STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
STACEY E. PICKERING
AUDITOR

February 12, 2014

Financial Audit Management Report

J. Ed Morgan
Commissioner of Revenue
Department of Revenue
1577 Springridge Road
Raymond, MS 39154

Dear Commissioner Morgan:

Enclosed for your review are the financial audit findings for the Mississippi Department of Revenue for the Fiscal Year 2013. In these findings, the Auditor's Office recommends the Mississippi Department of Revenue:

1. Strengthen controls over adjustments and abatements to taxpayer accounts;
2. Strengthen controls over statement and billing processes on taxpayer accounts;
3. Strengthen controls over deposit reconciliations;
4. Strengthen controls over reconciliations for sales tax collections;
5. Strengthen controls over checks received;
6. Strengthen controls over processing corporate tax returns;
7. Strengthen controls over processing individual income tax returns;
8. Strengthen controls over sales tax journal entries;
9. Strengthen controls over taxpayer credit balances;
10. Strengthen controls over the diversion of tax collections;
11. Strengthen controls over motor vehicle ad valorem tax reduction payments to counties;
12. Strengthen controls over gaming collections;
13. Strengthen controls over the accuracy of accounting records; and
14. Strengthen controls over abatement of sales tax penalties.

Please review the recommendations and submit a plan to implement them by March 6, 2014. The enclosed findings contain more information about our recommendations.

During future engagements, we may review the findings in this management report to ensure procedures have been initiated to address these findings.

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Mississippi Department of Revenue's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Mississippi Department of Revenue's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. The

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Office of the State Auditor has also issued an Information Systems Management Report on the Mississippi Department of Revenue dated February 12, 2014. That report should be read in conjunction with this report.

I hope you find our recommendations enable the Mississippi Department of Revenue to carry out its mission more efficiently. I appreciate the cooperation and courtesy extended by the officials and employees of the Mississippi Department of Revenue throughout the audit. If you have any questions or need more information, please contact me.

Sincerely,

Patrick Dendy, CPA
Director, Department of Audit
Enclosures

FINANCIAL AUDIT MANAGEMENT REPORT

The Office of the State Auditor has completed its audit of selected accounts included on the financial statements of the Mississippi Department of Revenue for the year ended June 30, 2013. These financial statements are consolidated into the State of Mississippi's *Comprehensive Annual Financial Report*. 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. The Office of the State Auditor's staff members participating in this engagement included Karlanne Coates, CPA, Jane Dussouy, CPA, Kayla McKnight, Jeanne Julious, Lee Alford, Yolanda Campbell, CPA, Wade Cosby, Sallie Dier, CPA, Kaylee Kasper, Emily McHan, CPA, Jeremy Miller, CPA, Stephanie Palmertree, CPA, David Stewart, Elevia Tate, Leigh Taylor, CPA, Heather Ward, CPA, Kristi Webb and Thomas Wirt, CPA.

Our procedures and tests cannot and do not provide absolute assurance that all state legal requirements have been met. In accordance with Section 7-7-211, Miss. Code Ann. (1972), the Office of the State Auditor, when deemed necessary, may conduct additional procedures and tests of transactions for this or other fiscal years to ensure compliance with legal requirements.

Internal Control over Financial Reporting

In planning and performing our audit of selected accounts included on the financial statements, we considered the Mississippi Department of Revenue's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on these accounts, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express an opinion on the effectiveness of the Mississippi Department of Revenue's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified.

However, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies identified in this letter as items 13-14 and 13-15 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies identified in this letter as items 13-16, 13-17, 13-18, 13-19, 13-20 and 13-21 to be significant deficiencies.

In addition, we noted certain control deficiencies involving internal control that require the attention of management. These matters are listed under the heading **OTHER CONTROL DEFICIENCIES** as items 13-22, 13-23, 13-24, 13-25, 13-26 and 13-27.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether selected accounts included on the financial statements of the Mississippi Department of Revenue are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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*.

