



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

March 2, 2017

Financial Audit Management Report

Herb Frierson, Commissioner of Revenue
Mississippi Department of Revenue
500 Clinton Center Drive
Clinton, Mississippi 39056

Dear Commissioner Frierson:

Enclosed for your review are the financial audit findings for the Mississippi Department of Revenue for the Fiscal Year 2016. In these findings, the Auditor's Office recommends the Mississippi Department of Revenue:

1. Strengthen controls over adjustments to taxpayer accounts;
2. Ensure supporting schedules for GAAP Packets are completed timely and accurately;
3. Strengthen controls over the reconciliation of Alcohol Beverage Control taxes; and,
4. Strengthen controls over vulnerability management, software obsolescence and IT security.

Please review the recommendations and submit a plan to implement them by March 16, 2017. 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.

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,

A handwritten signature in blue ink, reading "Stephanie C. Palmertree", is located below the "Sincerely," text.

Stephanie C. Palmertree, CPA, CGMA
Director, Financial Audit and Compliance Division
Enclosure

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, 2016. These financial statements will be 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 Thomas Wirt, CPA, Deanna White, CPA, David Ashley, CISA, Selena Davis, CPA, Jeremy Miller, CPA, Virginia Anderson, Brianna Blair, Veronica Funchess, Kortney Gaddy, Emily Mathis, Carrie Middleton, Vincent Steiner, Elevia Tate, Leigh Taylor, CPA, and Steve Wimberley, 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 preceding paragraph 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, as described in the following paragraphs, we identified certain deficiencies in internal controls that we consider to be material weaknesses and 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 deficiency identified in this letter as item 2016-005 to be a material weakness.

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 2016-006 and 2016-007 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 item 16-02.

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*.

Findings and Recommendations

Material Weakness

2016-005 Controls Should Be Strengthened over Adjustments to Taxpayer Accounts

Repeat Finding	Yes, 2015-016
Criteria	Good internal controls require a supervisory approval of significant and unusual adjustments made to taxpayer trial balances. The approval should be performed in a timely manner and adequately documented to identify the date of the approval.
Condition	The Mississippi Automated Revenue System (MARS) has security function levels that allow the capacity to perform certain types of activity within the system. Of the 602 users with access to MARS, 492 users with security function level 2702, or 82 percent, have the capability to change, transfer and reverse returns in the MARS system without another user interacting with the transaction. This function relates to manually clearing computer edit exceptions during the submission of tax returns in order to initially post the returns in the system, which is a fundamental job responsibility of many DOR employees who work return exceptions from work list queues tailored specifically for the employee. However, the function also allows return changes to be entered after the initial posting of a return, which results in a new system version of a return being created and posted to taxpayer account trial balances, without requiring any approval from another MARS user. The agency created a computer change request during fiscal year 2015 in response to this similar prior year finding in order for electronic MARS notifications to be sent to supervisors/managers when return change transactions greater than \$5,000 are made after the original return posting (i.e., amendments). However, per review of the computer change request and discussion with agency personnel, this change was not implemented during fiscal year 2016.
Cause	Unknown
Effect	Failure to require a supervisory review and approval of significant and unusual adjustments to taxpayer account balances could result in errors or fraud occurring and not being timely detected, which could result in misstatements to the agency's financial statements.
Recommendation	We recommend the Mississippi Department of Revenue strengthen controls over adjustments to taxpayer accounts by ensuring significant and unusual adjustments in the Mississippi Automated Revenue System are approved by appropriate management personnel. The approval should be documented for internal monitoring and audit purposes.

Significant Deficiencies

2016-006 GAAP Packet Supporting Schedules Should Be Completed in a Timely and Accurate Manner

Repeat Finding Yes, 2015-018

Criteria Section 27.104.4, Miss. Code Ann. (1972) requires each state agency to prepare annual financial statements at such times as determined by the State Fiscal Officer. The State Fiscal Officer is required to combine the financial statements into a comprehensive annual financial report (CAFR) and provide it to the State Auditor for post auditing. The law further requires the CAFR be published within six months after the June 30th close of the fiscal year. In addition, the Government Finance Officers Association (GFOA) requires CAFRs to be submitted within six months of the government's fiscal year end in order to be awarded a Certificate of Achievement for Excellence in Financial Reporting. It should be noted that the Department of Finance and Administration obtained an extension for the CAFR from GFOA this year due to the implementation of the Mississippi Accountability System for Government Information and Collaboration (MAGIC), the accounting system used by the State, in fiscal year 2015.

