of State equipment. Information regarding the investigation was not shared with the Internal Audit Unit until the investigation was completed. The results of this investigation confirmed certain matters that should have been reported in accordance with Section 4-33a, but were not.

Our review of case files from Human Resources investigations found that a documented review by the Human Resources director was often not evident.

Effect:

The lack of involvement by the Internal Audit Unit increased the risk that the review was not performed in the most objective manner possible, and prevented the opportunity for a timely evaluation of relevant internal controls.

The reporting requirements of Section 4-33a of the General Statutes may not be fully met.

Undocumented reviews by the HR Director increases the risk that the conclusions reached by staff may not be consistent.

Cause:

The Department had not apparently considered the advantages of utilizing the Internal Audit Unit for such matters.

The Human Resources Director claimed to be regularly reviewing all of those files but did not consider the need to document the review process.

Recommendation: The Department of Revenue Services' Human Resources Unit, in concert with the Internal Audit Unit, should establish agreed-upon guidelines concerning the roles of each unit in the performance of investigations, including the delegation of responsibility for complying with the reporting requirements of Section 4-33a of the General Statutes. In addition, there should be a documented review by the Director of Human Resources of investigations performed by staff of that Unit. (See Recommendation 8.)

Agency Response: "The Agency agrees with this finding in part.

The Department agrees that the Human Resources Director should formally document their review of the investigations conducted by the staff of the Human Resource Office. While the director has previously reviewed these investigations, formal documentation of this activity has not been maintained. A form has been developed for this purpose and will be used going forward.

The Agency is not in agreement with the implication that there are insufficient guidelines in place to differentiate the roles of the Human Resource Office and the Internal Audit Unit. The Human Resource Office is responsible for investigating instances of possible incompetence, neglect of duty, failure to comply with established policies and procedures, insubordination and misconduct. The Internal Audit Unit focuses on ensuring the accuracy of records, the appropriate use and protection of such records, and determining the adequacy of systems and controls.

The determination of which area should conduct the initial investigation is dictated by the nature of the reported or discovered issue. In the course of fulfilling their duties and responsibilities, each area often reaches a point in its investigation where it is both necessary and appropriate to involve the other unit.

The Agency believes that a review of the investigations that have been conducted by each of the two units in the past will show timely and appropriate involvement of the other unit as required.

The Department disagrees with the contention that a review of a whistle blower complaint "confirmed certain matters that should have been reported in accordance with Section 4-33a, but were not." Other than personal e-mail usage, the findings of the investigation did not support the allegation and therefore would not trigger Section 4-33a. The Department addressed the non-business use of e-mails on an agency-wide basis through training and communication."

Auditors' Concluding

Comment:

We believe that the personal e-mail usage in this case was of the extent that warranted reporting of the misuse of State resources as required by Section 4-33a. Of the subject matters that are typically reviewed by Human Resources, "misconduct" and "failure to comply with established policies and procedures" are overly broad and subject to interpretation. This was further evidenced by the handling of the stolen laptop in 2007, with the ensuing investigation being initiated by the Human Resources Unit. The Internal Audit Unit was involved after the scope of the investigation was found to be beyond the capability of Human Resources.

Proper Recording of Receipt Dates for Expenditures:

Criteria:

The State's accounting system uses the receipt date field to determine if an expenditure is accrued and recorded in the proper fiscal year. The State Comptroller's Office has issued Memorandum 2007-24 pertaining to the proper use of receipt dates.

Condition:

Our review of payments for hardware and software maintenance contracts found that the receipt dates were not recorded in accordance with the Comptroller's Memorandum 2007-24. The Department was using the end date of the maintenance period instead of the payment due date as directed in the Memorandum.

Effect:

In the instances that the contract periods overlapped fiscal years, the use of the contract end dates as the receipt dates could cause the expenditure to be accrued in the following fiscal year.

Cause:

The Department was not aware of the existence of Memorandum 2007-24, and claimed that verbal guidance received from the staff of the State Comptroller's Office conflicted with the formal guidance.

Recommendation:

The Department of Revenue Services should implement procedures to provide for adherence to the receipt date guidance promulgated in Comptroller's Memorandum 2007-24 in order to more accurately reflect the fiscal year to be charged for certain expenditures. (See Recommendation 9.)