Finding Number	Finding and Recommendation

MATERIAL WEAKNESSES

13-14 Controls over Adjustments and Abatements to Taxpayer Accounts Should Be Strengthened

Finding:

The Mississippi Automated Revenue System (MARS) has security level groups which allow access to users within the groups to initiate certain types of activities to taxpayer information. During our review of MARS security level groups at the Mississippi Department of Revenue, the following weaknesses were noted.

- 404 users out of 585 agency employees (not including Alcohol Beverage Control (ABC) employees), or 69%, have the ability to make adjustments to tax returns of all types in MARS without prior approval or authorization. These adjustments include adjusting the amount of the return, reversing the return, adjusting the return between periods and accounts, changing the return type between original, amended, or additional, and moving the payment or a portion of the payment between different taxpayer accounts and different tax types. Although each tax division can set its own internal adjustment approval threshold levels, these levels are not enforced by MARS and could be circumvented.

- 124 users out of 585 agency employees, or 21%, have the capability to request and approve an abatement of penalty and interest in MARS without prior supervisory review and approval. This includes employees across the different tax and administrative divisions that can enter abatements for any tax type managed in MARS. Although each tax division can set its own internal threshold level to require verbal authorization from a tax manager before processing the abatement, these levels are not programmed into the MARS system.

In addition, we noted Accounting personnel can enter adjustments to change amounts between tax types managed by different computer systems, such as reclassifying tax types by moving monies from the Legacy tax management computer system to MARS, without requiring prior supervisory review and approval. Also, personnel in the Accounting Change MARS security group,

which is comprised of Accounting Division personnel, can change payment amounts in MARS without supervisory review and approval.

Good internal controls require a supervisory review and approval of significant and unusual adjustments and abatements made to accounting records and to taxpayer's trial balances. This review and approval should be performed in a timely manner and adequately documented to identify the date of review and reviewer. Failure to require an independent supervisory review and approval could result in errors to the taxpayer's account information and possible misstatement of the accounting records occurring and not being timely detected.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls by establishing a threshold above which adjustments and abatements made within MARS are reviewed and approved by a person independent of preparing the transaction to ensure taxpayer account information is correct. In addition, the agency should ensure adjustments to payment amounts made by Accounting personnel are reviewed and approved by a person independent of preparing the transaction. This review and approval process should be adequately documented and performed within a timely manner.

13-15 <u>Controls over Statement and Billing Processes on Taxpayer Accounts Should Be Strengthened</u>

Finding:

During our review of controls over taxpayer accounts at the Mississippi Department of Revenue, we noted the Mississippi Automated Revenue System (MARS) has a functionality by which an indicator can be placed at the taxpayer, account or period levels of a taxpayer's financial information to suspend/stop activities that include, but are not limited to, the processing and mailing of statement of accounts, assessments and bills, and other correspondence (i.e. all mail) to taxpayers by system users. The MARS Indicator By Type of Indicator report shows, by the type of indicator chosen, the reason for the suspended activity indicator, the tax type(s), the filing period and the cease date of the indicator.

During our review of control procedures over the MARS system related to the stop/suspended statement and billing process, we noted there were 470 users that had access to apply indicators to the period, account and taxpayer levels of MARS taxpayer's financial information without supervisory approval. In addition, indicators can be applied without adding a time limit for expiration (i.e. cease date), or reason. It should be noted that the agency has indicated that in some instances it is necessary to have indefinite cease dates, such as for legal proceedings.

We also noted the following instances of usage during fiscal year 2013.

- For the Stop Mail indicator, we noted 100,865 instances of usage. Of the

100,865 instances, there were 99,148 instances in which activities were suspended at the taxpayer level which would affect all their accounts; 39,381 instances where there was no reason applied; and 43,028 instances in which there was an indefinite cease date of December 31, 9999 applied.