Condition The Mississippi Department of Revenue (DOR) prepares a schedule of *Un-transferred Tax Collections and Receivables* as of fiscal year end and provides the schedule annually to the Office of the State Treasurer (OST) in order for OST to compile the GAAP Packet for the Treasury Clearing Fund 3917100000 (9171). DOR did not perform a timely preparation of this schedule; and therefore, OST did not timely prepare the 9171 GAAP Packet. The final version of the schedule was submitted to OST on October 27, 2016 and the 9171 GAAP Packet was submitted by OST to the Department of Finance and Administration (DFA) on November 15, 2016. GAAP reporting packets were due to DFA by September 9, 2016 with OST receiving an extension to submit the 9171 GAAP packet by October 17, 2016.

In addition, based on testwork performed over the 9171 GAAP Packet, the following adjustments were made by auditor:

- 'Accounts Payable' was reclassified to 'Income Tax Refunds Payable' in the amount of \$46,632,657 to account for the income tax refund reserve balance at fiscal year-end. Income tax refunds payable is discreetly presented as a liability on the governmental funds balance sheet in the CAFR.
- 'Unearned revenue' was reclassified to a 'Due to Other Funds' liability account for \$5,570,000 in order to match the similar 'Due from Other Funds' accrued by the Department of Wildlife, Fisheries & Parks for petroleum taxes transferred by DOR in July annually.
- 'Other Taxes Receivable' and 'Gaming Fees' were increased by \$1,544,470 to correct the amounts queried by the Mississippi Automated Revenue System for gaming collections received after fiscal year end for filing periods lapsing prior to fiscal year end.

Cause Unknown

Effect The failure of agency personnel to submit required accounting schedules to the OST in a timely manner prevents the timely submission of the 3917100000 GAAP

packet to DFA and hinders the efficiency of the audit. These delays contributed in the CAFR not being published in accordance with state law and could result in the State of Mississippi not being awarded a Certificate of Achievement for Excellence in Financial Reporting by GFOA. Receiving GFOA's certificate increases the likelihood that credit agencies or other stakeholders may consider the state's financial statements in a positive manner. The timeliness of the CAFR being published impacts its relevance to various users of the CAFR. In addition, the Single Audit Act requires the State issue the Single Audit Report within nine months of fiscal year end, and no extensions are granted. The independent auditor's report on internal control over financial reporting and the schedule of expenditures of federal awards (SEFA) are both required to be included in the Single Audit Report and both are an integral part of the financial audit of the State. The failure to timely complete the CAFR could also hinder the timely submission of the Single Audit Report which could result in federal discretionary drawdowns being suspended.

Additionally, failure to properly classify payables in fiscal year 2016 resulted in a material misstatement that was corrected by audit via adjusting entries.

Recommendation We recommend the Mississippi Department of Revenue implement procedures to ensure the timely and accurate completion and submission of GAAP packet supporting schedules related to treasury fund 3917100000 to the Office of the State Treasurer in order to help ensure the CAFR and Single Audit Report are both published in accordance with state and federal law.

Furthermore, we recommend the Mississippi Department of Revenue thoroughly review payable transactions to ensure proper classification.

2016-007 Controls Should Be Strengthened over the Reconciliation of Alcohol Beverage Control Taxes

Repeat Finding No

Criteria The Miss. Code Ann. (1972) dictates distribution of state tax collections. Good internal controls dictates an automated system should be reconciled to ensure files created by the system agree with agency records and the state general ledger system.

Condition Alcohol Beverage Control (ABC) taxes were converted into the Mississippi Automated Revenue System (MARS) in October of 2015 during fiscal year 2016. MARS replaced the former method of diverting tax collections to a computer automated process. Through observations and discussions with management, it appears that MARS has been tested by the Department of Revenue (DOR) and the MARS developer to ensure the system is properly programmed to automate tax diversions based on specific tax laws as included in the Miss. Code Ann. (1972).

Since the implementation of ABC taxes into MARS, DOR has not performed a routine reconciliation between diversions files created by MARS to DOR's transfer records and balances recorded in the Mississippi Accountability System for Government Information and Collaboration (MAGIC).

Based on testwork performed, we noted liquor tax revenue had an ending debit balance of \$3,025,624 in the ABC Revolving Fund 3389500000. Unless specific

instances dictate otherwise, accounting principles dictate that revenue accounts should not have debit balances. The amount was corrected by audit via an adjusting entry to remove the debit balance to liquor tax revenue.

Cause	The agency does not currently have a reconciliation process between agency records, MARS, and MAGIC balances.
Effect	Failure to reconcile files created by the Mississippi Automated Revenue System to agency records and the Mississippi Accountability System for Government Information and Collaboration could result in misstatements to the State's financial statements. Failure to properly reconcile revenue in fiscal year 2016 resulted in a misstatement that was corrected by audit via an adjusting entry.
Recommendation	We recommend the Mississippi Department of Revenue strengthen controls over the diversion of Alcohol Beverage Control tax collections. Reconciliations should be routinely performed over diversion files created by the Mississippi Automated Revenue System and agency's transfer records for taxes and balances recorded in the Mississippi Accountability System for Government Information and Collaboration.

