

Audit Report

State Department of Assessments and Taxation

February 2018



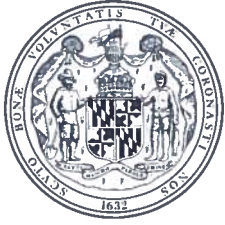
OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

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Legislative Auditor

February 22, 2018

Senator Craig J. Zucker, Co-Chair, Joint Audit Committee
Delegate C. William Frick, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the State Department of Assessments and Taxation (DAT) for the period beginning July 30, 2012 and ending November 11, 2015. DAT is responsible for administering the State's real and personal property tax laws, including various programs that provide property tax credits to homeowners and renters, as well as for administering various functions applicable to corporations.

Our audit disclosed that DAT did not conduct physical exterior inspections of all properties every three years as required by State law. Due to staffing limitations, inspections had been conducted for only 41 percent of the residential properties requiring an inspection during the 2015 assessment year. DAT made certain efforts to use an alternative approach to meet the inspection requirement but these efforts were ultimately unsuccessful. The total assessable real property tax base was valued at approximately \$714 billion as of July 1, 2017.

Our audit also disclosed that required supervisory reviews of property reassessments by the local office supervisors were not always performed and documented at the two local offices we reviewed that accounted for 25 percent of the State's assessable properties. These offices also lacked documentation that the local office supervisors had reviewed properties owned by employees in the local offices to ensure they did not modify their own accounts. Furthermore, DAT did not institute proper controls over the receipt and recording of certain real property data to ensure that the real property records were complete and accurate.

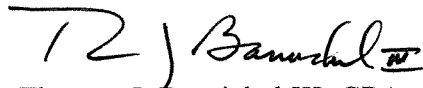
DAT also had not performed timely and comprehensive procedures to verify the accuracy of information on personal property returns and applications for certain tax credits. For example, DAT did not effectively use various automated reports

it created to help identify improper homestead property tax credits for review and follow-up. DAT also had not performed timely and comprehensive verifications to help ensure the accuracy of homeowners' tax credits (which totaled \$58.4 million in fiscal year 2016) or verify the propriety of credits redeemed by homeowners and the related reimbursement amounts requested by local jurisdictions.

Furthermore, we noted a number of deficiencies with DAT's security and control over its information systems and network. For example, DAT's procedures for logging and monitoring critical database and mainframe security events were not sufficient. In addition, intrusion detection prevention system protection did not exist for untrusted traffic entering the DAT network, and numerous DAT workstations were running an outdated and unsupported operating system. Finally, DAT had certain internal deficiencies relating to the processing of cash receipts.

The DAT's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by the DAT.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "TJ Barnickel III". The signature is written in a cursive style with a horizontal line above the first few letters.

Thomas J. Barnickel III, CPA
Legislative Auditor

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* Denotes item repeated in full or part from preceding audit report

Background Information

Agency Responsibilities

The State Department of Assessments and Taxation (DAT) is responsible for administering the State's real and personal property tax laws and various functions applicable to corporations (for example, issuing corporate charters and collecting certain taxes, such as gross receipts tax). DAT also administers programs that provide property tax credits primarily to homeowners and renters who meet the related eligibility requirements (such as, gross income limitations). DAT's headquarters is located in Baltimore City and assessment and taxation offices are located in each of the State's 24 local subdivisions.

According to the State's and DAT's accounting records, during fiscal year 2016, DAT's expenditures totaled approximately \$140.5 million and revenue collected totaled \$273.2 million. DAT's records for tax year beginning July 1, 2017, identified the total assessable real property tax base subject to State tax rates to be valued at \$714 billion, consisting of 2,324,960 individual properties.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the 11 findings contained in our preceding fiscal compliance audit report dated December 16, 2013. We determined that DAT satisfactorily addressed 6 of the findings. The remaining 5 findings are repeated in this report.

Our audit also included a review to determine the status of the seven findings contained in our performance audit report dated February 28, 2013, entitled *Department of Assessments and Taxation - Homestead Property Tax Credits*. We determined that DAT satisfactorily addressed six of these findings. The remaining finding is repeated in this report.

Findings and Recommendations

Real Property Assessments

Background

Under the provisions of the Tax-Property Article of the Annotated Code of Maryland, the Department of Assessments and Taxation (DAT) is responsible for uniformly assessing real property throughout Maryland at market value. Specifically, DAT is responsible for assessing real property on a three-year cycle based on an exterior physical inspection of the property in accordance with Title 8 of the Tax-Property Article. DAT maintains an Assessment and Administration Valuation System (AAVS) as its primary database system, which includes a wide range of information and history about individual properties, including assessed values. According to DAT's records for tax year beginning July 1, 2017, the assessable real property tax base subject to State and local tax rates totaled approximately \$714 billion, applicable to 2,324,960 individual properties.

Property assessments are conducted by assessors working in the 24 local assessment offices, under the DAT's direction and oversight. DAT certifies the assessed value of these properties to the 24 local subdivisions for the properties within each county and Baltimore City and these values are used by these jurisdictions (and municipal governments, when applicable) to prepare property tax bills. During this audit, we reviewed procedures at DAT headquarters and at two local assessment offices, which account for approximately 25 percent of the State's assessable properties.

Finding 1

Physical exterior inspections were not performed for all properties as required by State law.

Analysis

DAT did not perform physical exterior inspections for all properties due for reassessment during the three-year assessment cycle as required by State law. These inspections identify changes to the property that could impact the assessable value used to determine real property taxes. DAT made certain efforts to address this issue, which we commented upon in our preceding audit report, but these efforts were ultimately unsuccessful.

According to DAT's records, only 275,461 of the 676,066 residential real properties (that is, 41 percent) that were to be reassessed during the 2015 assessment year received an inspection of any kind. Specifically, 212,361 of these properties received physical inspections, 27,678 received an aerial review,

and 35,422 were subject to a neighborhood review, which is an assessment based on similar properties in the neighborhood as physically sighted by an assessor. The remaining properties were assessed via other computer-modeling methods, such as comparable property sales.

We were advised by DAT that the required number of physical inspections of properties have not been conducted for many years primarily because of staffing shortages. According to DAT records, 163 field assessors were responsible, as of August 3, 2016, for assessing approximately 2.3 million properties statewide during the three-year cycle. The number of assessors represents an increase of 11 since fiscal year 2012, but remains a reduction from the 230 assessors in 2002. DAT management advised us that, because of the limited number of assessors, physical inspections are generally conducted only when certain significant events occur, such as when a property is sold during the three-year assessment period. In addition, DAT management advised that assessors have historically relied on property sales and permit data received from the local governments to obtain updated property information in AAVS. However, as noted in Finding 3, sufficient controls were not established by DAT to ensure the data were received and properly entered into AAVS.

In response to a similar condition noted in our preceding audit report, DAT implemented a pilot program between November 2014 and January 2015 which involved using oblique aerial imaging for physical exterior inspections in Anne Arundel and Frederick counties. The pilot program resulted in an increase in the assessable base in both counties. For example, approximately \$32 million was added to the assessable base in Anne Arundel County. DAT estimated that the use of oblique aerial imaging for real property assessments across the State should result in increasing the assessable base statewide by as much as \$1.4 billion.

