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MISSISSIPPI

STATE TAX COMMISSION

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May 14, 2008

Stacey E. Pickering, State Auditor
Office of the State Auditor
501 North West Street
Suite 801
Jackson, MS 39201

RE: Financial Audit Findings

Dear Mr. Pickering:

With respect to your audit of the financial statements of the Mississippi State Tax Commission for the Fiscal Year ended June 30, 2007, we offer the following comments:

SIGNIFICANT DEFICIENCIES

Individual Income Tax Refunds Should be Properly Calculated

The Mississippi State Tax Commission agrees good internal controls are vital to ensure accuracy and that agency personnel must follow policies and procedures. There are several findings that relate to individual income tax refunds. Each finding is addressed below.

Finding:

Two instances were noted in which our agency's interface system for electronically filed returns received from the Internal Revenue Service incorrectly dropped the first digit of numbers longer than 7 digits (the field length available) on the second page of the "Non-Resident or Part-Year Resident" return on lines for total rent, royalties, partnerships, etc. and total income. This digit was moved up one line on the return which caused the "Tax Due" amount to be understated by \$422 and \$101,138 respectively.

Response:

The errors did not occur because the electronically filed returns contained dollar amounts that exceeded the field length available for electronically filed returns.

Corrective Action Plan:

This problem was reported to our Office of Information Technology (IT) for investigation. After investigating, IT determined the field length in the interface application is 12 digits long. The actual cause of the problem could not be determined because the data is no longer available for IT to research the problem. This type of data is only captured for a 90-day period. There is no evidence of this problem reoccurring. The accounts have been corrected and notices have been generated to the affected taxpayers. The adjustments on the above accounts have reduced the amount of the carryover available so that the taxpayers do not have to return the refunds.

Finding:

The Phoenix system converted the 2004 estimated payments from the old system (legacy) as part of the 2005 estimated payments which in two instances caused the taxpayers to receive overpayments in the amounts of \$175,307 and \$50,848. One taxpayer returned the \$175,305 overpayment. This payment is to be applied against future liabilities.

Response:

The decision was made prior to implementation of Phoenix that all estimates would be converted to the tax period that was currently due, i.e. 2005. At the time of conversion, taxpayers were submitting returns for 2004 and 2005. This only affected those taxpayers that had not filed 2004 and had available estimated payments for 2004. Taxpayers did not receive any more in refund or any less in refund than they should have.

Corrective Action:

This only resulted in a timing difference because the 2004 estimated payment would generally be applied against the 2004 tax return when filed. Although there may be some who have not filed 2004 returns, we do not anticipate this to be a problem in the future.

Finding:

Two instances were noted in which the taxpayer received an incorrect refund amount for both 2004 and 2005 amended returns. When audit procedures were performed, it was noted that the amount of itemized deductions per the "Schedule A" did not agree with the amount claimed for itemized deductions on the 2004 or 2005 return. After the two returns were recalculated using the itemized deductions per "Schedule A," the taxpayer should have received smaller refunds for both 2004 and 2005.

Response:

The employees that worked these amended returns did not verify the amount of the itemized deductions per the Schedule A attached to the return and allowed the amount shown on the front of the non-resident returns. The taxpayer will be contacted for the return of the overpayment.

Corrective Action:

The taxpayers have been contacted for the return of the overpayment. The amended returns were not initially processed, but they are now in the system being processed. This issue has been addressed to the staff along with other training issues to prevent this from occurring in the future.

Finding:

One instance was noted in which the Phoenix system incorrectly changed the spouse of the taxpayer's capital loss amount from 27,095 to 3,000 (which is the threshold). This error caused the taxpayer to be refunded \$163,925 instead of \$165,130 resulting in a \$1,205 underpayment.

Response:

This incorrect adjustment was due to an edit error that existed in the submission processing.

Corrective Action:

This system problem was subsequently corrected to correctly allow the capital gains to offset the capital losses.

Finding:

One instance was noted in which the 2004 "overpayment to be applied to next year's (2005) estimate" was not approved until after the 2005 refund was issued. This error caused the taxpayer to be paid \$96,046 more than they should have prior to approval of the 2004 estimate.

Response:

We agree with this finding. Although the refund was due to the taxpayer, approval of the payment should have been made before issuing the 2005 refund.