Agency Response:

"The Department agrees with this finding but disagrees with the stated cause that it "was not aware of the existence of Comptrollers Memorandum 2007-24".

As previously indicated, the agency has periodically received conflicting information from other sources (primarily via the

Comptroller's post audit process) as to what the appropriate receipt date should be for prepaid invoices. In fact, the draft version of this recommendation and the resulting discussions of it actually indicated that a date other than that which is prescribed in Memorandum 2007- 24 was to be used by the agency to properly process prepaid invoices.

The agency will strictly adhere to the criteria of Comptrollers Memorandum 2007-24 going forward and will reference this recommendation should the appropriateness of any receipt date be questioned in the future.”

Insufficient Commitment Amounts on Purchase Orders:

Criteria: Section 4-98 of the General Statutes provides that no budgeted agency shall incur an obligation except by the issue of a purchase order or other document. The amount to be charged against the appropriation of a budgeted agency shall be the amount to be spent in such year.

Condition: Our sample of 49 transactions revealed four instances in which the Department had balances on purchase orders that were insufficient to cover invoices for goods or services that had already been ordered. In three of these instances, the Department had a balance of \$1 on the purchase orders.

Effect: The records of the State Comptroller did not have a sufficient amount committed in order to cover the obligation incurred by the Department.

Cause: The Department felt that the process in place was effective because there was no way to know what the exact amounts were until the invoice was received from the vendor.

Recommendation: The Department of Revenue Services should institute procedures to anticipate the amounts to be expended and commit those amounts on purchase orders prior to incurring the obligation. (See Recommendation 10.)

Agency Response “The Department of Revenue Services agrees with this finding in part. There is agreement that Fund Accounting requirements dictate that an agency commit, at the time it enters into an obligation, the amount of funding expected to be charged against a fiscal year's appropriation. With the Core-CT system, funds equal to the stated value of the purchase order are committed at the time of its

issuance.

If the Agency was provided its full appropriation at the beginning of a fiscal year, this scenario would not be problematic. However, the agency receives its appropriation in four almost equal allotments throughout the fiscal year. Receipt of such funding does not necessarily match the cash flow needs of the department. As such, purchase orders issued in the first quarter for goods and services which will not be received until the third or fourth quarter of the fiscal year would encumber funds necessary to carry out required business operations in the first or second quarters.

Requests by DRS to have allotment totals more closely match its cash flow needs have not been honored by OPM. Unfortunately, without such an adjustment, the agency does not believe that it can carry out normal operations and be in compliance with this recommendation. It does wish to point out that the use of the purchase order “obligated amount” field allows the agency to show the full dollar amount of an obligation without prematurely encumbering required funds.”

Recording of Actual Receipt Dates to Verify Timely Deposit:

Criteria: Section 4-32 of the General Statutes requires that State agencies deposit and account for monies received within 24 hours of receipt, if the amount received by an agency exceeds \$500. The Department of Revenue Services receives more than \$500 every day, but has received exemptions from the State Treasurer allowing additional time to deposit and record certain tax payments.

Condition: Tax payments that are sent directly to DRS instead of the lockbox are recorded on the books of DRS using the postmark date as the receipt date. The use of these dates facilitates the recording of these payments in the tax system, but cannot be used to accurately determine whether the deposit criteria are being met.

Effect: There is reduced assurance that these payments are being deposited in a timely manner in accordance with the statutory requirements and applicable extensions received from the State Treasurer.

Cause: DRS has determined that the cost and effort to record the actual receipt dates for these tax payments is excessive compared to the benefit. However, we were unaware of any documented testing by DRS that indicated that the process in place resulted in timely deposits.

Recommendation: The Department of Revenue Services should consider occasional tests of their deposit process to confirm the belief that the tax

payments mailed directly to DRS are deposited in accordance with promulgated Statutes. (See Recommendation 11.)