- For the Stop Statement indicator, we noted that all 40,701 instances of usage were applied at the taxpayer level. In 6,323 instances, there was no reason applied and in 19,356 instances there was an indefinite cease date of December 31, 9999 applied.

- For the Stop Billing Processing indicator, we noted 29,589 instances of usage. Of the 29,589 instances, there were 28,024 instances in which activities were suspended at the taxpayer level; 22,443 instances in which there was no reason applied; and 5,141 instances in which there was an indefinite cease date of December 31, 9999 applied.

Good internal controls require a supervisory review on taxpayer accounts in which mail, billing and statement processes have been suspended. This review should be performed in a timely manner and documented. In order to provide an adequate audit trail, reasons and time frames should be required when applying indicators which stop the issuance of billings, statements, and mail to taxpayers. The application of indicators should be limited to those users who require it in the course of their work. Errors noted in the application of these indicators could result in errors to the taxpayer's account information not being timely detected and the possible under-collection of taxes.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over statement and billing processes over taxpayer accounts. Supervisory review and approval should be required when applying indicators to taxpayer accounts which stop/suspend mail, statements, and billing processes. The review and approval should be performed in a timely manner and documented. In addition, cease dates and the reason for the use of these indicators should be required. The agency should consider having special indicators for those accounts in legal proceedings. Furthermore, the ability to apply stop indicators should be reviewed to ensure it is limited to personnel who require it in the course of their work.

SIGNIFICANT DEFICIENCIES

13-16 <u>Controls over Deposit Reconciliations Should Be Strengthened</u>

Finding:

The Mississippi Department of Revenue began using a new integrated tax management system in October 2011, the Mississippi Automated Revenue

System (MARS). The agency is in the process of converting different taxes into MARS annually over a five year roll out schedule. Since the implementation of MARS, reconciliation procedures performed of tax deposits to payments uploaded and posted in former tax management systems replaced by MARS have become obsolete.

Our review of the reconciliation process revealed that after state fiscal year 2013 ended, agency personnel began designing procedures to reconcile payments received from various sources (including paper checks, electronic payments and agency clearing accounts), as recorded in agency records from bank deposit information, to MARS documentation of payments uploaded into MARS effecting taxpayer accounts. In addition, agency procedures include monthly reconciliations between bank statements and the transaction listings for credit card payments and between bank statements and transaction listings from the District Office Receipt Program (DORP). These reconciliations include reconciling ending bank balances and investigating differences noted. Reconciliations for credit card payments for state fiscal year 2013 were not performed until the fourth quarter of fiscal year 2013 and investigation of differences occurring in fiscal year 2013 for DORP were not performed until after fiscal year 2013.

Good internal controls require timely reconciliations to be performed between amounts deposited, uploaded, and posted to taxpayer accounts in order to detect and correct errors as soon as possible. The failure to perform reconciliation procedures in a timely manner could adversely affect the integrity of taxpayers' accounts and could also result in errors or fraud occurring without being detected in a timely manner.

Recommendation:

We recommend the Mississippi Department of Revenue ensure reconciliations of deposit transactions are prepared timely to ensure revenue is properly deposited, uploaded and posted to taxpayers' accounts. Reconciliations and follow-up procedures performed on differences noted should be adequately documented.

13-17 <u>Controls over Reconciliations for Sales Tax Collections Should Be Strengthened</u>

Finding:

The Mississippi Department of Revenue performs various deposit reconciliation procedures to ensure funds received are properly deposited and accurately recorded. The weekly DRDC (Deposits, Remittance and Data Capture) deposit reconciliation reconciles between the amount of funds received and uploaded to the LEGACY system for sales and use tax from the DRDC system to the amount of the same tax type deposited. The DRDC system deposits are the paper checks received and scanned by the agency's processing division. These payments are then uploaded to the Legacy system for the sales and use tax types. This DRDC reconciliation consists of three reports and serves as the primary review of DRDC deposits versus sales tax system upload.

