

STATE OF CONNECTICUT



*AUDITORS' REPORT
DEPARTMENT OF REVENUE SERVICES
FOR THE FISCAL YEARS ENDED JUNE 30, 2009 AND 2010*

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

Table of Contents

INTRODUCTION.....	1
COMMENTS.....	1
FOREWORD.....	1
Legislative Changes.....	2
RÉSUMÉ OF OPERATIONS	7
General Fund Revenues and Receipts.....	7
General Fund Expenditures.....	8
Special Transportation Fund.....	8
Audit Assessments	9
Appellate Division	9
Accounts Receivable.....	10
Penalty Waivers	11
Collections and Enforcement Division	11
CONDITION OF RECORDS.....	12
Administration of the Penalty Review and Abatement Review Committees	12
Failure to Adopt Regulations as Required by Statute	13
Statutory Reporting Requirements.....	14
Human Resources Unit - Investigations of Alleged Improprieties	15
Imprest Petty Cash Fund.....	17
Recording of Actual Receipt Dates to Verify Timely Deposit	18
Review and Approval of Sales and Use Tax Audits.....	20
Processing of Suspended Transactions	22
Collection and Enforcement Division - Outdated Procedures	23
Noncompliance with Section 12-39aa, Subsection (a), of the General Statutes.....	24
RECOMMENDATIONS.....	26
INDEPENDENT AUDITORS' CERTIFICATION	32
CONCLUSION	34

STATE OF CONNECTICUT



AUDITORS OF PUBLIC ACCOUNTS

State Capitol
210 Capitol Avenue
Hartford, Connecticut 06106-1559

JOHN C. GERAGOSIAN

ROBERT M. WARD

October 31, 2011

AUDITORS' REPORT DEPARTMENT OF REVENUE SERVICES FOR THE FISCAL YEARS ENDED JUNE 30, 2009 AND 2010

We have examined the financial records of the Department of Revenue Services (Department or DRS) for the fiscal years ended June 30, 2009 and 2010.

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

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

Section 12-1a of the General Statutes provides that the Department is under the direction of a commissioner. Pamela Law served as Commissioner of the Department of Revenue Services until her retirement, effective July 1, 2009. In June 2009, Richard D. Nicholson was appointed as her successor, effective July 1, 2009, and continued to serve in that position through the remainder of 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 91 of Public Act 09-3 of the June 2009 Special Session, which is applicable to taxable years commencing on or after January 1, 2010, establishes economic nexus as the basis for determining whether nonresident partners or members, if a member of a partnership or S corporation, are subject to Connecticut income tax on income derived from or connected with sources within the state. This act, to the extent allowed by the U. S. Constitution, subjects such members or partners to the state income tax on the basis of having a substantial economic presence in Connecticut.

Section 119 of Public Act 09-3 of the June 2009 Special Session, which is applicable to taxable years commencing on or after January 1, 2009, increases income taxes for those with taxable income over \$1,000,000 for joint filers, \$800,000 for heads of households, and \$500,000 for single filers and married people filing separately. It adds a third, higher-income tax bracket and increasing marginal tax rate for income in that bracket from 5.0 percent to 6.5 percent. It also increases the flat income tax rate for trusts and estates from 5.0 percent to 6.5 percent.

Sections 120 and 121 of Public Act 09-3 of the June 2009 Special Session bars individuals, trusts, and estates from counting the deductions for qualified domestic production activities under Internal Revenue Code Section 199 when determining their taxable income for the state's income tax. Thus, this section requires individuals, trusts, and estates to add back any deductions from qualified domestic production activities that were included in determining their federal adjusted gross income when calculating their Connecticut adjusted gross income for state income tax purposes. The income tax change is applicable to tax years commencing on or after January 1, 2009.

Section 122 of Public Act 09-3 of the June 2009 Special Session, effective September 8, 2009 and applicable to tax years commencing on or after January 1, 2009, delays the scheduled increase in the personal exemption for single filers by three years until the 2012 taxable year.

Section 123 of Public Act 09-3 of the June 2009 Special Session, effective September 8, 2009 and applicable to tax years commencing on or after January 1, 2009, delays the scheduled increase in the personal tax credit for single filers by three years until the 2012 taxable year.

Section 124 of Public Act 09-3 of the June 2009 Special Session, effective September 8, 2009 and applicable to tax years commencing on or after January 1, 2009, delays the scheduled increase in the Connecticut adjusted gross income thresholds used by single filers in calculating the reduction in the property tax credit allowable by three years until the 2012 taxable year.

- Sales and Use Tax

Section 108 of Public Act 09-3 of the June 2009 Special Session reduced the sales tax rate applicable to most taxable items and services from six percent to five and one-half percent effective January 1, 2010. In addition, Section 110 of Public Act 09-3 of the June 2009 Special Session reduced the use tax rate applicable to most taxable items and services from six percent to five and one-half percent effective January 1, 2010. The reduction in both the sales tax and use tax rate was contingent on the language in Section 113 of this act.

Section 113 of Public Act 09-3 of the June 2009 Special Session stipulated that the reductions in both the sales tax rate and use tax rate would not take effect if any monthly financial statement issued by the Comptroller, after September 8, 2009 and before January 1, 2010, indicated that the estimated gross tax revenue to the General Fund to the fiscal year ending June 30, 2010, is at least one percent less than the estimated gross tax revenue to the General Fund for the said fiscal year, included in this act pursuant to Section 2-35 of the Connecticut General Statutes. In addition, Section 113 stipulated, effective January 1, 2010, if the sales tax and use tax reductions take place and any of the Comptroller's monthly financial statements issued after January 1, 2010 and on or before June 30, 2010 indicate that the estimated gross tax revenue to the General Fund to the end of the fiscal year ending June 30, 2010 is at least one percent less than the estimated gross tax revenue to the General Fund for the said fiscal year, included in this act pursuant to Section 2-35 of the Connecticut General Statutes, the sales tax and use tax rate must be restored to six percent on July 1, 2010.