Corrective Action:

The Income Tax Bureau is investigating this issue to determine the cause. There is no evidence of this problem reoccurring.

Finding:

One instance was noted in which the taxpayer's dependent was not picked up by the Phoenix system. It was stated that the error occurred either from the scanner not picking up the dependent or an operator not keying the dependent into the system. This error resulted in a \$56 underpayment. This error was corrected after it was brought to the attention of management.

Response:

We agree with the finding.

Corrective Action Plan:

In order to prevent this error from occurring in the future, effective for 2008 processing, the threshold has been modified by IT so that these errors may be detected prior to posting the return to the account.

Finding:

One instance was noted in which the "Interest Penalty on Early Withdrawal of Savings" in the amount of \$10,210 was not picked up by the Phoenix system which resulted in a \$54 underpayment.

Response:

We agree with the finding. This issue was corrected. The amount of "Interest Penalty on Early Withdrawal of Savings" was inadvertently dropped from the calculation of Total Income on the Non-Resident Return for electronically submitted returns.

Corrective Action Plan:

These fields have been corrected by IT for future periods.

Finding:

One instance was noted in which the Phoenix system did not pick up the taxpayer's itemized deductions as shown on the "Schedule A" in the amount of \$5,404. Instead, the system used the standard deduction of \$4,600 when calculating the tax resulting in a \$40 underpayment.

Response:

We agree with the audit finding.

Corrective Action:

This error was corrected.

Check Receipts Logs Should Be Maintained

Finding:

During the review of the depositing and processing of cash receipts, it was noted that payments (checks) received in the income and withholding, sales, and miscellaneous divisions are not logged in and restrictively endorsed payable to the Tax Commission. It was stated in the auditor's report that the Tax Commission should implement controls or procedures to ensure that cash receipts received in the divisions are safeguarded while being processed in these divisions. Also, the Tax Commission should establish a reasonable monetary threshold for the checks that can be logged.

Response:

Due to the large volume of checks received in each tax area, it is inefficient for the areas to maintain a log of checks received. It would create a significant time delay in getting the checks to the Processing Bureau and ultimately to the bank for deposit. Currently, any check greater than \$50,000 received in Income Tax is immediately taken to Processing. Checks received in the Miscellaneous Tax Bureau are taken to the Processing Division twice daily and are not maintained in the area. In the Sales Tax Bureau, any check greater than \$100,000 is taken to the Processing Division immediately and all other checks received are taken in a timely manner.

Corrective Action:

We are actively working on internet filing/payment for the various taxes. In the month of April 2008, about 70% of all withholding, petroleum, and sales/use payments and associated tax returns were electronically transmitted. We expect these percentages to increase in future periods. The Tax Commission is working on providing internet filing/payment for other taxes as well. Converting to electronic payment will eliminate this problem.

OTHER CONTROL DEFICIENCIES

Procedures over Processing Individual Income Tax Refunds Should Be Strengthened

Finding:

There are four instances in which refunds were issued twice to taxpayers out of legacy system resulting in a total of \$6,258 in overpayments to taxpayers.

Response:

All four instances were due to credit advices and returns posting within several days of each other. These instances are related to the old legacy system and not the new Phoenix system. Phoenix is designed to prevent duplication of refunds.

Corrective Action:

All four instances have been assessed and two have been paid. The remaining two liabilities will be offset by any potential future refunds until paid in full. There were no problems noted from our current processing system.

Finding:

In one instance, a refund was issued twice (once from the legacy system and once again from the Phoenix system) which resulted in a \$949 overpayment.

Response:

The refund was issued on a credit advice during the last days of processing in the legacy system. The same return was in the processing queue for the Phoenix system when the Phoenix system went live. These errors were created during the conversion from the old legacy system to the new Phoenix system.

Corrective Action:

The duplicate refund has been assessed and paid in full. No problems were noted after the conversion in Phoenix.

Finding:

In another instance, a refund was issued and later reversed due to the taxpayer not sending in W2 info, and reissued when the W2 info was received. Both refunds were sent to the taxpayer and both were cashed/deposited resulting in an overpayment of \$3,104.