DAT introduced Senate Bill 115 during the 2016 legislative session which would have authorized DAT to use oblique aerial imaging across the State; however, the bill did not pass. Also, in its fiscal year 2017 budget request, DAT included \$2.2 million to extend the pilot project statewide, estimating that total costs would be \$5.6 million over a three-year period. However, because of privacy concerns, the \$2.2 million was removed from the budget allowance; furthermore, the fiscal year 2017 budget bill included language that no budgeted funds may be spent for the acquisition or creation of aerial images to conduct property tax assessments.

Recommendation 1

We recommend that DAT continue efforts to comply with State law that requires all real property in the State to be physically inspected on a triennial basis.

Finding 2

Supervisory reviews of property reassessments by the local office supervisors were not always performed and documented as required at the two local offices we reviewed. Both the local and area supervisors had certified that these reviews had been performed.

Analysis

Supervisory reviews of property reassessments by the local assessment office supervisors were not always performed and documented at the two local offices we reviewed, as required by DAT's quality assurance procedures. Both the local and area supervisors had certified that the supervisory reviews had been performed, raising questions as to whether the required monitoring of local office assessments was properly conducted and such reviews were comprehensive.

During our current audit period, DAT developed reassessment guidelines and a checklist of items to be performed by each of the local office supervisors. For example, the local office supervisor is required to perform annual reviews of 50 residential and 30 commercial reassessments processed by each assessor in their local office, selected at random. The local supervisor is also required to review all properties owned by employees in the local office to ensure the employees did not modify their own accounts. Documentation of monitoring tasks performed is to be maintained and the checklist is to be signed by the local supervisor certifying that each task has been completed. In addition, DAT area supervisors are required to verify that each of the local supervisors conducted the required monitoring and document this verification by signing the aforementioned checklist.

We reviewed two local offices for reassessments that occurred in calendar year 2015 for the 2016 tax year real property assessments. At both local offices, we determined that the required monitoring either was not performed or was not documented. The local supervisor in one office advised us that no reassessment reviews were conducted for the year because the supervisor was unaware of the requirement. For the other office, the supervisors did not document the reviews for certain assessors and did not review the required number of properties for all assessors.

Both local assessment offices also lacked documentation that the local office supervisors had reviewed properties owned by employees in the local office to ensure they did not modify their own accounts. One local office had 21 employees who owned real property, including 3 who had modified their own accounts; these changes did not impact the assessed value of the real property and

we verified the changes appeared proper. The other local office had 7 employees who owned property, none of whom had made changes to their accounts.

For both local offices reviewed, the local and area supervisors had signed the checklists certifying that the aforementioned tasks had been completed for the 2016 tax year real property assessment. As a result, there is a lack of assurance that the required monitoring of local office assessments was conducted and such reviews were sufficiently comprehensive.

Recommendation 2

We recommend that DAT ensure that local supervisors conduct required reviews and that area supervisors only certify these reviews after properly verifying that the reviews were performed.

Finding 3

DAT did not ensure that real property data recorded in AAVS were complete and accurate, and did not document supervisory reviews of assessment appeals and real property exemptions.

Analysis

DAT did not ensure that real property data recorded in AAVS were complete and accurate, and did not document supervisory reviews of assessment appeal decisions and real property exemptions. DAT relies on real property deeds and permit data received from the local governments to obtain updated property information, which is critical to ensuring accurate property valuations.

- At one local office tested, real property deeds and building permit data were manually entered in AAVS based on paper documents received from the local government. Our review disclosed that receiving logs were not prepared to establish initial accountability over the property deeds and building permits as a means to ensure all required documents were subsequently entered into AAVS. In addition, while the accuracy of the recorded property deeds was independently verified, the local office did not establish an independent review process to ensure that building permit data were accurately entered into AAVS. Our review of 10 building permits (5 from an AAVS query and 5 from paper files) disclosed that 2 were not accurately recorded in AAVS because of keying errors. In both instances, the recorded permit amounts were greater than the amounts on the supporting documentation. For example, in one instance, the permit value was recorded as \$7.5 million in AAVS when the value was actually \$750,000. Our review of 10 real property deeds did not disclose any discrepancies.

In addition, an employee in this local office had access capability which allowed the employee to record, change, and delete real property tax exemptions in AAVS, and independent supervisory reviews were not performed to ensure the transactions were properly supported. State law provides property tax exemptions for real property used for certain purposes (such as, charitable, religious, and educational). According to DAT's 2016 annual report, the statewide assessable base of exempt real properties for fiscal year 2016 totaled \$89.3 billion, including \$20.2 billion in this local jurisdiction. Our review of five exempt accounts in this jurisdiction disclosed that the exemptions appeared to be proper based on supporting documentation submitted by the applicants.

- At the other local office tested, property deeds and building permit data were received electronically from the local government and imported into AAVS by DAT headquarters and local office staff. We noted that DAT did not review system-generated reports of permit data that did not successfully import into AAVS, due to an error (such as an incorrect property account number), and take corrective action; as a result, these permits were not recorded in AAVS for consideration during the assessment process. For example, our test of eight permit processing errors reported in March 2016 disclosed that none had been resolved and entered in AAVS as of July 27, 2016. According to DAT records, during the period from November 2014 through May 2016, there were 306 permit processing errors in this local office.
- For both local offices, the supervisory reviews of real property (commercial and residential) appeal decisions recorded in AAVS were not always documented as required by the reassessment procedures. Our review of 10 appeal decisions recorded for calendar years 2014 through 2016 disclosed that 6 had no documented independent supervisory reviews of the appeal decisions recorded by local assessors. For 2 of these accounts, the appeal decisions resulted in decreasing the assessed values by approximately \$329.5 million (from \$360.9 million to \$31.4 million) while the values of the remaining 4 accounts did not change as a result of the appeals.

Similar concerns with the completeness and accuracy of certain critical real property data (real property sales, transfers, and permits) recorded in AAVS were commented upon in our preceding audit report.

Recommendation 3

We recommend that DAT enhance procedures by requiring each local assessment office to

- a. establish initial accountability and control over all property-related documents manually received from local governments, including deeds and permits (repeat);**
- b. resolve building permit processing errors and ensure the permits are subsequently recorded (repeat), and investigate the aforementioned building permit recording and processing errors; and**
- c. ensure that building permit data, property tax exemption transactions, and real property appeal decisions are properly recorded in AAVS based on supervisory review of supporting documentation, and that these verifications are documented (repeat).**

Personal Property Assessments

Background

Annually, DAT certifies the value of business-owned personal property (such as furniture, certain equipment, and inventory) based on returns filed by specific entities (such as corporations, limited liability companies, and partnerships) as prescribed by State law. These entities must file annual personal property returns with DAT by April 15 and must pay a filing fee of \$300 (\$100 under limited circumstances). During fiscal year 2016, according to its records, DAT collected \$84.9 million in personal property filing fees.