- Corporation Business Tax

Section 90 of Public Act 09-3 of the June 2009 Special Session imposed the Corporation Business Tax on any company that derives income from sources in Connecticut or that has a substantial economic presence in Connecticut, without regard to physical presence, and to the extent permitted by the Constitution of the United States. This section is applicable to income and taxable years beginning on or after January 1, 2010

Section 94 of Public Act 09-3 of the June 2009 Special Session imposed a ten percent Corporation Business Tax surcharge for income years beginning on or after January 1, 2009 and prior to January 1, 2012. The surcharge does not apply to companies whose annual gross income for the tax year was less than \$100 million or whose tax liability for the income year does not exceed the \$250 minimum tax. Companies that file combined or unitary returns for the income year are not eligible for the gross revenue exemption. In addition, a company must calculate its surcharge without any reduction on account of any credit against the company's corporation business tax.

Section 95 of Public Act 09-3 of the June 2009 Special Session decouples the Corporation Business Tax from the deductions allowed for qualified domestic production activities under Internal Revenue Code Section 199. Thus, this section requires corporations to disregard the federal qualified domestic production activities deduction when calculating net income for purposes of the state's Corporation Business Tax. This change to the Corporation Business Tax applies to income years starting on or after January 1, 2009.

Section 103 of Public Act 09-3 of the June 2009 Special Session, effective September 8, 2009, doubles the maximum preference tax from \$250,000 to \$500,000 for groups of companies filing combined corporation tax returns. Section 39 of Public Act 09-8 of the September 2009 Special Session applies the increase to income years starting on or after January 1, 2009.

Section 6 of Public Act 09-8 of the September 2009 Special Session, effective October 5, 2009, required corporation taxpayers making estimated tax payments to adjust their payments for the 2009 income year to reflect any additional tax liability from the surcharge imposed by Section 94 of Public Act 09-3 of the June 2009 Special Session. This section of the act overrides a safe-harbor law excusing corporation taxpayers from interest and penalties on estimated taxes if they pay in four quarterly installments totaling at least 90 percent of their liability for the current income year without regard to credits or 100 percent of their liability for the previous income year without credits, whichever is less.

- Cigarette and Tobacco Taxes:

Section 104 of Public Act 09-3 of the June 2009 Special Session increased the cigarette tax from \$2 to \$3 per pack effective for sales occurring on or after October 1, 2009.

Section 106 of Public Act 09-3 of the June 2009 Special Session imposed a \$1 tax on each pack of cigarettes that dealers and distributors had in their inventory at the close of business, or 11:59 p.m., on September 30, 2009. Each dealer and distributor was required to report to DRS the number of cigarettes in inventory as of that time and date and pay the tax by November 15, 2009.

Section 153, subsection (a) of Public Act 09-3 of the June 2009 Special Session increased the annual fee for a cigarette manufacturer's license from \$5,000 to \$5,250. The fee increase applies to licenses for the licensure period beginning on or after October 1, 2009.

Section 154 of Public Act 09-3 of the June 2009 Special Session increased the annual fee for a cigarette dealer's license from \$25 to \$50. The fee increase applies to licenses from the licensure period beginning on or after October 1, 2009. The section also increased the fee for a duplicate copy of a dealer's license from \$5 to \$15, effective October 1, 2009.

Section 18 of Public Act 09-8 of the September 2009 Special Session increased the annual fee for a license as a non-exclusive cigarette distributor (a distributor who does not sell cigarettes exclusively to retail stores that the distributor operates) from \$1,000 to \$1,250. This section is effective for the issuance of a new license for a period beginning on or after October 1, 2009 and applicable to the renewal of a license that expired on or after September 30, 2009.

- Estate and Gift Taxes:

Section 116 of Public Act 09-3 of the June 2009 Special Session, effective January 1, 2010, and applicable to estates of decedents who die on or after January 1, 2010, increased from \$2 million to \$3.5 million, the minimum value of the estate subject to the estate tax; reduced the marginal rates on taxable estates by 25 percent; and eliminated the tax cliff by applying the tax only to the marginal value over the taxable threshold.

Section 8 of Public Act 09-8 of the September 2009 Special Session, effective October 5, 2009, and applicable to the estates of those who die on or after January 1, 2010, includes in the Connecticut taxable estate the aggregate value of all Connecticut taxable gifts the decedent made on or after January 1, 2005. This section also stipulates that, for a person who dies on or after January 1, 2010, gifts subject to the higher tax rates in effect between January 1, 2005 and December 31, 2009 count towards the combined lifetime exclusion for estate tax purposes, but the estate is not entitled to any refund for gift taxes paid under those higher rates. The act instead

allows such estates a credit for any gift taxes paid on gifts made on or after January 1, 2005, as long as such credit does not exceed the amount of the estate tax due.

Section 118 of Public Act 09-3 of the June 2009 Special Session, effective January 1, 2010, and applicable to gifts made on or after January 1, 2010, increased, from \$2 million to \$3.5 million, the minimum value of the gift subject to the gift tax; reduced the marginal rates on taxable gifts by 25 percent; and eliminated the tax cliff by applying the tax only to the value of the gift over the taxable threshold. This section of the act also allows a taxpayer a credit against gift taxes owed for gifts made on or after January 1, 2010, but only for taxes previously paid for other gifts made on or after that date.

Section 12 of Public Act 09-8 of the September 2009 Special Session, effective October 5, 2009, and applicable to gifts made on or after January 1, 2010, expands the credit allowed under Section 118 of Public Act 09-3 of the June 2009 Special Session to include gift taxes previously paid on gifts made between January 1, 2005 and December 31, 2009. However, it limits the total credits to no more than the gift tax imposed on gifts made on or after January 1, 2010; thus, taxpayers are not entitled to any refunds of gift taxes paid at the higher rates in effect between January 1, 2005, and December 31, 2009.

- Other Taxes:

Section 1 of Public Act 08-1 of the June 11 Special Session, effective June 16, 2008, established a municipal conveyance tax rate of 0.25 percent for conveyances occurring on or after July 1, 2008, but before July 1, 2010.