OTHER CONTROL DEFICIENCIES

OTH 16-02 Controls over Vulnerability Management, Software Obsolescence and Security should be Strengthened

Repeat Finding No

Criteria *The Internal Control - Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) specifies that a satisfactory control environment is only effective when information and communication is reliable and accurate. An important aspect of accurate information and communication is that information technology ensures reliable communication and management.

Condition During our review of the Information Technology General Controls (ITGC) of the Mississippi Department of Revenue (DOR), we noted that outside information security assessments performed (one in Fiscal Year 2015 and one in Fiscal Year 2016) noted significant deficiencies in the obsolescence, security, and vulnerabilities of certain IT systems. Additionally we noted that Management was aware of the deficiencies and did not take timely corrective action to address these issues.

Cause Unknown

Effect Failure to properly correct or manage these vulnerabilities could result in the compromise of the confidentiality, integrity and reliability of data generated by the Mississippi Department of Revenue.

Recommendation We recommend the Mississippi Department of Revenue strengthen controls over software obsolescence, security and vulnerability management to ensure that areas of concern are noted and timely corrected.

End of Report



— DEPARTMENT OF —
REVENUE
STATE OF MISSISSIPPI

Office of the Commissioner

March 15, 2017

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 Department of Revenue for the Fiscal Year ended June 30, 2016, we offer the following comments:

2016-005 Controls Should be Strengthened Over Adjustments to Taxpayer Accounts

Response:

We agree. MDOR went through a system upgrade from Version 9 to Version 10 of MARS at the end of FY2016. The work required for the upgrade was significant and slowed down our progress on any requests for changes to be made to the system. MDOR recognizes the importance of good internal controls and the potential impact on financial statements when those are not in place.

Corrective Action:

The system notification to monitor these types of adjustments has been developed and is now in testing. It will be in place prior to the end of Fiscal Year 2017.

Name: Jennifer Wentworth
Date: 3/15/17

2016-006 GAAP Packet Supporting Schedules Should Be Completed in a Timely and Accurate Manner

Response:

We agree somewhat. However, it is important to note that it takes a significant amount of time to reconcile the information used to create the GAAP supporting schedules. DOR is not willing to sacrifice accuracy in order to compile the schedules earlier.

Corrective Action:

DOR has reviewed the procedures followed to compile the schedules and believes that complete and accurate information can be provided to the Treasury no earlier than October 1 of each year based on the current requirements. DOR is more than willing to participate in a joint meeting with DFA, Treasury and

Stacey Pickering, State Auditor
March 15, 2017
Financial Audit Findings
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the Auditor's Office to review the process and requirements for the schedules in order to attempt an earlier completion date, if that is possible.

Name: Jennifer Wentworth
Date: 3/15/17

2016-007 Controls Should Be Strengthened Over the Reconciliation of Alcohol Beverage Control Taxes

Response:

We agree. MDOR recognizes the importance of good internal controls and the potential impact on financial statements when those are not in place.

Corrective Action:

The DOR Accounting department has developed a process to reconcile the ending un-transferred collections balances for ABC tax collections. Those reconciliations are currently being performed and will be reviewed by management. We are using a similar process to the one developed for all the other MARS tax types.

Name: Jennifer Wentworth
Date: 3/15/17

If there any questions concerning these responses, please contact Jennifer Wentworth at Jennifer.Wentworth@dor.ms.gov.

Respectfully,



Herb Frierson,
Commissioner of Revenue



— DEPARTMENT OF —
REVENUE
STATE OF MISSISSIPPI

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March 15, 2017

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 Department of Revenue for the Fiscal Year ended June 30, 2016, we offer the following comments:

Controls over Vulnerability Management, Software Obsolescence and Security should be Strengthened

Response:

The DOR domain was compromised during the penetration test and vulnerability scan due to the null session issue on the domain controllers. It is important to note that our system was not compromised or vulnerable from outside the network. The compromise was accomplished only after the vendor performing our testing was allowed into our building, in DOR secured space, and provided an active port into our network, with the specific expectation that they would be attempting to find vulnerabilities. That distinction is important and was not made in the summary document. While it does not nullify the vulnerability, we feel it does reduce its significance.

Corrective Action:

DOR has worked over the last year to move any important data from the legacy applications into a format suitable for MARS searches in order to remediate the vulnerability. Two of those applications were completed in the last 6 months and the servers decommissioned, and the last legacy application move is slated to be completed in April 2017.

Name: Jennifer Wentworth
Date: 3/15/17

If there any questions concerning these responses, please contact Jennifer Wentworth at Jennifer.Wentworth@dor.ms.gov.

Respectfully,

Herb Frierson,
Commissioner of Revenue