Personal property assessed values are certified by DAT and are provided to Maryland's 24 local subdivisions. These jurisdictions (and municipal governments, when applicable) use the assessed values to calculate the taxes and then issue personal property tax bills to the applicable entities. The personal property tax rates, effective as of July 1, 2015, in the 24 local jurisdictions, ranged from 1.8075 percent to 5.62 percent, excluding the 5 jurisdictions with no personal property taxes. According to its records, as of April 30, 2016, DAT had processed 323,033 accounts related to the filing of personal property returns for the calendar year ended 2014, providing the local jurisdictions with a personal property assessable tax base of \$12 billion.

Finding 4

DAT did not use available information to identify entities that failed to register or file a personal property return and did not review and approve exemptions from personal property assessments that were granted by DAT employees. DAT also did not pursue late filing penalties in accordance with State regulations and waived or reduced penalty fees without any independent review and approval.

Analysis

DAT did not use available information from the Comptroller of Maryland to identify entities doing business in Maryland that failed to register and file a personal property return and did not review and approve exemptions from personal property assessments that were granted by DAT employees. DAT also did not pursue delinquent personal property return filing penalty accounts in accordance with State regulations and waived or reduced penalty fees totaling \$499,201 during the audit period without any independent review and approval.

- DAT did not use available information to identify entities that failed to register with DAT and file a personal property return. For example, DAT did not review Comptroller of Maryland records of entities receiving payments from the State and/or with active sales tax accounts to identify non-registered entities that were conducting business in the State. As of March 30, 2016, DAT had only reviewed the Comptroller of Maryland information for calendar year 2013 activity for domestic entities (formed in Maryland) in 10 of the 24 jurisdictions, and had only reviewed calendar year 2014 information for one jurisdiction. Four jurisdictions had not been subject to any such review since calendar year 2005. DAT sent questionnaires to 1,492 entities during its review of calendar year 2013 activity, which resulted in an increase to the personal property assessable tax base of approximately \$675,000 for 116 entities.
- DAT did not review and approve exemptions from personal property assessments that were awarded to certain entities. According to DAT records, as of November 7, 2016, approximately 54,800 entities were exempted from personal property assessments, including approximately 4,700 that were processed during our audit period. State law exempts certain entities (such as non-profit organizations) from filing fees, assessments, and taxation when submitting annual personal property returns. Our review disclosed that 151 DAT employees had the capability to process exemptions without any independent review and approval. DAT did not generate output reports of new exemptions granted for review, nor did it have a process to periodically ensure existing exemptions were still valid. Our review of 20 current

exemptions disclosed that they appeared proper based on available information.

- DAT did not pursue the collection of personal property filing penalties at the required intervals and did not refer unpaid penalties to the State's Central Collection Unit (CCU), as required. Penalties are calculated when personal property returns are filed late and are generally a percentage of the county assessment, plus interest (with the initial penalty ranging from \$30 to \$500). DAT management advised us that only two demands for payment are made – one initial demand and another approximately 18 months after the filing deadline. In addition, according to DAT records, as of March 10, 2016, there were 3,343 accounts totaling \$257,467 that had been delinquent for 3 to 131 months that had not been referred to CCU. State regulations require three written demands for payment be made at 30-day intervals after which the account is to be sent to CCU. The failure to pursue delinquent accounts decreases the chances of collecting the funds.

DAT also reduced or waived 4,221 penalties totaling \$551,685 during the audit period of which 3,543 totaling \$499,201 were not subject to any independent supervisory review and approval. Our review of 10 penalties totaling \$14,475 that were reduced to \$323 disclosed that none were subject to any review and approval and DAT could not provide justifications for reducing or waiving 8 penalties totaling \$7,196. State law authorizes DAT to waive penalties under certain circumstances (such as for entities with no history of untimely returns). According to DAT's records, during fiscal year 2016, DAT collected approximately \$1.1 million in penalties.

Recommendation 4

We recommend that DAT

- a. use available Comptroller of Maryland records, on a timely basis, to identify entities that have not registered with DAT and filed a personal property return;**
- b. ensure that independent supervisory personnel verify the propriety of exemptions from personal property assessments and periodically ensure that existing exemptions are warranted;**
- c. send dunning notices and refer accounts to CCU for collection assistance in accordance with CCU regulations; and**
- d. ensure that penalty reductions or waivers are subject to independent supervisory review and approval, and document the related justifications.**

Homestead Property Tax Credit

Background

State law established the homestead property tax credit (HPTC) to help homeowners who have had large assessment increases on their principal residence. The law limits the increase in county and State taxable assessments on individual owner-occupied properties to a fixed percentage of the preceding year's taxable assessment. Every county and municipality is required to establish the limit on taxable assessment increases at 10 percent or less each year. State law also limits the taxable assessment increase to 10 percent or less each year for computing the State's portion of the tax.

According to State law, only owner-occupied residences are eligible for the HPTC and a property owner may only receive the credit on one property. An owner generally must reside at the property for at least six months of the year, including July 1 of the year for which the credit is received. Married couples are considered a single entity for HPTC eligibility purposes.

DAT headquarters maintains a Homestead Credit Application System (HCAS) to receive online HPTC applications and to process mailed-in applications. HCAS conducts certain initial screening tests for eligibility and flags applications needing further review and information before DAT headquarters authorizes HPTC eligibility in the system. When a property is transferred to a new owner as evidenced by a deed, the property should lose its HPTC eligibility until a valid application for the credit is filed by the new owner with DAT's Homestead Property Tax Credit Department located at headquarters. The local assessment offices perform certain procedures to help ensure ongoing compliance with HPTC eligibility requirements as part of the assessment process and investigate allegations about property owners who are improperly receiving HPTCs.

On a weekly basis, the HCAS updates DAT's AAVS for any changes made at DAT headquarters, and local assessment offices can update AAVS directly, for HPTC eligibility. The information from AAVS is provided annually to local taxing authorities so that they can calculate the property taxes and credits and prepare the respective property tax bills. According to DAT records, approximately 392,100 properties received the HPTC for tax year starting July 1, 2016.

Finding 5**DAT did not effectively use various automated reports it created to help identify improper credits for review and follow-up.****Analysis**

DAT did not effectively use various automated reports it created to help identify improper credits for review and follow-up. For example, DAT did not have a method (such as using a risk-based approach) for prioritizing which accounts to review on the reports and conducting related follow-up for those deemed higher risk.

In addition, DAT has not performed an analysis of personnel and resource funding requirements, has not determined which data matches were the most efficient use of resources, and did not develop a comprehensive compliance program. In response to our prior report, DAT stated that it lacked sufficient resources to perform certain data matches and perform related follow-up.