Section 8 of Public Act 08-1 of the November 24, 2008 Special Session established a tax amnesty program that runs from May 1 through June 25, 2009. In this amnesty program, if a taxpayer pays the taxes due by June 25, 2009, 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 receipts 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.

- Tax Amnesty/Settlement Program:

Section 89 of Public Act 09-3 of the June 2009 Special Session requires the commissioner to establish a Tax Settlement Initiative Program for anyone who owes state taxes, other than motor carrier road tax, for any tax period for which DRS imposed interest or penalties for late payment or underreporting of taxes, or interest or additional tax because the taxpayer failed to file a return and DRS filed one for him. The program is to run from October 1, 2009 through December 31, 2009.

RÉSUMÉ OF OPERATIONS:

General Fund Revenues and Receipts:

General Fund tax revenues, license fees and all other revenues and non-revenue receipts totaled \$12,088,627,000 and \$11,993,855,000 for the fiscal years ended June 30, 2009 and 2010, 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 \$1,060,793,684 and \$1,070,370,153 for the fiscal years ended June 30, 2009 and 2010, respectively.

A summary of tax revenues, net of refunds, for the fiscal years ended June 30, 2009 and 2010, with 2008 figures presented for comparative purposes, is presented below:

(In Millions of Dollars)	<u>2009-2010</u>	<u>2008-2009</u>	<u>2007-2008</u>
Personal income	\$ 5,751	\$ 5,647	\$ 6,757
Sales and use	3,065	3,355	3,634
Corporations	505	443	615
Inheritance taxes	168	231	162
Public service companies	275	277	227
Insurance companies	204	133	199
Alcohol/cigarettes/tobacco	433	360	379
Petroleum companies	246	308	344
Real estate/controlling interest	97	93	163
Nursing homes	123	125	124
Admissions, dues and cabaret	34	37	37
All other taxes	<u>20</u>	<u>16</u>	<u>15</u>
Total	<u>\$10,921</u>	<u>\$11,025</u>	<u>\$12,656</u>

As presented in the above analysis, net General Fund tax revenues decreased by approximately 1 percent and 13 percent, respectively, during the years under review. The decreases were primarily due to declines in personal income and sales and use tax revenues. Revenues from sales and use and personal income tax receipts accounted for approximately 82 percent and 81 percent of tax revenues in total for the fiscal years ended June 30, 2009 and 2010, respectively. It should be noted that, as a result of the passage of Public Act 06-136, the tax revenue from petroleum companies is now 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, 2008, 2009, and 2010, is presented below:

	<u>2009-2010</u>	<u>2008-2009</u>	<u>2007-2008</u>
Personal services	\$54,658,546	\$59,747,812	\$57,151,966
Other expenses	7,420,417	9,977,588	10,668,283
Equipment	-	-	-
Total Budgeted Accounts	\$62,078,963	\$69,725,400	\$67,820,249
Restricted Appropriations	(30,070)	34,801	18,723
Totals	<u>\$62,048,893</u>	<u>\$69,760,201</u>	<u>\$67,838,972</u>

As presented above, operating expenditures decreased over the audited period. The decrease was primarily attributable to decreases in personal service costs and other expenses.

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, 2008, 2009, and 2010:

	<u>2009-2010</u>	<u>2008-2009</u>	<u>2007-2008</u>
Full-time	690	726	740
Part-time	12	13	13
Temporary or durational	<u>1</u>	<u>25</u>	<u>44</u>
Total	<u>703</u>	<u>764</u>	<u>797</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 \$490,014,536 and \$501,805,654 for the fiscal years ended June 30, 2009 and 2010, respectively.

Special Transportation Fund tax refunds, budgeted as reductions of tax revenues, totaled \$6,084,610 and \$7,314,974 for the fiscal years ended June 30, 2009 and 2010, respectively.

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

(In Millions of Dollars)	<u>2009-2010</u>	<u>2008-2009</u>	<u>2007-2008</u>
Motor fuel tax	\$370	\$364	\$375
Special motor fuel tax	106	104	96
Petroleum Companies	-	-	-
Motor carrier tax	<u>18</u>	<u>16</u>	<u>15</u>
Total	<u>\$494</u>	<u>\$484</u>	<u>\$486</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.

Audit Assessments:

Audits were conducted by examiners within the Audit Division to ensure taxpayer compliance, with regard to 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 \$478,676,003 and \$490,868,113, respectively, for the fiscal years ended June 30, 2009 and 2010. 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>2009-2010</u>	<u>2008-2009</u>	<u>2007-2008</u>
Corporation and Other Business-related taxes	\$ 291	\$ 233	\$ 227
Sales and use taxes	103	154	114
Personal income tax	55	47	95
Excise taxes	15	8	14
Public service taxes	15	23	12
All other taxes	<u>12</u>	<u>14</u>	<u>13</u>
Total	<u>\$ 491</u>	<u>\$ 479</u>	<u>\$ 475</u>

Appellate Division:

The Department's Appellate Division administers 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 appeals are available to taxpayers by means of litigation.

Auditors of Public Accounts

Appellate Division activity reports, reflecting resolution activity for the fiscal years ended June 30, 2008, 2009, and 2010, are presented below. Revisions resulted from both court and Appellate Division decisions.