Agency Response: “The Department agrees with this finding in part. As was discussed with the Auditors of Public Accounts, testing for compliance to the “24 hour rule” has been done in the past in order to determine the need for the exemptions. Additionally, as stated in the cause the Department has determined that the cost and effort to record the actual receipt dates for all tax payments is excessive when compared to the benefit. The current process was designed to process payments, including prioritizing larger dollar payments, as efficiently as possible given staffing limitations. The Department will perform tests to document compliance and verify the need for the exemptions to the “24 hour rule”.

Documentation and Review of Sales and Use Tax Audit Procedures:

Criteria: The integrity of the audit process is crucial to promoting the ultimate goals of voluntary compliance and collection of revenue due to the State.

The Department’s intranet site, as well as sound business practices, suggest that a quality control process should be in place for audits and should include certain forms (electronic or paper) to document the performance of the audit and whether the audit was carried out in accordance with promulgated procedures. Variances to such procedures should be explained for purposes of determining if all necessary steps were performed.

While the Sales and Use Tax audit process is basically the same for all entities, there are certain nuances that are specific to certain types of businesses. The existence of a checklist or audit plan would serve as a reminder to the staff that they may need to pursue certain specialized tax issues at certain types of businesses.

Condition: Most examiners in the Sales and Use Tax Division of the Department, except those in their first two years of employment, do not include in their audit workpapers the Field Audit Work Program (Form AU 260SUT). Our examination of audit files revealed that supervisors generally did not utilize a similar format to document their review of the procedures performed.

Effect: The omission of documented verification that the necessary steps have been performed may not by itself indicate that an audit was

deficient, but it reduces the reliance that can be placed on the audit process to ensure that all of the objectives were met. The inclusion of a workplan would also serve to enhance the review of workpapers by supervisors.

Cause: The Department expressed that the initial training sessions given to new staff includes the necessary use of the workplans and after two years staff are likely to know how to approach audits without the need to use these documents. It was also expressed that supervisors should be familiar enough with the audit process that they can review the audits without the need to compare the steps to the formal workplans.

Recommendation: The Department of Revenue Services should consider implementing the use of audit workplans to document that all of the necessary procedures were performed for each sales and use tax audit. (See Recommendation 12.)

Agency Response: “The Department disagrees with this finding. The assumption that there should be a checklist for each audit and without it that “it reduces the reliance that can be placed on the audit process that the objectives were met” is without merit. The Agency previously used a checklist, and has since replaced the checklist with an audit scorecard. Each audit gets reviewed by the audit supervisor and rated as far as quality and to ensure that the auditing objectives have been met. As explained to the Auditors of Public Accounts, the checklist did not provide a measure of quality now provided by the scorecard. While a checklist can be helpful, it does not provide flexibility in the audit process based on the condition of the individual taxpayer’s records under audit. The Department will examine the Auditors of Public Accounts request to implement a work plan for audits.”

Auditors’ Concluding

Comment: The “scorecard” referred to above is an instrument to assess the quality of the audit process performed. However, it does not, within itself, constitute the specific procedures that should be performed by the auditor on a particular engagement. Without a work plan, there is an increased risk that a procedure will be missed, and that missed procedure may or may not impact the audit. The absence of a work plan also increases the reliance on supervisors to detect missing procedures.

Processing of Suspended Transactions:

Background: Tax returns and payments entered into the tax administration system are sometimes unable to be processed and go into a “suspended” status. There are many different reasons for transactions to go into suspense, including a payment that does not match the coupon that is submitted, or a taxpayer name that does not match the social security number that is on file. Most suspended transactions are assigned a severity code based on the impact that it could have on a taxpayer’s account.

The resolution of suspended transactions is part of the routine procedures that should take place in any data processing environment, either on an ongoing basis or through the efforts of special projects designed to eliminate these transactions.

Criteria: Sound business practices would dictate that suspended transactions should be resolved in a timely fashion to prevent a delay in the processing of subsequent returns and to avoid allowing repetitive errors.

Condition: At the time of our review, we were provided with a report detailing 12,927 transactions that had been in a suspended status for 51 days or more. We examined 25 of these transactions and found five of them had been in suspense for a period of five months to three years. Three of these were resolved subsequent to the creation of the report and prior to our review, with two transactions remaining in suspense, one of which had been suspended for three years.