The DRDC deposit reconciliation is the only reconciliation tool used to identify reconciling items for the LEGACY system in comparison to DRDC deposits uploaded to the system. However, this weekly reconciliation only captures paper check deposits. There are no reconciliation procedures to reconcile electronic payments recorded in the LEGACY system to other deposit reports. Electronic deposits accounted for approximately 89% of sales tax collections and 72% of use tax collections during fiscal year 2013. In addition, there are no reconciliation procedures to ensure amounts deposited and uploaded to the LEGACY system are posted to taxpayers' accounts.

During our review of the agency's DRDC reconciliation process, the following weaknesses were noted.

- During the fiscal year ending June 30, 2013, there were 11 out of 52 weeks, or 21%, in which none of the three DRDC reports were printed. The agency did not maintain records to indicate if no data was available to print the reports during the noted weeks or if available reports were not run.

- For the final 21 weeks of fiscal year 2013, from February through June, the Out of Balance report was not printed. As indicated by the agency, the Out of Balance report is reviewed more extensively and is considered the most important reconciliation tool of the DRDC reconciliation process.

It should be noted that effective October 7, 2013, the sales and use tax types were converted over to the Mississippi Automated Revenue System (MARS) and MARS reconciliation procedures are under development.

Good internal controls require timely reconciliations to be performed between amounts deposited, uploaded, and posted to taxpayer accounts. Reconciliation procedures should include electronic deposits as well as paper checks, and should be prepared in a timely manner. Failure to do so could result in errors or fraud occurring without being detected in a timely manner and could adversely affect the integrity of taxpayers' accounts. Also, because overpayments and tax due notices are processed using the individual taxpayer account information, misleading or erroneous results could be generated.

Recommendation:

We recommend the Mississippi Department of Revenue ensure reconciliations of all deposit transactions posted in the MARS system are prepared timely to ensure revenue is properly deposited and posted to taxpayers' accounts. Reconciliation procedures should be adequately documented with initials and dates.

13-18 <u>Controls over Checks Received Should Be Strengthened</u>

Finding:

The Mississippi Department of Revenue processing division receives numerous

trays of mail each day which consists of tax returns, checks and correspondence. For all mail containing checks, the clerks verify that the amount on the check and the return agree and that there is an account number on the return. If there is a problem with the return or check, such as a missing account number or instances in which the check and return don't agree, then the return and check are forwarded to the Data Assembly/Pre-Edit section of the processing division for resolution of the problem. If the Data Assembly/Pre-Edit section cannot correct the problem, the return and check are forwarded to the appropriate tax divisions for further research/correction. In some instances, the mail is sent directly to the tax divisions prior to being processed. Some of the major reasons checks and returns are sent directly to a tax division is a city schedule or master file schedule is not attached to a sales tax return; the return and check are out of balance more than $500 before being processed; the return is for oil and gas severance taxes within the miscellaneous tax division for processing; or the mail is addressed to a specific employee within the tax division.

Review procedures performed for fiscal year 2013 revealed that checks which were sent to the divisions by the Data Assembly/Pre-Edit section were not adequately controlled by the processing division. The log maintained by the Data Assembly/Pre-Edit section only included one large dollar check sent to the tax divisions during the fiscal year. Management indicated the log had only been reviewed once in approximately the last nine years when a check was missing. The checks sent to the divisions were not logged (except for the one mentioned above) or restrictively endorsed by the processing division.

We also noted the corporate, income, sales and miscellaneous tax divisions had not implemented adequate controls or procedures to ensure that checks received in their divisions were properly safeguarded while being processed in these divisions. Check logs were not maintained by any of these divisions. It should be noted that personnel in the tax divisions are authorized to make adjustments or apply stop indicators to taxpayer's accounts which could result in the circumvention of controls established within the delinquency system.