	<u>2009-2010</u>	<u>2008-2009</u>	<u>2007-2008</u>
Cases resolved	1,281	1,357	1,526
Original assessments	\$201,231,363	\$129,055,739	\$162,495,352
Revised assessments	<u>115,640,543</u>	<u>72,702,594</u>	<u>83,377,722</u>
Assessment reductions	<u>\$ 85,590,820</u>	<u>\$ 56,353,145</u>	<u>\$ 79,117,630</u>
Percentage reduction	43%	44%	49%

Accounts Receivable:

The Department's accounts receivable are derived from various sources, including audit assessments, delinquency assessments, penalty and interest charges, and returns filed without remittances or filed with an underpayment of tax liability. A summary of accounts receivable as of June 30, 2008, 2009, and 2010, is presented below:

	<u>June 30, 2010</u>	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Taxes Receivable:	\$	\$	\$
Corporation tax	109,568,930	188,153,020	130,376,520
Income tax	377,042,602	290,927,927	222,671,397
Sales and use tax	201,575,807	207,881,710	186,093,892
Other taxes	<u>33,385,600</u>	<u>33,196,506</u>	<u>31,893,301</u>
Total Taxes Receivable	<u>\$721,572,939</u>	<u>\$720,159,163</u>	<u>\$571,035,110</u>
Reductions:			
Credits	(126,100,076)	(112,126,128)	(89,297,577)
Appellate reductions	(135,252,795)	(105,742,933)	(89,916,078)
Estimated uncollectible	<u>(187,876,676)</u>	<u>(187,438,792)</u>	<u>(147,150,465)</u>
Total Reductions	<u>(449,229,547)</u>	<u>(405,302,853)</u>	<u>(326,364,120)</u>
Net Taxes Receivable	<u>\$272,343,392</u>	<u>\$314,856,310</u>	<u>\$244,670,990</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. The reductions from taxes receivable include credits, appellate and court reductions, and aged tax receivables 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 the Department 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 2010, 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
2008-2009	8,942	\$8,984,488	2,697	\$4,652,796	6,245	\$4,331,692
2009-2010	5,539	\$3,311,234	3,443	\$2,563,714	2,096	\$747,520

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 \$122,235,123 and \$148,077,777 during the 2009 and 2010 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. The committee did not hold a meeting during the audited period.

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 and transfer the amounts to the tax suspense book. The amounts transferred will eventually be considered, due to the statutorily required seven-year waiting period, for inclusion on abatement approval requests. Accounts totaling \$19,185,113 and \$13,027,795 were referred to this status during the 2008-2009 and 2009-2010 fiscal years, respectively.

CONDITION OF RECORDS

Our audit of the Department of Revenue Services identified the following areas that need improvement and warrant comment:

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, the Secretary of the Office of Policy and Management, and the Commissioner of the Department of Revenue Services, or their designees. 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. DRS staff review the cases submitted to the 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.

Condition: Neither committee has adopted formal operating procedures. As a result, there are no benchmarks to judge the sufficiency of the number of files examined or the extent of those reviews by the committees.

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.

Cause: A lack of administrative oversight contributed to this condition.

Conclusion: Although neither of the committees has adopted formal procedures detailing the process by which the recommended cases will be reviewed within the respective committee, we note that the Department has implemented comprehensive and well documented processes for the review and assessment of the penalty waivers and abatements of taxes and for the determination of whether to subsequently recommend the cases to the respective committee for approval. In addition, we note that the Department issued a policy statement in June 2010, which sets forth the standards that apply when determining whether to recommend the waiver of a penalty to the Penalty Review Committee. With respect to the abatement of taxes, the Department has adopted regulations that set forth the guidelines the commissioner shall consider for the purposes of certifying to the Abatement Review Committee that the tax is uncollectible. We will not repeat the prior recommendation at this time.

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 the Department 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 adopted the required regulations.

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

Cause: The Department does not consider the adoption of the regulations required under this section of the General Statutes to be a high priority.

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 1.)

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 continues to reflect relatively low priority and has not adversely affected continuous implementation of the law in terms of periodically registering 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 no 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.

Condition: The Department did not comply with the mandatory reporting requirements of Section 12-7a, subsection (b) and Section 12-7b, subsection (d) of the General Statutes. Instead, the data was supplied as requested.

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 the designated state agencies request it.

Conclusion: The reportable condition relative to the Department's statutory reporting requirement under Section 12-7b, subsection (d), of the General Statutes existed throughout our current audited period. However, subsequent to the audited period but prior to the completion of our audit, we were provided with information and relevant documentation that exhibits and supports the Department's actual and planned on-going compliance with its statutory reporting requirement under Section 12-7b, subsection

(d), of the General Statutes. Accordingly, in consideration of the Department's recently exhibited compliance, we have determined that an audit recommendation is no longer warranted with respect to this specific reporting requirement.

We have presented a recommendation in each of our two prior audit reports to address the reportable condition related to the Department's statutory reporting requirement under Section 12-7a, subsection (b), of the General Statutes. The Department has stated that the specific reporting requirement imposed by the current statutory language has been rendered obsolete primarily due to the significant advances in information technology and to the imposition of stringent data protection requirements to ensure the security of taxpayer-related data since the passage of the enacting legislation. For instance, the Department indicated that the information required to be reported under the statute is now readily available on an as needed or on-demand basis to the user agency due to the advances in information technology. In addition, the added responsibilities imposed on the user agency related to the protection and security of the taxpayer-related information included in the report has led to the user agency questioning the offsetting utility of the report. In fact, subsequent to the audited period, the Department obtained written confirmation from the user agency that the statutorily required report is no longer needed. Therefore, in consideration that the Department has not complied with our prior recommendations to address the perceived obsolescence of the current statutory language through a request to the state legislature to either repeal or, otherwise, amend the current language, we will present this matter for consideration as a recommendation in our office's Annual Report to the Connecticut General Assembly.

Human Resources Unit – Investigations of Alleged Improprieties:

Background: Most agencies have a human resources and/or affirmative action unit to manage most facets of the personnel function. Oftentimes, these units become involved in investigations related to accusations of discrimination, harassment, and violations of most workplace rules.

Criteria: In order to provide assurance that the conclusions reached and actions taken as a result of investigations are reasonable and consistent, the Human Resources Unit should conduct its investigations following a formal, written set of procedures. In addition, the unit's administrator should formally document the review of the investigations conducted and agreement with the conclusions reached by staff.

Condition: Our review disclosed that the Department's Human Resources Unit has not implemented any standardized written procedures for the purpose of conducting investigations. It appears that investigations are conducted on a case-by-case basis without the use of formal written procedures.

In addition, our review of case file documentation related to the Human Resources Unit's investigations disclosed a lack of documented evidence to support the Human Resources Administrator's review of the case files prepared and agreement with the conclusions reached by staff.