- DAT did not ensure the local offices reviewed and resolved items appearing on weekly reports that identified differences between the homeowner eligibility field on HCAS and the comparable field on DAT's AAVS. For example, one report identified manual overrides made to the homeowner eligibility field in HCAS that resulted in a conflict with the related field in AAVS. The manual override could be used, for example, to change a rejection code that the owner did not reside at the property once it was determined by the Homestead Property Tax Credit Department that the applicant did reside at the property. We compared the March 15, 2016, and May 3, 2016, conflict reports for one jurisdiction and noted that 2,854 of the 2,984 conflicts on the March report had not been corrected and still appeared on the May report.
- DAT did not review a pending report that identified accounts that were placed in pending status that may no longer be eligible for HPTCs. According to DAT records, as of May 16, 2016, there were 13,697 accounts that were in pending status, of which 12,163 had been pending for more than 30 days. These accounts were previously approved for a credit but were placed in pending status by the HCAS due to a discrepancy in the homeowner information, such as the inclusion of a co-owner in AAVS but not in HCAS. Our review of 15 accounts pending more than 500 days as of May 16, 2016, disclosed that DAT did not attempt to investigate 9 of the accounts until we inquired about them in June 2016. The subsequent investigation of the 9 accounts resulted in 3 accounts losing their eligibility for the credit.

Resolving these accounts in a timely manner is critical since the homeowners receive HPTCs while in pending status.

- DAT did not follow up on results of certain income tax record matches that identified significant discrepancies. For example, one match compared the addresses of taxpayers on HCAS with the Comptroller of Maryland's tax records to help determine if the homeowner was residing at the address listed as his/her primary residence. DAT ran this match on October 6, 2014, and January 17, 2016, but, as of May 10, 2016, had not completed its review of either match report. Specifically, as of May 10, 2016, DAT had only reviewed 3,897 of the 26,979 accounts on the October match report, and had not reviewed any of the accounts on the January match report. The January match identified discrepancies in the addresses for 156,040 accounts. The reduced assessed value for these 156,040 accounts totaled \$261.6 million for State tax purposes, \$682.7 million for county tax purposes, and \$290.2 million for municipal tax purposes.

During our prior homestead performance audit (Finding 7), we conducted a similar match, and 11 of the 30 properties tested were not eligible for the credit. These 11 properties had their county and State taxes improperly reduced by \$248,133 and \$22,111, respectively, during fiscal years 2007 through 2013.

Recommendation 5

We recommend that DAT

- a. perform an analysis of personnel and resource funding requirements and develop a comprehensive compliance program to help ensure that HPTCs are only granted for eligible properties (repeat); and**
- b. review reports of potentially ineligible accounts, including those noted above, and take appropriate corrective action (repeat).**

Homeowners' Tax Credit

Background

During fiscal year 2016, DAT approved 46,751 homeowners' tax credits (HTC) totaling approximately \$58.4 million. HTCs are awarded to homeowners with a combined household income up to \$60,000, allowing a credit against each homeowner's property tax bill when the property taxes exceed a fixed percentage of the person's gross income. To receive the HTC, homeowners must submit an application, along with supporting documentation, to DAT by September 1 of the

fiscal year for which the HTC is being requested. For example, applications for the fiscal year 2016 property taxes were due by September 1, 2015.

DAT headquarters staff process the HTC applications, determine the amount of each credit, and notify the local jurisdictions of credits granted. The local jurisdictions issue the credits on the tax bill or as refunds, depending on when the application was received. Local jurisdictions then submit monthly requests to DAT for reimbursement of the HTCs redeemed by taxpayers.

DAT conducts audits of selected approved HTC applications to ensure the taxpayers qualified for the HTCs, that proper supporting documentation (such as a federal income tax return) was submitted, and that application data were accurately recorded in DAT's automated system. These audits are critical because HTC applications and related eligibility determinations are not subject to independent review and approval at the time of processing. In addition, to ensure the propriety of amounts redeemed by homeowners and the local jurisdiction reimbursement requests, DAT runs exception reports that identify differences between the HTCs granted to homeowners and the amounts redeemed by taxpayers, as reported by the jurisdictions.

Finding 6

DAT had not performed timely and comprehensive verification procedures to help ensure the accuracy of HTCs awarded, and did not verify the propriety of redeemed HTCs and related reimbursement requests from local jurisdictions.

Analysis

DAT had not performed timely and comprehensive verification procedures to help ensure the accuracy of homeowners' tax credits (HTC) awarded, and did not verify the propriety of redeemed HTCs and related reimbursement requests from local jurisdictions.

HTCs Awarded Were not Adequately Reviewed for Propriety

- DAT had not completed audits of certain questionable HTC applications nor conducted any audits of randomly selected applications to ensure they were processed correctly. DAT generates reports that identify questionable approved HTC applications for audit. Specifically, these reports identify (a) applications for which the reported income did not agree with the income reported on the applicant's State income tax return, and (b) applications for which there was a 20 percent or more change in the applicant's income from the previous year. As of March 2016, DAT had not audited any of these

questionable applications nor conducted any audits of randomly selected applications for calendar years 2012 through 2015.

This condition was commented upon in our two preceding audit reports. In response to our prior audit, DAT advised that it would stop conducting random audits of HTC applications and reallocate those resources to help reduce the backlog of audits of questionable applications. Nevertheless, DAT has made minimal progress in the audits of questionable applications (that is, the audits were still four years behind at the time of our fieldwork). As a result of our audit, DAT advised that, as of July 2017, it had completed reviewing the questionable applications for HTCs granted in 2012 and had almost completed reviewing the questionable applications for HTCs granted in 2013, but could not estimate when the review of these applications would be completed for calendar years 2014 and 2015.

- DAT did not perform an independent review of manually processed HTCs to ensure that only authorized credits were processed for payment. HTCs are processed manually when the homeowner does not receive an individual real property tax bill (such as in the case of a housing cooperative) and for new home purchases where the tax credit must be prorated for less than a calendar year. In these instances, tax credits are processed manually by DAT employees and submitted to a supervisor for review and approval. The supervisor prepares an authorizing memo, then submits the memo to accounting for processing of the disbursement on the State's accounting system.

Specifically, tax credits submitted by the supervisor were not independently reviewed for propriety. Furthermore, DAT was not able to generate an output report of the manually processed credits to identify these credits for review purposes. As a result, the supervisor could authorize improper credits to be processed which may not be readily detected. According to the supervisor's log, 517 homeowners' tax credits totaling \$421,253 were manually processed during fiscal year 2016.

DAT did not Verify the Propriety of Redeemed HTCs and Local Jurisdictions' Related Reimbursement Requests

- DAT did not ensure all jurisdictions submitted monthly electronic files of homeowner-redeemed HTCs and did not use the files submitted to verify the propriety of the jurisdictions' related reimbursement requests. As of March 2016, 4 jurisdictions had never submitted any of the required files because, according to DAT management, they lacked the technology to submit these files electronically, and 5 other jurisdictions had not submitted the files for

periods ranging from 7 to 65 months, dating back to November 2010. These 9 jurisdictions had approved HTC's totaling \$11.3 million in fiscal year 2015.