The agency has implemented an upgrade to the Deposit, Remittance & Data Capture (DRDC) system called Fairfax, which includes the software package Check 21. Check 21 allows for checks to be scanned and electronically deposited. However, during the majority of fiscal year 2013, withholding tax was the only tax that Check 21 supported. Good internal controls require that receipts which bypass the normal processing stream be controlled to expedite the deposit of checks into the bank and reduce the potential for errors or fraud to occur without being detected in a timely manner.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over checks received by the various tax divisions. For checks that are routed to the tax divisions, the agency should develop a check receipts log in each division and restrictive endorsements should be placed on checks at the earliest possible moment. Due to the volume of checks received by the divisions, management should consider a reasonable dollar threshold for checks which need to be logged. The threshold should not be so large that significant errors or fraud

could occur without being promptly detected. In addition, we recommend the logs in each tax division and in the processing division be reviewed by management to ensure the proper disposition of the checks recorded on the logs.

13-19 Controls over Processing Corporate Tax Returns Should Be Strengthened

Finding:

A review of 56 corporate income and franchise tax return and payment transactions posted in the Mississippi Automated Revenue System (MARS) at the Mississippi Department of Revenue revealed the following problems.

- The amount of penalty and interest imposed as a result of a taxpayer's underestimate was overstated by $2,108 and posted to the taxpayer's trial balance. This incorrect amount was then billed to and paid by the taxpayer after a lien was created for the improper balance due.

- A pass-through entity Partnership's tax return was improperly changed to a pass-through entity S-Corporation. This resulted in the estimate payments already paid by the taxpayer for the Partnership return not being posted to the taxpayer's account as well as the addition of an incorrect franchise tax. Had the account been properly posted, a refund of $177 would have been due to the taxpayer.

- A taxpayer submitted a $589 check payment that scanned through the Deposits, Remittance, and Data Capture system (DRDC) but was posted to another taxpayer's account causing the amount to be refunded to the wrong taxpayer. The taxpayer who submitted the original payment was then billed and paid the tax again with additional penalty and interest for a total payment of $624.

- A taxpayer submitted a $150 check payment that scanned through DRDC, but the taxpayer's Federal Employer Identification Number (FEIN) was incorrectly read by the scanner. Therefore, the payment is pending in MARS without being properly recorded to the taxpayer's account.

- Two corporate tax returns reported net operating losses (NOL) totaling, in aggregate, $190,247 on the Income Tax Schedule; however the amounts were not picked up by MARS version 1 of the Income Tax Schedule. The errors were flagged and corrected in MARS but the correction did not result in the NOL amounts being properly posted to the taxpayers' NOL MARS accounts. It appears the corrections did not calculate down to the line on the Income Tax Schedule where the NOL amounts are transferred to the taxpayer's NOL MARS accounts.

- A taxpayer's $25 minimum franchise tax was posted twice on their MARS trial balance due to the tax being posted once from an agency

audit and again from the taxpayer's tax return.

- A taxpayer submitted a $25 check payment for the minimum franchise tax that scanned through DRDC, but the filing period was not properly picked up. The payment was posted to a filing period not used by the taxpayer. The taxpayer was then billed and paid the tax again with penalty and interest for a total payment of $27.

Good internal controls require proper posting of taxpayer information to the taxpayer accounts to ensure the integrity of recorded amounts. The effect of the conditions listed above resulted in improper billings to taxpayers by the Mississippi Department of Revenue because of inaccurate trial balances on taxpayer accounts in MARS. This could also affect the financial reports of the agency by generating incorrect receivable amounts.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over the processing of tax returns on corporate income tax and pass through entity accounts in MARS to ensure that returns and related payments are properly posted for financial reporting purposes and for taxpayer accounts.

13-20 <u>Controls over Processing Individual Income Tax Returns Should Be Strengthened</u>

Finding:

During fiscal year 2013, the Mississippi Department of Revenue replaced the Phoenix system for processing income tax with the Mississippi Automated Revenue System (MARS). During testwork performed on 35 individual income tax refunds, we noted two instances in which invalid amounts were transferred from the old version of DRDC (Deposits, Remittance, and Data Capture) system to MARS. The two returns were 2011 returns completed using the Non-Resident or Part Year Resident Individual Income Tax Return form.