Effect: It is likely that many of these transactions may not have a financial impact. However, transactions that have been suspended and not resolved in a timely manner may prevent the Department from being able to readily identify patterns that could be indicative of a potential problem.

Cause: The Department has dedicated its resources to resolving those higher-priority issues that were expected to generate revenue, as opposed to clearing up transactions that were not expected to have a financial impact.

Recommendation: The Department of Revenue Services should consider modifying its current procedures to resolve suspended transactions in a more timely manner. (See Recommendation 13.)

Agency Response: “The Department agrees with this finding in part. We prioritize workloads based on the financial affect of the item. As it was

pointed out to the Auditors of Public Accounts none of the items in question had any financial affect on the taxpayer account. The Department does not believe that, in these trying fiscal times, it is prudent to re-assign staff from revenue generating processes to tasks that will not produce any revenue to the State. Departmental procedures for processing taxpayer information are such that if there was a problem with a form or calculation on a return it would be identified early in the process. The comment that these transactions not being resolved in a timely manner may prevent the Department from being able to identify patterns that could be indicative of a potential problem embellishes the true effect of this condition. However, within its limited resources, the Department will look to develop procedures to minimize and process the older transactions.”

Unauthorized Inspection of Tax Return Information:

Criteria: In order to promote voluntary compliance by taxpayers, the public must maintain a high degree of confidence that financial information furnished to taxing authorities is protected against unauthorized use or disclosure.

Section 12-15, subsection (a), of the General Statutes states that no employee of the State or any other person who has access to returns or return information shall disclose or inspect any such return or return information, except as provided in said Section. Section 12-15, subsection (g), states that any person who violates any provision of said Section shall be fined not more than \$1,000 or imprisoned not more than one year, or both.

The unauthorized inspection of tax information is commonly referred to as “browsing”.

The taxpayer is often in the best position to determine if their information has been divulged as the result of a browsing incident.

Condition: The Department has historically identified a few instances of browsing each year. We were informed that the policy of the Department does not include referral of the violators to prosecuting authorities, nor does the Department notify the taxpayer whose return information was browsed.

Effect: The Department is not in compliance with the provisions of Section 12-15, subsection (g).

Notifying taxpayers that have been the subject of browsing incidents permits them to remain vigilant for any effects of the

browsing. Adopting a policy to notify taxpayers that have been subject to browsing should serve as an additional deterrent.

Cause: The Department had not established procedures to comply with the statutory requirements and had not adopted a policy to notify the subjects of browsing.

Recommendation: The Department of Revenue Services should consider establishing procedures to comply with the requirements of State statutes regarding the prosecution of browsing offenders, as well as notifying those taxpayers that have been the subject of browsing. (See Recommendation 14.)

Agency Response: “The Department agrees with this finding in part. The Department considers protecting taxpayer privacy paramount to maintaining taxpayer confidence and has been in the forefront of protecting taxpayers’ privacy. To this end, the Department continues to enhance its use of technology and management oversight to monitor and protect the integrity and confidentiality of taxpayer information. In furtherance of these efforts, and in recognition of the provisions of Conn. Gen. Stat. §12-15(g), the Department will place responsibility for enforcement of the Department’s browsing policy with the Department’s Special Investigations Section (“SIS”). SIS will be required to investigate each suspected case of browsing and will be authorized to take appropriate law enforcement actions if it determines that state law has been violated. The Department is in the process of developing and implementing new data security policies and procedures to conform with the above.”

Maintenance and Disposition of Seized Property Cases:

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, and 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.

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. Statutes of

limitations exist after which a hearing cannot be requested and the case should be closed. Proceeds from any sales of such items are to be deposited with the State Treasurer.

Criteria: Procedures should provide for the timely close-out of cases. The accurate maintenance of case records is crucial to better reflect the true caseloads of the investigators.

Condition: At the time of our review, fourteen cases were designated as open with a hearing pending. Our examination of all of these cases found that they should have been considered closed and the related seized property either destroyed or otherwise disposed of. Some have been waiting for months to determine if a request for a hearing has been filed, and three cases had been open for over two years. These cases were well beyond the statute of limitations.