- For those jurisdictions that submitted monthly electronic files of homeowner-redeemed HTC's, DAT could not always document that it reviewed differences between the HTC's granted and the amounts redeemed by taxpayers. DAT generated exception reports that compared the monthly electronic files of homeowner-redeemed HTC's with HTC amounts it had authorized. Our test of seven fiscal year 2015 monthly exception reports for seven jurisdictions with redeemed HTC's totaling \$362,956 disclosed that DAT could not document that it reviewed differences on any of the reports. We independently reviewed four of these HTC discrepancies from three jurisdictions' exception reports. Our review disclosed that, as of May 17, 2016, DAT had not resolved one of the four discrepancies in which a homeowner had redeemed an \$8,900 HTC even though DAT had only authorized \$3,709. Based on the follow-up efforts performed by DAT subsequent to our request, it appears that differences related to the other three discrepancies were adequately explained.

In addition, for these jurisdictions that submitted the files, DAT did not compare the redeemed HTC's with HTC's it had granted to verify the propriety of reimbursement requests submitted and paid to the jurisdictions.

The aforementioned conditions could result in the failure to identify and recover improper HTC's and/or excessive reimbursements to local jurisdictions. Similar conditions were noted in our preceding audit report.

Recommendation 6

We recommend that DAT

- a. perform timely audits of HTC applications (repeat);**
- b. develop output reports of manually processed HTC's and perform independent reviews of manually processed HTC's, including those noted above;**
- c. take appropriate action to recover HTC's that are determined to be potentially improper; and**
- d. ensure local jurisdictions submit monthly files of redeemed HTC's, review differences between the amounts of redeemed HTC's and those authorized by DAT, and use the files to verify the propriety of reimbursement requests (repeat).**

Information Systems Security and Control

Overview

DAT's Office of Information Technology (OIT) was solely responsible for the Department's information technology (IT) support. However, beginning in July 2014, DAT began a conversion to use the State of Maryland Department of Information Technology's (DoIT) IT support services, which includes the following functions:

- Network and Information Technology Security Services (including firewall and intrusion detection prevention systems (IDPS) and malware protection)
- IT Service Desk
- Hardware Support
- Software Support
- Web and Geographic Information Services
- IT Procurement Services

OIT is responsible for operating and maintaining mainframe and server-based systems, including monitoring of application and database security. DoIT operates a statewide network that connects DAT's local offices and DAT headquarters. The statewide network provides DAT users' access to various IT services including the AAVS, Annapolis Data Center mainframe based applications, a database management system, network services, email services, and Internet access.

Finding 7

DAT's procedures for logging and monitoring critical database and mainframe security events were not sufficient.

Analysis

DAT's procedures for logging and monitoring critical database and mainframe security events were not sufficient.

- For a critical production database, numerous critical security and audit events (for example database grant, revoke, or deny events) were not logged. For security and audit events that were logged, the logs had not been reviewed for approximately nine months ending in May 2016. After that date, DAT advised these logs were reviewed but documentation did not exist to support such reviews. Accordingly, unauthorized changes to this database could occur that could result in inappropriate changes to production data without detection

by management. Similar conditions were commented upon in our preceding audit report.

- For several key mainframe systems (including the Maryland Business Entity System) we determined the following:
 - reports of logged activity reflecting authorized modifications of significant data and programs files were generated but not reviewed;
 - reviews of additions, changes and deletions of security software rules governing critical program and data files did not include an examination of the documentation supporting the log entries to ensure the propriety and proper authorization of the changes made; and
 - reports of logged activity reflecting modifications of rules governing critical mainframe transactions were not generated for subsequent review.

The State of Maryland *Information Security Policy* requires that information systems must generate audit records for all security-relevant events, including all security and system administrator accesses and procedures must be developed to routinely (for example daily or weekly) review audit records for indications of unusual activities, suspicious activities or suspected violations, and report findings to appropriate officials for prompt resolution.

Recommendation 7

We recommend that DAT

- a. log all critical database security and audit related events, regularly generate reports of these logged events, review these reports on a timely basis, document these reviews, and retain the documentation for future reference; (repeat) and**
- b. generate reports of critical mainframe security events and transactions, perform reviews of these reports (including examination of supporting documentation), document these reviews and retain the documentation for future reference.**

Finding 8

IDPS protection did not exist for untrusted traffic entering the DAT network and numerous DAT workstations were running an outdated and unsupported operating system.

Analysis

IDPS protection did not exist for untrusted traffic entering the DAT network and numerous DAT workstations were running an outdated and unsupported operating system.

- An IDPS was not used for untrusted traffic entering DAT's network. The firewall operated and maintained by DoIT included an integrated IDPS which can either block potentially malicious traffic or alert firewall administrators of such traffic. However, the firewall was not configured to apply IDPS protection to any of the 57 firewall rules allowing traffic from untrusted sources to the DAT network. Thus, traffic entering the DAT network from the Internet, the Statewide Intranet, contractors, and a public university was not covered by IDPS. DAT and DoIT personnel advised us that no other network or host based form of IDPS protection had been implemented. Accordingly, the DAT network had no IDPS protection relative to untrusted third party traffic entering its network. A similar condition was commented upon in our prior audit report.

Strong network security uses a layered approach, relying on various resources structured according to assessed network security risks. A properly utilized IDPS can aid significantly in the detection/prevention of, and response to, potential network security breaches and attacks. The State of Maryland *Information Security Policy* requires that intrusion detection/prevention tools and techniques must be employed to monitor system events, detect attacks, and identify unauthorized use of information systems and/or confidential information.

- Most of the workstations maintained by DoIT were running an outdated and unsupported operating system. Specifically, as of August 26, 2016, 466 of the 630 workstations at DAT were running an outdated and unsupported operating system which had not been supported by the manufacturer for over two years, leaving systems running this operating system vulnerable to attack.

Recommendation 8

We recommend that DAT, in conjunction with DoIT,

- a. perform a documented review and assessment of DAT network security risks and identify how IDPS coverage should be best applied to the DAT**

- network to include IDPS coverage to all inbound untrusted traffic, (repeat) and
- b. ensure that all workstations run operating system software that is currently supported by the related manufacturer.

Finding 9

Controls over the services provided by DoIT were not sufficient to properly secure the DAT network.

Analysis

Controls over the services provided by DoIT were not sufficient to properly secure the DAT network.

- Our test of the advanced security appliances used by DoIT to provide network and IT security services to DAT determined that DoIT did not fully utilize the expanded capabilities of these appliances to provide enhanced security for the DAT network. Specifically, we noted that five available features (including the ability to allow or deny traffic based on the application traversing the network) that would provide enhanced network security for DAT were not fully used.
- DAT and DoIT did not perform periodic reviews of DAT firewall rules to ensure that all rules were up-to-date and only allowed necessary connections to DAT network resources. We were advised that as of August 3, 2016, a firewall rule review had not been performed over the DAT firewall rule base since its DoIT implementation in July 2014. For a large and dynamic organization like DAT, its network and necessary access to/from network devices are constantly changing. Regular reviews of firewall rules (performed jointly by DAT and DoIT) are necessary to ensure that rules remain current, and that outdated or insecure rules are removed.
- Procedures for ensuring that DAT requested changes are made to its DoIT maintained and operated appliance/firewall were not adequate. Specifically, written procedures did not exist regarding DAT requests for, and approvals of, firewall changes submitted to DoIT and a standard firewall change request form was not used. In addition, DAT did not positively confirm that all DAT requested appliance/firewall changes had been appropriately completed. In this regard, DAT did not have read access to its appliance/firewall configuration to independently verify that requested changes were appropriately made.