Effect: The lack of both standardized written procedures for conducting investigations and formal documented reviews by the Human Resources Administrator increases the risk that the conclusions reached and actions taken as a result of such investigations may not be consistent.

Cause: The Human Resources Unit believes every investigation is unique and, therefore, a standardized approach is not warranted.

Although the Human Resources Unit's administrator claimed to be involved in the investigations, no consideration was given to the need to formally document the review and approval process.

Recommendation: The Department's Human Resources Unit should implement standardized written performance and review procedures relative to its investigation process. Such procedures should include documentation to substantiate the Human Resources Administrator's review of the case files prepared and agreement with the conclusions reached by staff. (See Recommendation 2.)

Agency Response: "The Department agrees with this finding. However, please be assured that the Department adheres to existing State of Connecticut statutes, personnel policies and procedures regarding human resource and personnel activities. The current process includes but is not limited to a review of the allegation of wrongdoing; fact-finding activities including interviews with individuals who can provide relevant information; a review of the alleged violator(s) employment history; a review of the office's labor relations database for similar issues and outcomes. Additionally it requires the review and approval by the Human Resources Administrator of the facts and the recommendations. Such current processes are in conformance with State statutes, regulations and union contracts. In order to address this recommendation, the Department will create and implement a comprehensive manual of

its current standard procedures regarding the investigatory process.”

Imprest Petty Cash Fund:

- Criteria:* The State Comptroller State Accounting Manual provides guidelines to agencies regarding the establishment and administration of petty cash funds. The State Comptroller’s guidelines include the requirements that the checking account bank statements be reconciled on a monthly basis by a person other than the petty cash fund custodian and/or one who has the authority to sign checks, and that the employees authorized to receive cash advances for travel expenses from the Petty Cash Fund submit a completed Form CO-17XP-PR, Employee Reimbursement Voucher, with the required documentation, to the agency business office within five working days after returning from travel.
- Condition:* Our examination revealed that the custodian of the Department’s petty cash fund also performed the monthly bank reconciliations between the Department’s records and the checking account bank statements contrary to the Comptroller’s guidance.
- In addition, we found that the Department did not record, or otherwise document, the actual submission date of the Form CO-17XP-PR, Employee Reimbursement Voucher, and the required documentation supporting the employee’s travel expenses. As a result, we were unable to test the Department’s compliance during the audited period with the State Comptroller’s guidelines relative to the timely submission of the required documentation by those employees who were authorized to receive petty cash advances for travel expenses.
- Effect:* The identified control weaknesses reduce the Department’s ability to comply with the State Comptroller’s guidelines relative to the administration of a petty cash fund.
- Cause:* The Department lacked the administrative oversight necessary to ensure that the proper segregation of duties was maintained and the procedures related to the submission of the required documentation for the settlement of cash advances to employees for travel expenses were adequate.
- Recommendation:* The Department should implement the procedures necessary to ensure that it administers its petty cash fund in compliance with the requirements of the State Comptroller State Accounting Manual. (See Recommendation 3.)

Agency Comment: “The Department agrees with this finding in part but is confident that adequate controls are in place to protect state assets, including changes made to better comply with the Comptroller’s guidelines.

The DRS Business Office has always provided administrative oversight in the monthly review performed by the Revenue Services Tax Supervisor (RSTS). Petty Cash checks are required to be signed by two managers. The RSTS reviews the monthly statements and associated backup material and then acknowledges the validity of the documents with his signature. For the past several months the RSTS performs the monthly review at the Petty Cash custodian’s desk and reconciles the statements.

Regarding the lack of an actual submission date to ensure timely filing of the Employee Reimbursement Voucher (CO-17XPS), the forms are hand signed and dated. Weekly “dunning” notices are sent to the director of the individual that has extended beyond the “5 Business Day” rule.

The Department has recently changed its process. In order to better verify submission date, the Business Office now date stamps the back of the CO-17X-PR when they are received from staff.”

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: In our prior audit, we found that the tax payments sent directly to DRS, instead of the lockbox, were recorded on the books of DRS using the postmark date as the receipt date. We concluded, however, that the postmark date could not always be used to accurately determine whether the deposits were made in a timely manner.

Our current review revealed that there has not been any significant change in the prior audit reportable condition. We found that the Department’s use of the postmark date as the receipt date could not be used to accurately determine whether the deposit criterion is being met, due to the Department’s lack of consistency in the designation of the postmark date.

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

Cause: The Department believes that the cost and effort to record the actual receipt dates for these tax payments is excessive compared to the benefit. In addition, DRS has failed to establish, or otherwise apply, a consistent standard for determining the postmark date and, thus, the receipt date for such payments.

Recommendation: The Department of Revenue Services should establish a consistent standard for defining the postmark date to apply to the payments mailed directly to DRS to ensure that they are deposited in accordance with promulgated statutes. (See Recommendation 4.)

Agency Response: “The Department disagrees with this finding. As explained during this audit process, there are specific rules in place for what date is recorded in the system. The triggers are the date it is received by DRS and the “postmark date” on the envelope. This procedure is consistently applied.

The changes suggested for re-programming in the system are cost prohibitive and not likely be the most efficient use of limited state resources. During this audit, the Department specifically identified other ways to confirm that this requirement is being met. Furthermore, the Department has performed several “tests” of deposits to validate the timeliness of the deposits and has shared this information with the staff of the Auditors of Public Accounts. All mail postmarked on or prior to the due date of the return is considered timely and recorded as such. That approach was reviewed and accepted in the previous audit cycle between the DRS and prior APA staff. This provides a reasonable, efficient and effective control.”

Auditors’ Concluding

Comment: In its response, the Department identifies two triggers for determining what date to use to record receipts in the system, the date the payment is received and the postmark date. With respect to the first trigger noted by the Department, our testing revealed that the Department does not actually use this date for the purpose of recording the receipt of payments. Thus, it is the second trigger, which the Department refers to as the postmark date, that is the focus of the finding. Our current audit testing revealed that the Department is not consistent in its use of the postmark date. We found that it is evident that the Department has not clearly defined, or otherwise identified, what the postmark date is or should be for the purpose of ensuring the timeliness of deposits, because the Department does not necessarily or routinely use the actual date as

stamped on the envelope when recording its referenced postmark date.