Effect: In the cases cited, the contraband was comprised mostly of tobacco products. Since these will likely be destroyed, there is little financial impact to the State. However, the delay in closing these cases makes statistics from the caseload database misleading.

Cause: Special Investigation Section staff attributed the delays to a lack of resources due to the need to assign investigators to other higher-priority tasks.

Recommendation: The Department of Revenue Services should consider implementing procedures that will avoid unnecessary delays in the closing of case files and any related transacting of seized property after it is deemed to belong to the State. (See Recommendation 15.)

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

Management of Equipment Inventory:

Criteria: Internal control policies promulgated by the State Comptroller in the State Property Control Manual including periodically reconciling subsidiary records to the balances reflected in the control account. The movement or reassignment of computer equipment is normally tracked by the Information Services Division and then reported to the business office for recording in Core-CT. Other than timing differences, there would be an expectation that the databases would agree.

Condition: We noted successful efforts by the Department to improve the accuracy of its inventory records since the last audit. However, a comparison between the Department’s Information Services Division and Core-CT inventory records noted 29 laptop

computers for which the assigned custodian differed between the two databases. The Information Services Division maintains separate inventory records for purposes of tracking more detailed information than would be required for inventory valuation purposes.

Effect: Internal controls over equipment are reduced, increasing the risk of undetected losses and reducing reliance on Core-CT as the primary inventory record.

Cause: The records of the Information Services Division were not reconciled to the Core-CT inventory record to ensure that relevant data was properly recorded in both systems.

Recommendation: The Department should examine its procedures regarding asset management to further enhance controls over laptop computers. (See Recommendation 16.)

Agency Response: “The Department disagrees with this finding. The discussions with and the documentation provided by the Auditors of Public Accounts regarding this finding indicate that all agency assets were properly accounted for in the agency’s only asset management system (Core-CT).

It is important to again point out that the information that is used to maintain the accuracy of this system’s database comes from two sources. The Business Office supplies updates on additions (purchases) and deletions (surplus) while the Information Services Division’s (ISD) Help Desk provides location changes. The results of the equipment inventory review would appear to validate that the process that the agency utilizes to track assets is effective.

This finding appears to be based upon a comparison of the information maintained in the agency’s asset management system and that which resides on the ISD Help Desk’s work order system. Since the two systems are used for different purposes, the criteria utilized for maintaining entries in the respective databases is also different.

The Department maintains that it has sufficient procedures in place to properly and reasonably account for its assets. Further, it contends that the accuracy of its asset inventory could not be maintained at its current level if appropriate and regular communication did not exist between the Business Office (additions and deletions), the ISD Help Desk (relocations) and the property control agent.”

Auditors' Concluding

Comment: As stated by the Agency, the information used to maintain the accuracy of the inventory database comes from two sources. The number of variances between the two records seems to suggest that Core-CT is not being relied upon for detailed location information. If that is the case, there should be periodic reconciliations between the two sources in order to provide assurance that all assets are being tracked.

Comparison of Job Descriptions to Assigned Duties:

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: Our prior audits 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. DRS finally received approval to change the specifications of the former Tax Unit Assistant Manager position, which resolved in part a few of these instances. However, we continued to note instances in which the new specifications were not being adhered to. This is in addition to the previously unresolved conditions.

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

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

Recommendation: The Department of Revenue Services should enter into further discussions with the Department of Administrative Services to modify current job specifications or establish new ones that conform to the intended uses of those classes. Where necessary,

positions should be red-circled to prevent refilling them without making organizational changes. (See Recommendation 17.)

Agency Response: “The Department agrees with the finding. It has red circled those positions which, due to staff reductions, reorganizations, and increased use of automation, may no longer be properly classified.

Additionally, the Agency will submit a request to the Department of Administrative Services by July 1, 2009, to modify the job specification for the Revenue Services Tax Supervisor classification to reflect its use within the Administration Division’s Tax Products Group.”

Clarification of Confidentiality Provisions of Section 12-15 of the General Statutes:

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.