Recommendation 9

We recommend that DAT, in conjunction with DoIT

- a. fully utilize the expanded capabilities of the advanced security appliances to properly secure the DAT network;**
- b. jointly perform regular (at least annual) reviews of the DAT firewalls' rules to ensure that only necessary and properly defined rules are active, document these reviews, and retain such documentation for audit verification;**
- c. develop and maintain written official procedures for appliance/firewall changes which include an official change request form; and**
- d. obtain read access to its appliance/firewall configuration, independently verify that all appliance/firewall change requests have been appropriately made, and retain documentation supporting these verifications for future reference.**

Cash Receipts

Finding 10

Controls were not in place to ensure that personal property filing fee collections were properly accounted for, secured, and deposited.

Analysis

Proper controls were not established over checks received in payment of personal property filing fees (generally \$300 per filing) to ensure collections were properly accounted for, secured, and deposited. According to DAT records, during fiscal year 2016, personal property return filing fee collections totaled \$84.9 million including \$51.5 million in lockbox collections, \$25.3 million received and processed at DAT headquarters, and \$8.1 million received online via the DAT website.

- Checks received at DAT headquarters were held for up to two days after receipt and were processed by as many as four employees before being recorded and restrictively endorsed. In addition, the checks were kept in plain view on employee desks and were accessible to the public and to the contractual custodial staff prior to being forwarded to the DAT finance office for deposit preparation. Furthermore, DAT personnel routinely removed checks from the deposit if there were errors found with the associated personal property return but did not document the disposition of these checks. For example, one batch of 60 checks received on September 23, 2016, had 9 checks removed and DAT could not readily determine the disposition of these checks.

- DAT did not adequately verify that its fiscal year 2015 lockbox collections totaling approximately \$62 million had been deposited into the State's account. Monthly reconciliations were not always properly or completely performed. For example, based on our tests, the balance of the State's accounting records, as reflected in several reconciliations, did not agree with the actual balance in the State's accounting records, and DAT could not explain these discrepancies. Our test of five daily lockbox collections disclosed that they were properly deposited to the State's account.

In addition, the employee conducting the deposit verification of collections received and processed at DAT headquarters had access to the related collections, resolved chargebacks, and did not use the original record of checks received as part of the deposit verification process. The lack of documented independent verifications was commented upon in our two preceding audit reports.

The Comptroller of Maryland's *Accounting Procedures Manual* requires immediate recording, restrictive endorsement, and safeguarding of collections, and that independent verifications of receipts from initial source documents to deposit be performed.

Recommendation 10

We recommend that DAT

- a. restrictively endorse and record all checks immediately upon receipt, and safeguard and document the disposition of all checks received; and**
- b. perform independent and proper deposit verifications, including using the original record of checks received (repeat).**

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the State Department of Assessments and Taxation (DAT) for the period beginning July 30, 2012 and ending November 11, 2015. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine DAT's financial transactions, records and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included corporate fees and taxes, homeowners and homestead property tax credits, real property assessments, procurements and disbursements, information systems security and control, cash receipts, and payroll. Our audit also included various support services (such as payroll, purchasing, maintenance of accounting records and related fiscal functions) provided by DAT to the Property Tax Assessment Appeals Board, which is audited separately. We also determined the status of the findings contained in our preceding audit report. In accordance with Section 2-1220(a)(4) of the State Government Article, we also conducted a follow-up review of the actions taken by DAT to address the findings from our performance audit report dated February 28, 2013.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of DAT's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data) and the State's Central Payroll Bureau (payroll data), as well as from the

contractor administering the State's Corporate Purchasing Card Program (credit card activity). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from these sources were sufficiently reliable for the purposes the data were used during this audit.

We also extracted data from the Assessment and Administration Valuation System, the Maryland Business Entity System, the Homeowner's Tax Credit System, and the Homestead Credit Application System for the purpose of testing certain areas, such as real property assessments, corporate fees and taxes, and tax credits. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

DAT's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect DAT's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to DAT that did not warrant inclusion in this report.

The response from DAT to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise DAT regarding the results of our review of its response.

APPENDIX

LARRY HOGAN
GOVERNOR

BOYD RUTHERFORD
LT. GOVERNOR



DEPARTMENT OF
ASSESSMENTS & TAXATION

MICHAEL HIGGS
DIRECTOR

DENISE HERNDON
DEPUTY DIRECTOR

February 20, 2018

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
301 West Preston Street, Room 1202
Baltimore, Maryland, 21201

Dear Mr. Barnickel,

The State Department of Assessments & Taxation (SDAT) herewith submits its responses to the audit findings and recommendations contained in your compliance audit report for the period beginning July 30, 2012 and ending November 11, 2015.

If you need any additional information concerning the Department's audit response, please feel free to contact me with any questions or concerns.

Very Truly Yours,

A handwritten signature in black ink, appearing to read 'M. Higgs'.

Michael Higgs
Director

cc: Denise Herndon, Deputy Director
Kate Holmes, Associate Director
Corbett Webb, SDAT Chief of Staff
Christine Timanus, CPA OLA Assistant Director, QA&PDD
Adam Westover, CPA OLA Audit Manager
File

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Finding 1

Physical exterior inspections were not performed for all properties as required by State law.

Recommendation 1

We recommend that DAT continue efforts to comply with State law that requires all real property in the State to be physically inspected on a triennial basis.

Department Response

DAT agrees with this finding; corrective action is in progress.

The Department has introduced SB10 for the 2018 Session which would repeal the requirement that SDAT performs a physical inspection of every property in every three year assessment cycle. It would replace it with a requirement to perform physical inspections in circumstances where the property value is being initially established, a significant change has occurred to the property, the property has sold and the Department deems an inspection necessary for the purpose of a market analysis, or the taxpayer requests an inspection as part of an active appeal.

The requirement for a physical inspection of all properties was first enacted in 1970 at a time when county governments did not routinely provide the Department with copies of all building permits. Physical inspections were needed to find these improvement additions. Furthermore, in 1970 other tools and resources that assessors now use routinely—such as MRIS, CoStar, and Real Capital Analytics—did not exist. Additionally, since 1975 the number of assessors has decreased significantly while the number of real property accounts has roughly doubled. It has become impossible and unnecessary to perform physical inspections as required by statute, and to comply with this outdated law SDAT would need to hire approximately 200 additional field assessors at an annual cost of \$9,000,000.

SDAT will be able to comply with SB10 with existing resources.

Finding 2

Supervisory reviews of property reassessments by the local office supervisors were not always performed and documented as required at the two local offices we reviewed. Both the local and area supervisors had certified that these reviews had been performed.