Response:

The ability to reverse a paid refund by agency personnel other than those in Accounting has been addressed.

Corrective Action:

The IT Bureau has removed the Income Tax Bureau personnel's authority to reverse refunds. Currently, only the Accounting Bureau's has authorization to reverse refunds. The taxpayer will be contacted for the return of the refund issued in error.

Finding:

Another instance is where a 2004 return was processed as the 2005 return, and the 2005 return had already been processed.

Response:

The taxpayer's refund for 2004 should have been \$310 and not \$874 (which is the refund amount for the 2005 return). One of the employees in the Income Tax Bureau initially processed the 2005 return and later erroneously processed 2004 return as the 2005 return.

Corrective Action:

A letter was sent to the taxpayer assessing the difference.

Returned Income Tax Refund Checks should be properly secured

Finding:

During the review process of the returned checks, it was noted that three file cabinet drawers had returned refund checks that had not been logged into the system. These file cabinet drawers are unlocked throughout the day and can be accessed by authorized and unauthorized personnel. Leaving the file cabinet open throughout the day allows authorized and unauthorized personnel access to the checks and could result in theft or loss of logged and/or unlogged checks.

Response:

The returned checks are kept in two filing cabinets located immediately outside one of the employees' cubical wall. These filing cabinets are open during normal working hours but are locked after hours. All employees in the Individual Income Tax Bureau need access to the cabinets during working hours in order to accomplish their job duties. Many of the phone calls received in the phone queue are due to returned refund checks.

Corrective Action:

We have considered the recommendations to secure and lock the cabinets at all times but find this process to be excessively cumbersome on the employees. The two employees that have primary responsibility for refund checks are constantly in the filing cabinets and having to unlock the cabinets each time would prohibit them from performing their job duties in a timely and efficient manner.

Controls over Sales Tax Journal Entries Should Be Strengthened

Finding:

A journal entry was incorrectly prepared using \$3 instead of \$300 as the discount which caused the tax payment amount recorded in the system to be increased by \$297.

Response:

In a "\$" type batch of journal entries, this entry occurred in regards to the 2% discount amount. The \$300 discount was incorrectly entered as \$3. Because both sides of the data entry amounts were \$3, the system did not reject the item. The city diversion was entered correctly on the JE.

Corrective Action:

A JE to address the \$297 balance has been processed of as 8/17/07 correcting this processing error. This issue will be addressed to the staff along with other training issues to prevent this from occurring in the future.

Finding:

A JE was incorrectly prepared using the net tax due, after consideration of the discount, as the gross tax. The discount was then erroneously applied again, which caused the tax payment amount recorded in the system to be reduced by \$1450.

Response:

In a "\$" type batch of JEs, the JE was large enough to be split in two JEs. This error of two JEs is really one issue. The preparer listed the net tax due as gross tax, and took the discount out again. However, the taxpayer was paying

two locations on a single location and only taking a single \$50 discount per payment. Therefore, the JE should have transferred gross tax instead of net tax due.

Corrective Action:

This JE was corrected and processed on 8/17/07. The correction was split in two JEs (in the same manner as the erroneous JEs). This issue will be addressed to the staff along with other training issues to prevent this from occurring in the future.

Finding:

Two returns from a taxpayer were keypunched multiple times by the processing department. One payment was deducted twice for the same period in the amount of \$100,795 resulting in an error of \$100,795. Another payment was deducted three times for the same tax period in the amount of \$104,713 resulting in an error of \$209,426. These errors caused the tax payments amounts recorded in the system to be increased by \$310,221.

Response:

We agree with the findings.

Corrective Action:

This issue has been addressed with the supervisory review of JEs and will be included within the approval process. Also, this issue has been addressed to the staff along with other training issues to prevent this from occurring in the future.

Controls over Abatement of Sales Tax Penalties Should Be Strengthened

Finding:

A personal computer system (FoxPro) was used to manually enter information and generate tax due letters. It was noted that when a penalty was abated, there was no documentation in the system of the reason for the abatement or the identity of personnel who made the decision. The system maintained a "letter history for account" which indicates abatement was made but did not provide the amount or the identity of the employee who worked on the account. The Tax Commission's policy states that supervisory approval should be obtained for abatements over \$5,000 made within the sales tax division, and should be scanned into the MSTC Document Archives System (MDA).