In order for the Auditors of Public Accounts to effectively perform their auditing duties as assigned under Section 2-90 of the General Statutes, as well as conducting investigations under Section 4-61dd of the General Statutes (the Whistleblower Act), it is sometimes necessary to gain access to confidential information. The confidentiality provisions and related penalties for violations that apply to the respective State agencies also apply to the Auditors.

Condition: 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. However, specific protection of the informant is not provided for. Thus disclosure of an informant’s identity would not constitute a statutory violation and would not necessarily subject a DRS employee to penalties.

Sections 2-90 and 12-15 of the General Statutes, as currently constructed, clearly grant the Auditors of Public Accounts access to confidential taxpayer information when performing their routine auditing duties in accordance with Section 2-90. However, the Auditors are also required to conduct investigations of whistleblower matters under Section 4-61dd and the Commissioner

of Revenue Services has denied the Auditors the same access for these inquiries. The Auditors of Public Accounts have included a corresponding recommendation in their 2008 Annual Report to the General Assembly.

Effect: The absence of the statutory protection does little to put an informant at ease that their identity will not be divulged. The integrity of whistleblower investigations is reduced if the Auditors are not permitted access to all applicable information. Both of these scenarios seem to conflict with sound public policy.

Cause: It appears that the Department had not seen the need to provide statutory protection to informants that choose to supply information directly to DRS instead of utilizing the whistleblower process.

Section 12-15 of the General Statutes grants the Auditors access to confidential information when performing their duties under Section 2-90 of the General Statutes. The whistleblower duties assigned to the Auditors under Section 4-61dd of the General Statutes are not referenced in Section 2-90.

Recommendation: The Department of Revenue Services should seek statutory revisions that specifically grant anonymity to those that supply the Department with information about the potential wrongdoing of taxpayers and provide for access by the Auditors of Public Accounts during the performance of any duties that may be assigned to them. (See Recommendation 18.)

Agency Response: “The Department disagrees with this finding. This condition addresses two distinct issues. The first issue involves a perceived lack of protection of confidential informants. The Department, however, is of the position that confidential informants are specifically addressed (and protected) in the definition of “return information” in C.G.S. §12-15(h)(2). C.G.S. §12-15(h)(2), in part, provides as follows: “Nothing in the preceding sentence, or in any other provision of law, shall be construed to require the disclosure of . . . the identity of a confidential informant, whether or not a civil or criminal tax investigation has been undertaken or completed.” As evidenced by this language, C.G.S. §12-15(h)(2) protects the identity of confidential informants. As such, the Department does not understand the APA’s position on this issue.

The second issue relates to C.G.S. §12-15(b)(2), which provides that the Commissioner may disclose “returns or return information to [APA], when required in the course of duty under chapter 23.” Because the APA “are also required to conduct investigations of whistleblower matters under Section 4-61dd,” which is contained in

chapter 48, you recommend that the Department “seek statutory revision[] . . . and provide for access by the Auditors of Public Accounts” to return and return information in the context of whistleblower investigations. In making this recommendation, the APA ignores critical language in C.G.S. §4-61dd. To this end, C.G.S. §4-61dd provides that information gathered during a Whistleblower investigation is subject to public disclosure upon conclusion of the investigation. Therefore, if C.G.S. §12-15(b)(2) was amended in accordance with the APA’s recommendation, then any “return” and “return information” reviewed by the APA in the course of such an investigation would be subject to disclosure.

Although the Department and the APA have different interpretations of the interplay between Conn. Gen. Stat. §4-61dd and Conn. Gen. Stat. §12-15, the Department is willing to work with the APA to determine if such statutes can be amended in such a way so as to address the Department’s concerns (as described above) regarding the potential disclosure of confidential information.”

Auditors’ Concluding

Comment:

With regard to the protection of informants, the current statutory language states that there is nothing that can be construed to require disclosure of an informant. However, this is not equivalent to a prohibition on revealing the identity of an informant, and does not provide specific protection to those that come forward with information regarding tax evaders.

Concern of the Department that confidential information can be disclosed upon the completion of a whistleblower investigation is wrong. Section 4-61dd of the General Statutes specifically states that “the Auditors of Public Accounts and the Attorney General shall not, after receipt of any information from a person under the provisions of this section, disclose the identity of such person...” Section 1-210 (the Freedom of Information Act), subsection (b), subpart (10), specifically exempts from disclosure “Records, tax returns, reports and statements exempted by federal law or state statutes...” and subpart (13) specifically exempts from disclosure records of an investigation under the provisions of section 4-61dd (the Whistleblower Act).

RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 2005 and 2006, contained a total of 13 recommendations. Of those recommendations, six have been implemented or otherwise resolved. The status of recommendations contained in the prior report is presented below.

Prior Audit Recommendations:

- The Department of Revenue Services should pursue the elimination of the State Tax Review Commission authorized by Section 12-34d of the General Statutes. This recommendation is being repeated. (See Recommendation 1.)
- 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. This recommendation is being restated to reflect current conditions. (See Recommendation 2.)
- 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. This finding is being repeated. (See Recommendation 5.)
- The Department should consult with the Comptroller's Property Control Manual and bring its policies and procedures into conformance. We have restated this finding to reflect the current conditions. (See Recommendation 16.)
- 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. This issue has been addressed.
- The Department should enforce the submission of medical certificates in accordance with Section 5-248-2 of the State Regulations and applicable labor agreements. This recommendation has been resolved.
- 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. This finding has been resolved.

- 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. The Department has adequately addressed this issue.
- 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. This finding has been modified to reflect current conditions. (See Recommendation 17.)
- 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. This recommendation is being repeated. (See Recommendation 18.)
- The Department should take steps to ensure that the planned updates to the disaster recovery and business continuity plans occur in a timely fashion. This issue has been resolved.
- 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. This recommendation is not being repeated.
- 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. This recommendation is being repeated. (See Recommendation 15.)

Current Audit Recommendations:

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

Comment:

The Commission has not met since 1994, and the terms of all members have expired.

- 2. The Department of Revenue Services should encourage the Penalty Review and Abatement Review Committees to adopt formal procedures detailing the process by which cases will be reviewed. Consideration should also be given to amending the**

relevant legislation in order to replace the DRS representatives and/or make the representatives' roles only advisory in nature.

Comment:

The Committees did not have documented procedures to operate under, and we question the independence of a DRS representative on the Committees.

- 3. The Department should consider seeking legislation repealing the Small and Medium-Sized Business Users Committee authorized by Section 12-3f of the General Statutes.**

Comment:

The Committee has not met since 1995.

- 4. The Department of Revenue Services should implement regulations requiring periodic registration for the issuance of fisherman tax-exempt permits in accordance with Section 12-412 of the General Statutes.**

Comment:

The Department has not established regulations as required.

- 5. 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 did not prepare formal reports because the information was typically supplied to using agencies upon request.

- 6. The Department of Revenue Services should implement procedures to ensure that the attendance records of employees suspended without pay accurately reflect the status of those employees.**

Comment:

The annual attendance records of suspended employees did not have entries to indicate the employees' status on those days.

- 7. The Department of Revenue Services should consider increasing the frequency of its reviews of sick leave usage for purposes of determining which employees are required to provide medical certificates.**

Comment:

Reviews were done quarterly, which could leave a span of a few months before the Department realizes that a medical certificate is not on hand.

- 8. The Department of Revenue Services' Human Resources Unit, in concert with the Internal Audit Unit, should establish agreed-upon guidelines concerning the roles of each unit in the performance of investigations, including the delegation of responsibility for complying with the reporting requirements of Section 4-33a of the General Statutes. In addition, there should be a documented review by the Director of Human Resources of investigations performed by staff of that Unit.**

Comment:

Procedures in place did not ensure compliance with the reporting requirements of Section 4-33a, nor was the review by the HR Director of investigations documented.

- 9. The Department of Revenue Services should implement procedures to provide for adherence to the receipt date guidance promulgated in Comptroller's Memorandum 2007-24 in order to more accurately reflect the fiscal year to be charged for certain expenditures.**

Comment:

Payments in advance for data processing maintenance services were not recorded with proper receipt dates.

- 10. The Department of Revenue Services should institute procedures to anticipate the amounts to be expended and commit those amounts on purchase orders prior to incurring the obligation.**

Comment:

Procedures in place at the Department did not provide for commitment of funds prior to receipt of the vendor invoice, which is normally after the obligation has been incurred.