Our testwork revealed the file used to upload income data from DRDC to MARS was not properly designed to hold an excess of 10 digits, including cents. Therefore, the greatest amount transferred would be $99,999,999.99. For any amounts $100,000,000 or greater, the system would store data in a 10 digit format from left to right making the amount appear as $10,000,000.00. It appeared the maximum value limit required for return fields was set too low in the upload file and didn't allow large income data values to transfer properly for the noted return type above. In addition, for one of the returns tested, we noted the amount calculated to be deducted from Medical and Dental Expenses (Line 1b) was captured incorrectly on the Schedule A - Itemized Deductions form. This error caused the AGI from Federal Form (1040) from Lines 1b and 6b and the amount calculated to be deducted from Employee Business Expenses or Miscellaneous Itemized Deduction fields to be recalculated by MARS incorrectly based on the invalid values scanned and/or keyed.

Good internal controls require income data provided by the taxpayer and transferred between systems be properly captured, calculated and posted to accurately report taxpayer data. In the two instances noted, these errors did not affect the overall financial results of the respective tax returns due to negative Mississippi AGI. However, the failure to properly capture financial data could potentially cause a return in which income for their Mississippi AGI was reported to be processed incorrectly. It should be noted that after the auditor's inquiry, a system service request was created to review and correct this problem.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over processing individual income tax returns. Agency personnel should review maximum value limits for system return fields and data parameters on upload files used to transfer data between systems in order to ensure individual income tax return data is correctly captured, calculated and posted to taxpayer's accounts. In addition, controls over taxpayer information that is scanned with low confidence levels should be strengthened to ensure data captured and recalculated is accurate.

13-21 <u>Controls over Sales Tax Journal Entries Should Be Strengthened</u>

Finding:

During sales tax journal entry testwork at the Mississippi Department of Revenue, we selected nine journal entries exceeding $500,000 to test. Our testwork revealed the following problems.

- One journal entry document totaling $1,447,118 could not be located by agency personnel.

- One journal entry document totaling $1,850,425 was not authorized by supervisory personnel.

It should be noted that agency policy requires all sales tax journal entries over $5,000 to be reviewed by supervisory personnel. Good internal controls should ensure that accounting records are maintained to provide an audit trail for transactions in order to verify the validity and correctness of the journal entry. Good internal controls also require significant journal entries be reviewed and approved by a responsible official not involved with the origination of the entry. Failure to ensure journal entries are maintained and correctly prepared could adversely affect taxpayer account information and could also allow errors or fraud to occur without being detected in a timely manner.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over sales tax journal entries to ensure journal entry documents are maintained by agency personnel. A supervisory review should be performed for significant sales tax journal entries to ensure entries are properly prepared. This review should be performed in a timely manner and documented.

OTHER CONTROL DEFICIENCIES

13-22 Controls over Taxpayer Credit Balances Should Be Strengthened

Finding:

During our review of user-initiated adjustments to corporate income tax returns at the Mississippi Department of Revenue, we noted an instance in which a converted return was erroneously reversed from the taxpayer's trial balance in the Mississippi Automated Revenue System (MARS); however, the converted payments remained posted. This error resulted in an improper credit balance of $2,406,778 on the taxpayer's account. When the auditor brought this error to the attention of agency personnel, it was subsequently corrected. It should be noted that MARS has a credit balances report available for agency personnel to review. However, per our discussion with agency personnel in the income tax division, these reports were not consistently reviewed. Credit balances can result in refunds to taxpayers or a reduction of future taxes owed.