With respect to the Department's comment implying that the prior APA staff reviewed and accepted the results of the Department's tests to validate the timeliness of deposits, we note that our prior audit staff's approval was limited to the Department's agreement to initiate the testing of its deposits. Our approval was necessarily limited, as noted, because we did not perform any independent tests of the Department's methodology for testing the timeliness of its deposits as part of our prior audit.

Review and Approval of Sales and Use Tax Audits:

Background:

During the audited period, the Department's Audit Division initiated the transition of its audit process from a hard-copy format to a virtual format. In the virtual audit environment, all the evidence in support of the taxpayer audit, including procedures performed, audit finding(s), and administrative reviews and approvals, are maintained in an electronic format. With respect to the audits performed and maintained in a paper document format, the supervisory and managerial reviews and approvals of the examiner's performance and relevant documentation were evidenced, or otherwise acknowledged, by the actual signing and dating of the appropriate audit review forms. However, in the virtual audit environment, the support for the supervisory and managerial level reviews and approvals relative to the performance, completeness and quality of the audit is evidenced, in part, via email correspondence between the audit examiner, audit supervisor and audit manager.

Criteria:

The state has established laws and regulations for the collection of taxes and for ensuring taxpayers comply with tax collection efforts. The Department has established policies and procedures for the establishment of the state's tax collection laws and regulations, including the establishment of the Department's Audit Division, which performs taxpayer audits based on established criteria. The Audit Division ensures that its revenue examiners perform the taxpayer audits in accordance with the Department's policies and procedures primarily through its supervisory and managerial level reviews of taxpayer audit files.

Condition:

We found that the virtual audit files forwarded from one supervisory level to the next via email correspondence, as part of the current review and approval process, appeared to constitute their acceptance of compliance with the Department's policies and

procedures. It appears such acceptance of compliance was made despite the lack of any formal or definitive signatures to substantiate the performance of the requisite supervisory and managerial level reviews and acknowledgements of approval.

Effect: The Department's virtual audits may be considered approved and in compliance with the Department's policies and procedures without any formal or definitive evidence to support the supervisory level reviews and approvals, leading to questionable accountability relative to the performance and quality of such audits.

Cause: In the transition of its taxpayer audit process from a hard-copy format to a virtual format, it appears that the Department's Audit Division did not consider the need for functionality of formal or definitive signatures as evidence of supervisory level reviews and acknowledgements of approval.

Recommendation: The Department's Audit Division should implement the procedures and/or functionality, as necessary, to ensure that its virtual audit process includes the requirement for formal and definitive signatures and/or acknowledgements to substantiate the performance of the requisite supervisory and managerial level reviews and approvals. (See Recommendation 5.)

Agency Response: "The Department disagrees with this finding. Accountability is never in question and the Department did consider the need for signatures during the virtual audit review and approval process. The Department chose to use "e-signatures" to replace "wet signatures". According to the Department of Information and Technology (DOIT) we are in compliance with what they recommend as well as the guidelines published by the National Institute of Standards and Technology (NIST) and the Government Printing Office (GPO). The e-mail process that is currently in place does satisfy the requirement for an electronic signature. In addition, only a limited number of identified staff are authorized to submit an audit for billing and based on the dollar amount of the audit additional reviews may be required. Both of these actions can be traced back to a specific staff member. There is a "paper trail" of the review comments from the Supervisor to the Examiner that remains with the Supervisor for future reference that validates the review process. With that being said the Department will look in to the possibility of using "ITAS Case Notes" to document the review process and the transfer responsibility amongst staff as the audit is reviewed."

Auditors' Concluding

Comment:

While the Department's email process could potentially fulfill the function of an e-signature as part of the virtual audit process, we found that the emails often lacked the clear and explicit language referencing, or otherwise acknowledging, that the requisite supervisory and managerial level reviews were performed and approvals were received.

Processing of Suspended Transactions:

Background:

Tax returns and payments entered into the tax administration system are sometimes unable to be processed, thereby entering into a suspended status. There are many different reasons for transactions going 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 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:

In our prior audit, we found transactions that had been in suspense for periods ranging from five months to three years. While our current review revealed that the Department has initiated efforts toward prioritizing its workloads to better focus its limited resources on those transactions that will have the greater financial impact, we found that those efforts have not been successful. Our test of a sample of 16 transactions selected from a listing of approximately 1,400 high priority transactions, which were suspended for periods ranging from five months to nearly three years, disclosed that nine, or approximately 56 percent, of the sampled transactions were not pursued, or otherwise corrected, in a timely manner. We also found that the Department incurred an interest liability for \$686 due to a delayed refund relative to one of the identified exceptions.

Effect:

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 and/or may result in the creation of a liability in the form of interest owed for late refund.

Cause: The Department's current practices fail to ensure the consistent and proactive follow-up on those suspended transactions considered high priority.

Recommendation: The Department of Revenue Services should strengthen its internal control procedures to ensure the timely resolution of suspended transactions, with emphasis on those transactions considered either high priority and/or identified as having a potential financial impact for the state. (See Recommendation 6.)

Agency Response: "The Department agrees with this finding. Currently the DRS makes every attempt to prioritize suspended transactions based on the financial impact, the resources required to correct the suspended item and the length of time it has been in suspension. DRS has instituted steps to ensure that suspended transactions are resolved in a timely manner as possible."

Collection and Enforcement Division – Outdated Procedures:

Background: The Department of Revenue Services Collection and Enforcement Division (C&E) is responsible for the collection of overdue taxes and the enforcement of the state tax statutes and regulations for those who refuse to voluntarily comply.

Criteria: Proper internal control dictates that formal written procedures should be established, maintained and disseminated to provide guidance to employees in the performance of their assigned duties.

The responsibility of designing and implementing internal controls is a continuous process. As conditions change, control procedures may become outdated and inadequate. Management must anticipate that certain procedures will become outdated, inadequate and/or obsolete, and that it will become necessary to modify its internal controls in response.