Recommendation 2

We recommend that DAT ensure that local supervisors conduct required reviews and that area supervisors only certify these reviews after properly verifying that the reviews were performed.

Department Response

SDAT agrees with this finding; corrective action has been completed.

The Department has instituted a quality assurance review of assessor field work for accuracy.

Residential Assessment Reviews - Supervisors are required to review at least 25 residential accounts on a random basis valued on MD Value for each residential assessor over the course of the reassessment year. The reviews should include 10 accounts with a permit, 10 accounts that sold within the last two years, and 5 additional accounts that were physically reviewed.

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Commercial Assessment Reviews - Supervisors are required to review at least 25 commercial accounts on a random basis for each commercial assessor over the course of the reassessment year. The reviews should include at least 15 commercial accounts valued with the cost method in the field and at least 10 commercial accounts valued using the income approach with income and expense documentation submitted by owners.

For assessors that only value *new construction*, supervisors should review 10 new construction pick-ups per assessor over the course of the reassessment year. The accounts should be new construction projects or permits with more than \$100,000 in added value.

At the time of the assessment review, supervisors:

- 1) Write the property tax account number of each assessment reviewed on the quality assurance checklist form.
- 2) Review the selected assessments. Reviews of the 25 accounts for each assessor are spread throughout the assessment year, so there may be 2 reviews (of 13 accounts each) or 4 reviews (of 6 or 7 accounts each) periodically during the assessment year.
- 3) Record any notes or concerns, areas that need improvement, *etc.* on the quality assurance checklist form. The supervisor signs and dates the quality assurance checklist form to document the review.
- 4) Discuss the review notes with the assessor. The assessor signs and dates the quality assurance checklist to document that results of the quality assurance review were discussed.
- 5) Ensure that they (the County Supervisor) and/or the Assessor Supervisor provide any training or retraining needed.

The local county supervisors are now required to review property records for real property owned by an SDAT employee. Effective July 1, 2017, each SDAT Local County Supervisor began running two Administration and Valuation System (AAVS) reports each year to verify that no employee made any additions, changes, subtractions or edits to the real property record for any property he/she owns. AAVS, the Department's real property database, maintains an internal audit trail which logs the entry of all new data, any changes made to existing data and any deletions of data by employee logon id.

July AAVS Report - First Snap Shot

Obtain a list of all SDAT employees as of July 1. Include the employee's name, user id and the geographic area of any property owned. Run the Geographic Area Report, an AAVS generated report listing employees that have any ownership interest in real property the geographic area designated for reassessment beginning the following January. For any employee ownership interest identified, a screen shot of the AAVS record is uploaded into a Google documents folder labeled by the month and year.

November Audit Trail Review

Once all the reassessments are complete and updated in AAVS, an AAVS generated audit trail report is run to determine if any employee made any changes to the AAVS property record for his/her own property. The screen shots of the July AAVS record are compared to the November audit trail report to verify no modifications were made by the employee to the AAVS record for his/her property.

In 2017 there were no instances of an employee making changes to his/her property record. In the event this should occur in the future, it would result in immediate disciplinary action.

Finding 3

DAT did not ensure that real property data recorded in AAVS were complete and accurate, and did not document supervisory reviews of assessment appeals and real property exemptions.

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Recommendation 3

We recommend that DAT enhance procedures by requiring each local assessment office to

- a. establish initial accountability and control over all property-related documents manually received from local governments, including deeds and permits (repeat);**
- b. resolve building permit processing errors and ensure the permits are subsequently recorded (repeat), and investigate the aforementioned building permit recording and processing errors; and**
- c. ensure that building permit data, property tax exemption transactions, and real property appeal decisions are properly recorded in AAVS based on supervisory review of supporting documentation, and that these verifications are documented (repeat).**

Department Response

3a. SDAT agrees with the finding; corrective action has been completed.

For Deeds: The Land Records Office in each county forwards the recorded deed with a property transfer sheet to the local SDAT county office. As required by Tax-Property Article §3–104(a)(2), the Supervisor of Assessments transfers ownership of property as of the date of deed recordation. A new SDAT local office process has been established that requires SDAT staff to scan the property transfer sheet and first page of the deed upon receipt to create an initial record of receipt. The scanned transfer sheets and deeds will be saved electronically by month received.

For Permits: As required by Tax-Property Article §5-103 local governments must forward a copy of all issued building permits to the county assessment office. Approximately 8 counties currently provide electronic permit data, the remaining 16 local governments submit paper permits. When paper permits are received, the permits are sorted by dollar value upon receipt at the local SDAT office. A new SDAT local office process has been established that requires SDAT staff scan paper permits received to create the initial record of receipt as follows:

- (1) Permits \$100K or more are scanned, keyed into AAVS, and result in a real property reassessment that tax year.
- (2) Permits less than \$100K are scanned, keyed into AAVS, and result in a reassessment during the next reassessment cycle.
- (3) Permits that do not affect assessed value, such as permits for fences, sheds, retaining walls, electrical outlets, etc., are boxed and retained for a period of 4 years for reference by the local office. The scanned permits will be saved electronically by value group (\$100K+ or > \$100K) and month received.

When permits are received electronically, they are imported into AAVS. A report of import errors is sent to the local office. Errors that prevent upload into AAVS include invalid real property account number, duplication of permit data already recorded in AAVS, and permits for accounts not in AAVS in the case of new construction.

3b. SDAT agrees with the finding; corrective action has been completed.

Paper Permits - Using the AAVS Permits Report, the SDAT County Supervisor, or his/her designee, verifies all permits scanned are entered into AAVS. Any scanned permits not in AAVS are noted and entered into AAVS. In addition, the SDAT County Supervisor in each SDAT office, or his/her designee, now reviews a total of 10 permits **per week**, five \$100K+ permits and five permits > \$100K. Any errors identified in the weekly verification are noted and corrected.

Permits received electronically are imported into AAVS by HQ staff. A weekly report of import errors is emailed to the local SDAT office. Errors that prevent permit data upload into AAVS include: invalid real property account number, duplication of permit data already recorded in AAVS, and permits for accounts not

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in AAVS in the case of new construction. The office manager researches all import errors and keys the correct permit data into AAVS. The SDAT County Supervisor or his/her designee, reviews each error report to verify that the cause of each import error has been resolved. The weekly error report is initialed and dated to document supervisory review.

3c. SDAT agrees with the finding; corrective action has been completed.

The process for verifying permit data is outlined above in response to 3b.

Tax Exempt Real Property Transactions - A weekly AAVS Exception Report is generated and sent to each SDAT county office. The Exception Report is a list of all real property account transfers in that week with a tax exemption at the time of transfer. The office manager researches transactions on the report and takes the appropriate action, usually to remove the tax exemption. However, there are instances, such as death of a spouse, when ownership is transferred from joint to the surviving spouse, in this case the tax exemption should remain in place. The SDAT Assistant County Supervisor, or his/her designee, reviews each exception report to verify that each exception has been resolved. The weekly exception report is initialed and dated to document supervisory review.

