



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

February 5, 2018

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 2017. In these findings, the Auditor's Office recommends the Mississippi Department of Revenue:

1. Strengthen controls over adjustments to taxpayer accounts;
2. Strengthen controls over the reconciliation of Alcohol Beverage Control (ABC) taxes;
3. Strengthen controls over accrued compensated absences;
4. Strengthen controls over the documentation of ABC Inventory; and
5. Strengthen controls over the calculation Telecommunication Ad Valorem Tax Subsidy payments.

Please review the recommendations and submit a plan to implement them by February 28, 2018. The enclosed findings contain more information about our recommendations.

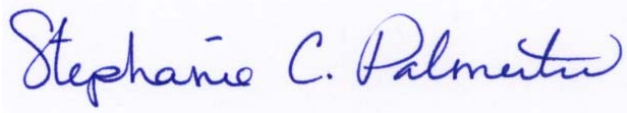
During future engagements, we may review the findings in this management report to ensure procedures have been initiated to address these findings.

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 that reads "Stephanie C. Palmertree". The signature is written in a cursive, flowing style.

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, 2017. 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 Deanna White, CPA, Thomas Wirt, CPA, David Ashley, CISA, Selena Davis, CPA, Jeremy Miller, CPA, Virginia Anderson, Veronica Funchess, Kortney Gaddy, Shavonda Lott, Emily Mathis, Carrie Middleton, 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 2017-011 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 2017-012 and 2017-013 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 OTH 17-01 and OTH 17-02.

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*. However, we noted certain immaterial instances of noncompliance that require the attention of management. These matters are noted under the heading **OTHER CONTROL DEFICIENCIES AND IMMATERIAL NONCOMPLIANCE AND OTHER MATTERS**.

MATERIAL WEAKNESS

Findings and Recommendations

2017-011	<u>Controls Should Be Strengthened over Adjustments to Taxpayer Accounts.</u>
Repeat Finding	Yes, 2015-016 and 2016-005
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 600 users with access to MARS, 489 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 2017.
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

Findings and Recommendations

2017-012 Controls Should Be Strengthened over the Reconciliation of Alcohol Beverage Control Taxes.

Repeat Finding Yes, 2016-007

Criteria *The Mississippi Code Annotated (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 documented 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 over the Fund 3389500000 GAAP Packet, the following adjustments were made by auditor:

- 'Sales' account was debited for \$5,298,891 and 'Liquor Tax' was credited by the same amount to correct the reversing credit entry to Sales during fiscal year 2017. 'Sales' instead of 'Liquor Tax' was erroneously debited during an accrual entry for fiscal year 2016. The entry reversed in fiscal year 2017 and resulted in an over-statement of Sales revenue.
- 'Sales' was credited for \$1,405,695; 'Liquor Tax' was credited for \$544,116; 'Accrued Taxes Payable' was credited for \$136,402; 'Unearned Revenue' was debited for \$2,086,213. These entries were made to recognize MARS revenue in MAGIC for transactions that occurred on June 28, 2017.

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 2017 resulted in misstatements that were corrected by audit via adjusting entries.

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.

2017-013 Controls Over Accrued Compensated Absence Should Be Strengthened

Repeat Finding No

Criteria Good internal controls require that employee leave recorded in the Statewide Personnel and Human Resource System (SPAHRs) be reviewed by agency personnel to ensure that leave slips are in agreement with leave that is entered in SPAHRs. In addition, good internal control requires that the agency should periodically ensure that the agency's records of employee leave balances are also in agreement with DFA's Accrued Compensated Absence Report.

Condition During our review of accrued compensated absences, we noted five instances in which the total hours taken per the employee leave slips did not match the hours taken on the SPAHRs browse leave report. Our testwork also revealed that the agency does not reconcile their internal employee leave balance records to DFA's employee leave balance.

Cause Unknown

Effect Failure to timely update employee leave balances and conduct a reconciliation to DFA's Accrued Compensated Absence Report could result in a misstatement of the accrued compensated absences liability balance for GAAP financial reporting and could yield an incorrect available leave balances for employees.

Recommendation We recommend that the Mississippi Department of Revenue strengthen internal controls related to their personal leave policies and procedures. This should include establishing a process to ensure leave is timely reported in SPAHRs to allow for accurate available leave balances. The agency should also establish procedures for reconciling their internal employee leave records to DFA's Accrued Compensated Absence Report to ensure that the accrued compensated leave liability balance for GAAP financial reporting purposes is properly stated.

OTHER CONTROL DEFICIENCIES AND IMMATERIAL NONCOMPLIANCE AND OTHER MATTERS

Findings and Recommendation

Other Control Deficiency

OTH 17-01 Controls Should Be Strengthened over ABC Inventory

Repeat Finding No

Criteria	Good internal controls provide for proper documentation of inventory count records and documentation of inventory adjustments in MARS.
Condition	Based on Inventory testwork performed for ABC Revolving Fund 3389500000, for two (2) instances out of ten (10) items tested, proper documentation of MARS item totals nor agency count totals were available; therefore, variance calculations of inventory could not be confirmed.
Cause	Unknown
Effect	Failure to maintain adequate internal controls over Inventory could allow errors or fraud to occur without being promptly detected.
Recommendation	We recommend the Mississippi Department of Revenue – Division of Alcoholic Beverage Control keep accurate and complete records of inventory counts including documentation of the MARS inventory count totals and agency count totals.

***Other Control Deficiency
Immaterial Noncompliance***

Note: This item (OTH 17-02) is not considered to have a material affect on the financial statements and therefore will not be reported in the YellowBook.

OTH 17-02	<u>Controls Over the Calculation of the Telecommunications Ad Valorem Tax Subsidy Payments Should be Strengthened</u>
Repeat Finding	No
Criteria	<i>Section 27-38-3 and Section 27-38-5, Miss. Code Ann. (1972)</i> requires the Mississippi Department of Revenue to issue a refund to telecommunication companies who meet certain requirements, Further, good internal controls should be in place to ensure that the refund payments are properly calculated and proportionally allocated among the eligible telecommunication companies.
Condition	During our review of the telecommunication ad valorem tax subsidy payments, we noted refund payment amounts due to the telecommunication companies were incorrectly calculated and refunded.
Cause	Lack of oversight by agency personnel.
Effect	Failure to perform an adequate supervisory review to ensure the refund payments are properly calculated could result in misallocation of funds.
Recommendation	We recommend the Mississippi Department of Revenue strengthen controls related to telecommunication ad valorem tax subsidy payments to ensure all refund payments are distributed properly based upon funds available and eligible claims submitted by the telecommunication companies.

End of Report