Condition: Our review disclosed that the Collection and Enforcement Division's procedures were outdated. We found that the most recent updates to the division's current procedures were implemented during the early phases of the Department's implementation of its Integrated Tax Administration System (ITAS), which occurred during the calendar year 2004. Accordingly, the division's current procedures do not reflect all of the changes brought about by the implementation of the ITAS that

impact its employee duties and responsibilities, and system processing.

Effect: The ability to train staff, as well as the effectiveness and efficiency of the functions performed within the Collections and Enforcement Division may be diminished.

Cause: The updating of formal, comprehensive written procedures for the Collections and Enforcement Division has not been designated as a high priority.

Recommendation: The Department should improve its internal controls by updating and maintaining its formal, comprehensive written procedures related to the functions of its Collection and Enforcement Division. (See Recommendation 7.)

Agency Response: “The Department agrees with these findings and has taken corrective action, including several recent updates to the C&E intranet webpage that provides our organization, procedures and guidelines. The Bureau’s Compliance Support Unit has been assigned to update all procedures for both the Audit Division and the C&E Division. Changes to audit procedures are nearly complete, and additional updates to C&E procedures are forthcoming.”

Noncompliance with Section 12-39aa, Subsection (a), of the General Statutes:

Criteria: Section 12-39aa, subsection (a), of the General Statutes provides that “if any return, claim, statement, or other document required to be filed with or any payment required to be made to the Department of Revenue Services within a prescribed period on or before a prescribed date under authority of any provision of the general statutes is, after such period or such date, delivered by United States mail to the Department of Revenue Services, the date of the United States postmark stamped on the cover in which such return, claim, statement, or other document, or payment, is mailed shall be deemed to be the date of delivery or the date of payment, as the case may be...”

Condition: We were informed by members of the Department of Revenue Services’ administrative staff that the Department has been following a practice of allowing a grace period in determining the timeliness of receipt of required tax returns or payments when received after the prescribed period or due date. For instance, with respect to required resident (individual) income tax return filings, we were informed that the DRS’ general practice has been to

accept, as timely filed in compliance with Section 12-39aa, subsection (a) of the General Statutes, any filing received within the grace period of three business days immediately following the prescribed period or due date, regardless of the postmark date.

Effect: The Department's practice is not in compliance with the provisions of Section 12-39aa, subsection (a) of the General Statutes.

Cause: The Department believes that the use of a grace period allows for the more effective and efficient use of its limited resources, and, therefore, enhances its staff's productivity during those periods immediately following a prescribed period or due date, when the demands on its resources are the greatest due to the large volume of filings.

Recommendation: The Department of Revenue Services should establish the procedures necessary to ensure its compliance with Section 12-39aa, subsection (a) of the General Statutes.
(See Recommendation 8.)

Agency Response: "The Department disagrees with this finding. The Department believes that it is in substantial compliance with the requirements of Section 12-39aa, and that DRS utilizes its administrative authority to practically and effectively process the millions of returns received. The "grace periods" have been in effect for over 30 years. Cut-off testing for mail received within the grace period confirms that the mail was postmarked on or prior to the due date of the return. Those returns that were received after the grace period were examined and posted using the date of the postmark that was stamped on envelope. The Department believes that using the "grace periods" is a more efficient and effective use of its limited staff resources – this is confirmed by the results of the cut-off testing that was performed."

Auditors' Concluding

Comment: While we acknowledge that the Department's current practice of allowing a grace period in determining the timeliness of receipt of the filing of required tax returns or payments when received after the prescribed period or due date evolved from its desire to maximize the productivity of its limited staff resources, the practice does not comply with the current statutory language.

RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 2007 and 2008 contained a total of 18 recommendations. Of those recommendations, 13 have been implemented, resolved, or not repeated. The status of recommendations contained in the prior report is presented below.

Prior Audit Recommendations:

- 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. Section 12-34d of the General Statutes was repealed effective June 7, 2010. The recommendation has been addressed by the Department and will not be repeated.
- 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. With respect to the first component of the condition that resulted in this prior audit recommendation, the Department issued a policy statement in June 2010 which sets forth the standards the Department will apply when determining whether to waive or recommend the waiver of a penalty. In addition, with respect to the abatement of taxes, the Department has adopted regulations that set forth the guidelines the commissioner shall consider for the purposes of certifying that the tax is uncollectible. Accordingly, we will not repeat the first component of this recommendation at this time. The second component of the recommendation is being referred for possible inclusion in our office's Annual Report to the Connecticut General Assembly, as it requires a technical change to the Connecticut General Statutes.
- The Department should consider seeking legislation repealing the Small and Medium Sized Business Users Committee authorized by Section 12-3f of the General Statutes. Section 12-3f of the General Statutes was repealed, effective June 7, 2010. The recommendation has been addressed by the Department and will not be repeated.
- 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. Our current review revealed that there was no change in the condition that produced this recommendation. The recommendation will be repeated. (See Recommendation 1.)
- The Department should consult with 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 recommendation will not be repeated for the following reasons: (1) Subsequent to the audited period but prior to the completion of our audit, we were provided with information and relevant documentation that exhibits and supports the Department's

actual and planned on-going compliance with its statutory reporting requirement under Section 12-7b, subsection (d) of the General Statutes. Accordingly, we have concluded that the Department has addressed this component of the prior audit reportable condition; (2) With respect to the second component of the prior audit reportable condition relative to the lack of compliance with the statutory reporting requirement under Section 12-7a, subsection (b) of the General Statutes, a recommendation is being referred for possible inclusion in our office's Annual Report to the Connecticut General Assembly, as it requires a technical change to the Connecticut General Statutes.