- 11. The Department of Revenue Services should consider occasional tests of their deposit process to confirm the belief that the tax payments mailed directly to DRS are deposited in accordance with promulgated Statutes.**

Comment:

The system in place at the Department only records the postmark date of incoming mail and does not permit a comparison of actual receipt dates to the dates of deposit.

- 12. The Department of Revenue Services should consider implementing the use of audit workplans to document that all of the necessary procedures were performed for each sales and use tax audit.**

Comment:

Most examiners did not include workplans in their workpapers to document that all necessary procedures were performed.

- 13. The Department of Revenue Services should consider modifying its current procedures to resolve suspended transactions in a more timely manner.**

Comment:

Over 12,000 transactions had been in a suspended status for 51 or more days at the time of our inspection.

- 14. The Department of Revenue Services should consider establishing procedures to comply with the requirements of State Statutes regarding the prosecution of browsing offenders, as well as notifying those taxpayers that have been the subject of browsing.**

Comment:

Referral of browsing offenders to prosecuting authorities was normally not done.

- 15. The Department of Revenue Services should consider implementing procedures that will avoid unnecessary delays in the closing of case files and any related transacting of seized property after it is deemed to belong to the State.**

Comment:

At the time of our review we found 14 open cases that should have been closed and the seized property destroyed.

- 16. The Department should examine its procedures regarding asset management to further enhance controls over laptop computers and eliminate duplication of effort.**

Comment:

Assigned users of laptops were not always correctly recorded in the asset management system, and a comparison of the system data to the detailed records was not done on a regular basis.

- 17. The Department of Revenue Services should enter into further discussions with the Department of Administrative Services to modify current job specifications or establish new ones that conform to the intended uses of those classes. Where necessary, positions should be red-circled to prevent refilling them without making organizational changes.**

Comment:

We continued to note positions that were not being utilized in accordance with official job specifications.

- 18. The Department of Revenue Services should seek statutory revisions that specifically grant anonymity to those that supply the Department with information about the potential wrongdoing of taxpayers and provide for access by the Auditors of Public Accounts during the performance of any duties that may be assigned to them.**

Comment:

There are no statutory provisions granting anonymity to informants, and access provided to the Auditors of Public Accounts during whistleblower investigations is not consistent with the access granted for their other statutory duties.

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, 2007 and 2008. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grant agreements 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 grant agreements applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly initiated, authorized, recorded, processed, and reported on consistent with management's direction, 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, 2007 and 2008 are included as a part of our Statewide Single Audits 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 grant agreements 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.

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

In planning and performing our audit, we considered the Department of Revenue Services' internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating the Agency's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of providing assurance on the effectiveness of the Agency's internal control over those control objectives.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis unauthorized, illegal, or irregular transactions or the breakdown in the safekeeping of any asset or resource. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Agency's ability to properly initiate, authorize, record, process, or report financial data reliably consistent with management's direction, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is more than a remote likelihood that a financial misstatement, unsafe treatment of assets, or noncompliance with laws, regulations, contracts and grant agreements that is more than inconsequential will not be prevented or detected by the Agency's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that noncompliance with certain provisions of laws, regulations, contracts, and grant agreements or the requirements to safeguard assets that would be material in relation to the Agency's financial operations, noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions, and/or material financial misstatements by the Agency being audited will not be prevented or detected by the Agency's internal control.

Our consideration of the internal control over the Agency's financial operations, safeguarding of assets, and compliance with requirements would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over the Agency's financial operations, safeguarding of assets, and compliance with requirements that we consider to be material weaknesses, as defined above.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Department of Revenue Services complied with laws, regulations, contracts and grant agreements, 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, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. However, providing an opinion on compliance with those 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 or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain matters which we reported to Agency management in the accompanying "Condition of Records" and "Recommendations" sections of this report.

The Department of Revenue Services' response to the findings identified in our audit is included in the accompanying "Condition of Records" section of this report. We did not audit the Department of Revenue Services' response and, accordingly, we express no opinion on it.

This report is intended for the information and use of Agency management, 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