Good internal controls require that agency personnel review taxpayer accounts with significant credit balances to ensure that the credit posted on the taxpayer's MARS trial balance is accurate. Failure to review taxpayer accounts with significant credit balances for error may result in an inaccurate credit balance on the taxpayer's account and possible loss of revenue to the State.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over the review of taxpayer accounts with significant credit balances to ensure the credit on the taxpayer's account in MARS is accurate.

13-23 Controls over the Diversion of Tax Collections Should Be Strengthened

Finding:

While testing diversions of tax revenue at the Mississippi Department of Revenue, we noted the agency did not maintain an audit trail to document support for untransferred collections of tax types managed in Mississippi Automated Revenue System (MARS). While the agency did reconcile the total amount of all untransferred collections recorded in agency records to the "cash in treasury" balance sheet account in state treasury fund 9171, the agency did not reconcile the ending monthly balances of untransferred collections by MARS tax types to documentation maintained within the system.

Withholding and corporate income taxes have specific reserve accounts in MARS that restrict money in the state treasury fund 9171 for income tax refunds and estimates for incentive program payments and rebates; however, after factoring out reserves and estimates, large amounts of untransferred collections still existed. After discussions with agency personnel, it appeared the majority of the remaining untransferred balances in excess of reserves was due to taxpayer accounts with credit balances which caused the system to automatically hold money in the state treasury fund 9171. However, there was no supporting

documentation maintained or utilized by the agency to quantify the amounts automatically held by MARS for these credit balances that could be used to verify the month ending untransferred collections balances were correct.

In addition, the June 2013 ending monthly balance of untransferred gaming tax collections reported in agency documentation did not agree to subsequent months' diversions to local government entities by $1,568,300. This discrepancy appeared to result from an over diversion of gaming tax to the state general fund 2999 during the conversion of gaming tax into MARS during October 2011.

Good internal controls require that audit trails be maintained for the diversion process. The failure to maintain support for untransferred tax collections results in ending monthly balances that cannot be verified to ensure tax collections are being diverted timely.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over the diversion process of tax collections. The agency should maintain documentation which supports the month ending balances of untransferred collections by tax types for taxes managed by MARS.

13-24 <u>Controls over Motor Vehicle Ad Valorem Tax Reduction Payments to Counties Should Be Strengthened</u>

Finding:

During our review of reimbursements of legislative tag credits to counties from the Motor Vehicle Ad Valorem Tax Reduction Fund maintained by the Mississippi Department of Revenue, we noted the following weaknesses.

The central file and data management system for the Motor Vehicle Licensing Bureau (MVLB) was maintained on the agency's local area network using a drive that was accessible to all MVLB staff from the period July 2012 through the week of March 18, 2013. There was no access control list (ACL), no authorization restrictions (within MV staff), and no individual file protection guidelines established to ensure information input into the same reports by multiple MVLB employees was not improperly changed. We noted monthly adjustment sheets, which were saved on this drive, allowed multiple access and input by MVLB personnel. The adjustments sheets, prepared by MVLB personnel, are used to populate a reimbursement report used by accounting personnel to make payments to counties. However, we did observe the implementation of a password protection control to restrict unauthorized access during the week of March 18, 2013.

There were no known agency controls, system edits or review procedures in place to detect or prevent inaccurate data input by counties before submission to Accounting for reimbursement from the period July 2012 through January 2013. Agency personnel indicated they had implemented a monthly analytical review procedure in February 2013 of financial reports generated from the MVLB system to ensure amounts per the report are reasonably correct. However, these

review procedures were not documented.

Recommendation:

We recommend the Mississippi Department of Revenue continue to strengthen internal controls over the MVLB systems which process payments to counties for legislative tag credits by ensuring access to accounting information is restricted to appropriate personnel. In addition, monthly analytical procedures established to review financial reports generated from computer applications should be documented.

13-25 Controls over Gaming Collections Should Be Strengthened

Finding:

Our review of internal controls over gaming collections at the Mississippi Department of Revenue revealed the agency utilizes the Accounts with Debits report and the Report of Overdue Expectations to monitor for delinquent gaming returns. During our testwork over these reports, we noted the following weaknesses.