- 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. The Department has taken the necessary steps to substantially address this recommendation. The recommendation will not be repeated.
- 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. Our review found no repetition of the condition that produced the prior audit recommendation. The recommendation will not be repeated.
- 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. The recommendation will be revised and presented in modified form to address the current condition. (See Recommendation 2.)
- The Department of Revenue Services should implement procedures to provide for adherence to the receipt date guidelines promulgated in the Comptroller's Memorandum 2007-24 in order to more accurately reflect the fiscal year to be charged for certain expenditures. The Department has taken the necessary corrective action and complied with our prior audit recommendation. The recommendation will not be repeated.
- 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. The Department has adequately addressed this recommendation. The recommendation will not be repeated.
- 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. Our review found no change in the condition that resulted in this recommendation. This recommendation will be

revised and presented in modified form to address the current condition. (See Recommendation 4.)

- 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. This recommendation will be revised and presented in modified form to address the current condition. (See Recommendation 5.)
- The Department of Revenue Services should consider modifying its current procedures to resolve suspended transactions in a more timely manner. This recommendation is being repeated in modified form. (See Recommendation 6.)
- 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 who have been the subject of browsing. The Department has taken the necessary corrective action and complied with our prior audit recommendation. The recommendation will not be repeated.
- 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. The Department has substantially addressed this recommendation. The recommendation will not be repeated.
- The Department should examine its procedures regarding asset management to further enhance controls over laptop computers and eliminate duplication of effort. The Department has substantially addressed this recommendation. The recommendation will not be repeated.
- 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. The Department has taken the necessary steps to substantially address this recommendation. The recommendation will not be repeated.
- The Department of Revenue Services should seek statutory revisions that specifically grant anonymity to those who 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. As this matter was addressed with a recommendation for a technical change to the Connecticut General Statutes in our office's Annual Reports to the Connecticut General Assembly for 2008, 2009 and 2010, the recommendation will not be repeated.

Current Audit Recommendations:

- 1. 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.

- 2. The Department's Human Resources Unit should implement standardized written performance and review procedures relative to its investigation process. Such procedures should include documentation to substantiate the Human Resources Administrator's review of the case files prepared and agreement with the conclusions reached by staff.**

Comment:

The case file documentation related to the Human Resources Unit's investigations disclosed a lack of documented evidence to support the Human Resources Administrator's review of the case files prepared and agreement with the conclusions reached by staff

- 3. The Department should implement the procedures necessary to ensure that it administers its petty cash fund in compliance with the requirements of the State Comptroller State Accounting Manual.**

Comment:

There was a lack of proper segregation of duties relative to the administration of the Department's petty cash fund. In addition, the Department did not record, or otherwise indicate, the actual submission date of the Form CO-17XP-PR, Employee Reimbursement Voucher, and the required documentation supporting the employee's travel expenses, resulting in the inability to test the Department's compliance with the State Comptroller's guidelines relative to the timely submission.

- 4. The Department of Revenue Services should establish a consistent standard for defining the postmark date to apply to the payments mailed directly to DRS to ensure that they are deposited in accordance with promulgated statutes.**

Comment:

The Department's use of the postmark date as the receipt date does not accurately indicate whether the deposit criterion is being met due to the lack of consistency in the designation of the postmark date.

- 5. The Department's Audit Division should implement the procedures and/or functionality, as necessary, to ensure that its virtual audit process includes the requirement for formal and definitive signatures and/or acknowledgements to substantiate the performance of the requisite supervisory and managerial level reviews and approvals.**

Comment:

In the transition to conducting its audits in a virtual environment, or electronic format, the Audit Division overlooked the need to adopt, or otherwise incorporate, the requirement for formal or definitive signatures to substantiate the performance of the requisite supervisory and managerial level reviews and acknowledgements of approval.

- 6. The Department of Revenue Services should strengthen its internal control procedures to ensure the timely resolution of suspended transactions, with emphasis on those transactions considered either high priority and/or identified as having a potential financial impact for the state.**

Comment:

Our test of a sample of transactions selected from a listing of high priority transactions, which were suspended for periods ranging from five months to nearly three years, disclosed that approximately 56 percent of the sampled transactions were not pursued, or otherwise corrected, in a timely manner. We also found that the Department incurred an interest liability for \$686 due to a delayed refund relative to one of the identified exceptions.

- 7. The Department should improve its internal controls by updating and maintaining its formal, comprehensive written procedures related to the functions of its Collection and Enforcement Division.**

Comment:

The Collection and Enforcement Division's procedures are outdated. The Division's current procedures do not reflect all of the changes brought about by Department's implementation of the latest phases of its Integrated Tax Administration System and do not reflect its employees' duties and responsibilities and system processing.

- 8. The Department of Revenue Services should establish the procedures necessary to ensure its compliance with Section 12-39aa, subsection (a) of the General Statutes.**

Comment:

The Department has been following a practice of allowing a grace period in determining the timeliness of receipt of the filing of required tax returns or payments when received after the prescribed period or due date.

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, 2009 and 2010. This audit was primarily limited to performing tests of the Department's compliance with certain provisions of laws, regulations, contracts and grant agreements and to understanding and evaluating the effectiveness of the Department's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grant agreements applicable to the Department are complied with, (2) the financial transactions of the Department are properly initiated, authorized, recorded, processed, and reported on consistent with management's direction, and (3) the assets of the Department are safeguarded against loss or unauthorized use. The financial statement audits of the Department of Revenue Services for the fiscal years ended June 30, 2009 and 2010, 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:

Management of the Department of Revenue Services is responsible for establishing and maintaining effective internal control over financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants. 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 Department's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over those control objectives. Accordingly, we do not express an opinion on the effectiveness of the Department of Revenue Services' internal control over those control objectives.

A deficiency in internal control 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 and correct on a timely basis unauthorized, illegal or irregular transactions, or breakdowns in the safekeeping of any asset or resource. *A material weakness* is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions and/or material noncompliance with certain provisions of laws, regulations,

contracts, and grant agreements that would be material in relation to the Department's financial operations will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance with requirements was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over the Department of Revenue Services' 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 Department'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 Department management in the accompanying Condition of Records and Recommendations sections of this report.

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

This report is intended for the information and use of Department 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.



Robert Koch
Principal Auditor

Approved:



John C. Geragosian
Auditor of Public Accounts



Robert M. Ward
Auditor of Public Accounts