Response:

The current FoxPro system used for our assessment does not document the origin of the item "deleted" from the system as the result of abating or canceling a penalty or additional tax assessment. Currently we have supervisor approval for abatements over \$5,000 which is manually done and no cumulative list of abatement or cancellation actions is generated by the FoxPro system such as the STARS (withholding tax) and the Phoenix (income tax) systems. The sales tax abatements are manually scanned into MDA as a reference document to support the action. The identity of the employee requesting the action and the supervisor are noted in the scanned documentation.

Corrective Action:

An investigation was conducted by our IT department to review available options in our FoxPro system in regards to generating cumulative lists of abatement or cancellation actions such as STARS and Phoenix generate. It was concluded that the FoxPro system does not have the capabilities nor would it be feasible to generate such reports using the FoxPro system. The IT department is searching for means to generate these reports from programs that we may acquire in the future.

Finding:

There are no listing of abatements generated for management review. It was noted the withholding tax division utilizes such a printout which provides a tool for management's use in tracking the occurrence of penalty abatements.

Response:

We agree with the audit finding.

Corrective Action:

As stated above, an investigation was conducted by our IT department to review available options in our FoxPro system in regards to generating cumulative lists of abatement or cancellation actions such as STARS and Phoenix generate. It was concluded that the FoxPro system does not have the capabilities nor would it be feasible to generate such reports using the FoxPro system. The IT department is searching for means to generate these reports from programs that we may acquire in the future.

IMMATERIAL NONCOMPLIANCE

State Laws and Agency Policies Concerning Delinquent Sales Taxes Should Be Followed

Finding:

A taxpayer's December 2006 payment in the amount of \$278 less a discount of \$6 was not posted until the end of February 2007. This taxpayer was at the 50% penalty stage. No penalty was assessed and the discount was improperly allowed on the payment. The total error amount for the taxpayer was the \$139 penalty plus the \$6 discount. No penalty was assessed and no abatement was noted in MDA.

Response:

We agree with this audit finding.

Corrective Action:

We have assessed penalty on this account. This issue will be addressed to the staff along with other training issues to prevent this from occurring in the future.

Finding:

A taxpayer's September 2006 and January 2007 sales taxes were paid after the due date. This taxpayer was at the 50% penalty stage. The September 2006 payment in the amount of \$3,309 less the \$50 discount and a \$72 tax credit was paid in November 2006. No penalty was assessed and the discount was improperly allowed which resulted in an error in the amount of \$1,669. The January 2007 payment in the amount of \$2,617 less the \$50 discount and a \$10 tax credit was paid in May 2007. The penalty was paid but the discount was improperly allowed which resulted

in an error of \$75. The total error amount for this taxpayer was \$1,744. This taxpayer had a delinquent period for which there was no penalty assessment or abatement.

Response:

We agree with the finding.

Corrective Action:

The two periods noted in the audit finding have been assessed and paid by the taxpayer. This issue will be addressed to the staff along with other training issues to prevent this from occurring in the future.

Finding:

A taxpayer made ten tax period payments totaling \$22,203 for the tax periods ranging from August 2005 to May 2006 in September 2006. This taxpayer was at the 50% penalty stage and should have been assessed a penalty in the amount of \$11,102. No penalties were assessed. This single payment for multiple periods was not penalized and no abatement was noted in MDA.

Response:

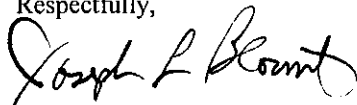
We agree with this finding. There were no references made to the circumstances involving Hurricane Katrina, and the affected district office gave approval to assess the penalty due. Penalty has now been assessed on this item in the amount of \$11,101.50.

Corrective Action:

The process for Post Audit to assess penalties and additional tax is to be reviewed with the staff to prevent items such as these from being missed.

Our staff is available to furnish any additional information requested or further details concerning this audit of our financial statements and the implementation of suggested changes.

Respectfully,

A handwritten signature in black ink, appearing to read "Joseph L. Blount". The signature is fluid and cursive, with the first name "Joseph" and last name "Blount" clearly distinguishable.

Joseph L. Blount, Chairman
And Commissioner of Revenue