- Gaming delinquency reports previously generated by agency personnel through Mississippi Automated Revenue System (MARS) were not maintained and therefore were not available for review by the auditor or agency personnel.

- There was a lack of adequate documentation of review procedures performed by agency personnel.

- For nine out of 52 weeks, or 17.3%, of the fiscal year ending June 30, 2013, neither the Accounts with Debits report nor the Report of Overdue Expectations were accessed by agency personnel.

Good internal controls require reports used to identify delinquent gaming taxpayers be reviewed consistently and the review be adequately documented. Furthermore, past reports generated by the agency should be accessible in MARS to allow for a proper audit trail. Failure to conduct timely follow-up on delinquent gaming returns could result in the under collection of revenue by the agency and noncompliance with state laws.

Recommendation:

We recommend the Mississippi Department of Revenue strengthen controls over gaming collections by ensuring delinquency reports are reviewed in a timely manner. Past delinquent reports reviewed by agency personnel in MARS should be accessible for audit purposes and documentation of the review process of the reports should be maintained to provide a proper audit trail.

13-26 Controls over the Accuracy of Accounting Records Should Be Strengthened

Finding:

During our review of gaming tax revenue at the Mississippi Department of Revenue, we noted for the period of February 1, 2013 through May 31, 2013, the gaming fees and taxes amount was overstated by $11,820,018 in the accounting records in comparison to the amounts reported in the Mississippi Automated Revenue System (MARS). Agency accounting personnel use a MARS revenue data cube to post daily revenue collections to the accounting records for tax types within the MARS system. An amount of $3,000,000 is diverted from the gaming revenue to the Gaming Counties Bond Sinking Fund each month. A separate line for the Gaming Counties Bond Sinking Fund was added to the MARS revenue data cube. However, the addition of the separate line caused the $3,000,000 to be erroneously reported twice in the MARS revenue data cube, once as part of gaming revenue and again as a separate line item.

After this error was brought to the attention of agency management, the accounting records for February 2013 through May 2013 were revised to show correct amounts. While this error did not cause a misstatement to the GAAP reporting package, this error misstated the Daily Cash Report which is distributed by accounting personnel to other agency personnel, other state agencies and public officials who are a part of the decision-making process for the state.

Good internal controls require that accounting reports used and distributed by the agency, both internally and externally, be accurately stated. The failure to ensure the accuracy of accounting reports could result in errors being made and not being detected timely and decisions made could be based on incorrect information.

Recommendation:

We recommend the Mississippi Department of Revenue continue to strengthen controls to ensure all accounting reports are accurate.

13-27 Controls over Abatement of Sales Tax Penalties Should Be Strengthened

Audit procedures performed over the abatement of sales tax penalties at the Mississippi Department of Revenue revealed there was no listing of abatements generated for management review. A personal computer system (Foxpro) was used to manually enter information and generate tax due letters. We noted that when a penalty was abated, there was no documentation in the system of the reason for the abatement or the identity of agency personnel who made the decision. The system maintained a "letter history for account" which indicates an abatement was made but did not provide the amount or the identity of the employee who worked on the account. It should be noted the agency's policy is that supervisory approval should be obtained for abatements over $5,000 made within the sales tax division, and that documentation should be scanned into the MDA (MDOR Document Archives) system.

Good internal controls require accounting records be maintained for abatements of

penalty and interest and that abatements be monitored by supervisory personnel to ensure their propriety. Failure to maintain adequate internal controls could allow errors or fraud to occur without being promptly detected. It should be noted that sales tax was converted over to the Mississippi Automated Revenue System (MARS) effective October 7, 2013.

Recommendation:

We recommend the Mississippi Department of Revenue ensure controls are adequately designed and implemented over the abatement of sales tax penalties in the MARS system by ensuring the reason for the abatement and the identity of the agency personnel authorizing the abatement is properly documented.

End of Report