Real Property Appeal Decisions - Supervisory review of real property appeals has been in place for years. As required by Tax-Property Article §8-205(c), the appeal of an assessment shall be noted in the assessment worksheet that relates to the property whose value or classification was appealed. Supervisors are now required to ensure that the reviews are documented by initialing and dating the right top corner of the appeal worksheet at the time of his/her review.

Personal Property Assessments

Finding 4

DAT did not use available information to identify entities that failed to register or file a personal property return and did not review and approve exemptions from personal property assessments that were granted by DAT employees. DAT also did not pursue late filing penalties in accordance with State regulations and waived or reduced penalty fees without any independent review and approval.

Recommendation 4

We recommend that DAT

- a. use available Comptroller of Maryland records, on a timely basis, to identify entities that have not registered with DAT and filed a personal property return;**
- b. ensure that independent supervisory personnel verify the propriety of exemptions from personal property assessments and periodically ensure that existing exemptions are warranted;**
- c. send dunning notices and refer accounts to CCU for collection assistance in accordance with CCU regulations; and**
- d. ensure that penalty reductions or waivers are subject to independent supervisory review and approval, and document the related justifications.**

Department Response

4a. The Department believes it is in compliance with this recommendation.

The Department does use data provided by the Comptroller of Maryland and the Department of Labor, Licensing, and Regulation (DLLR) to identify domestic entities that have not filed an Annual Report and may need to file a business personal property tax return as required in Corporations & Associations Article § 3-503(b)(1).

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Each year, in October, the Comptroller of Maryland and the DLLR provide SDAT with a certified list documenting every Maryland corporation that has paid taxes to the Comptroller, or unemployment insurance contributions to DLLR, as required in Corporations & Associations Article § 3-503(b)(1). Annually in October, the Department generates a certified list from its own internal data of every entity in SDAT records that has not filed an annual report on or before October 1, as required by Corporations & Associations Article § 3-503(c). The Department uses the certified “failure to file an annual report” list to identify foreign entities that have not completed the annual registration as required by Corporations & Associations Article § 7-205.

In November each year, the Department declares the entities described above as forfeited, null, and void, and mails forfeiture notices as stipulated in Corporations & Associations Article § 3-503(3).

The Department performed a cost benefit analysis on the 2013 foreign entity pilot data as summarized in the charts below. This analysis is limited to the SDAT revenue generated and costs incurred to mail 600 initial letters and 300 second letters. The Department determined each letter sent generated approximately \$10.46 in revenue, however, the total cost of each letter sent was approximately \$29.52.

Summary of SDAT Revenue Generated in the Discovery Pilot for Foreign Entities

Type of Response	Number of 1st Letter Responses	Number of 2nd Letter Responses	Total Number of Responses	Required to pay \$100 Requalification Fee	Required to pay \$300 Annual Report Filing Fee	Total SDAT Revenue Generated	Less Total Cost	Net SDAT Revenue Generated	Revenue Generated per Letter Sent
No Response	171	188	359						
Bad Address	20	1	21						
Returned Mail	63	19	82						
No longer does business in Maryland	61	25	86						
Filed under a different entity	71	25	96						
Total Cost - No Revenue	386	258	644	no	no	\$0.00	\$19,010.88	-\$19,010.88	
Need to Requalify by filing an Annual Report	No Fees.	125	29	154	no	no	\$0.00	\$4,546.08	-\$4,546.08
			0						
Revived Filed Annual Report & paid fees.	89	13	102	yes	yes	\$40,800.00	\$7,827.28	\$32,972.72	
Total Letters Sent	600	300							
Revenue Created - Cost						\$40,800.00	\$31,384.24	\$9,415.76	\$10.46

Summary of SDAT Cost Incurred in the Discovery Pilot for Foreign Entities

Type of Response	Number of 1st Letter Responses	Number of 2nd Letter Responses	Total Number of Responses	Printing & Postage Cost per Letter	Total Cost of Letters w/ Print & Postage by Category	Labor Cost per Letter	Total Cost of Letters w/Labor by Category	Total Cost of Letters by Category	Cost per Letter
No Response	171	188	359	\$0.47	\$168.73	\$29.05	\$10,428.95	\$10,597.68	
Bad Address	20	1	21	\$0.47	\$9.87	\$29.05	\$610.05	\$619.92	
Returned Mail	63	19	82	\$0.47	\$38.54	\$29.05	\$2,382.10	\$2,420.64	
No longer does business in Maryland	61	25	86	\$0.47	\$40.42	\$29.05	\$2,498.30	\$2,538.72	
Filed under a different entity	71	25	96	\$0.47	\$45.12	\$29.05	\$2,788.80	\$2,833.92	
Total Cost - No Revenue	386	258	644					\$19,010.88	
Need to Requalify by filing an Annual Report	No Fees.	125	29	154	\$0.47	\$72.38	\$29.05	\$4,473.70	\$4,546.08
Revived Filed Annual Report & paid fees.	89	13	102	\$0.47	\$47.94	\$29.05	\$2,963.10	\$3,011.04	
Total Letters Sent	600	300							
Total Cost					\$423.00		\$26,145.00	\$26,568.00	\$29.52

Please see Attachment 1 for revenue and cost calculation details. Attachment 1 is located after the finding 10 response.

The Department has determined it is fiscally irresponsible to spend \$29.52 per letter, to generate \$10.46 in revenue; especially when not every legal entity is required to pay an annual report filing fee or file a business personal property tax return. This is not an effective or responsible use of tax payer money, therefore SDAT respectfully rejects this portion of the recommendation.

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Auditor's Comment: DAT's response mentions an annual process that it uses to identify foreign business entities that have not filed annual reports and, as a result, it declares these entities as forfeited. Our finding addresses a different longstanding process DAT has used to identify non-registered domestic entities conducting business in the State. As noted in the report finding, DAT's partially completed process for some of the 24 jurisdictions in 2013 resulted in increased personal property tax base, benefiting the affected jurisdictions. DAT's response also states that it recently completed a "cost benefit analysis" of foreign entity pilot data from 2013 and concluded that it is not an effective use of taxpayer money and should be discontinued. However, DAT's analysis did not address the process noted in our finding to identify non-registered domestic entities. Furthermore, the analysis did not recognize additional personal property tax revenue to the jurisdictions. Before concluding the recommended process is "not an effective or responsible use of tax payer money," DAT should perform a comprehensive cost benefit analysis of domestic entities that also recognizes potential tax revenue to the local jurisdictions. DAT should also consider whether the recommended process could employ a targeted approach in a manner that uses reasonable DAT resources.

4b. SDAT agrees with this finding; corrective action has been completed.

In June 2016 the Quality Control & Audit (QCA) team was established. The QCA team reviews the processing of business personal property (BPP) tax returns and exemptions. In addition to improving upon its exemption application approval process, the Department's database (MBES) has been updated to lock the "exemption field". An exemption cannot be processed in the MBES system without the exemption code being keyed into the exemption field in the SSAM screen. Only 5 user IDs, 2 BPP supervisors and the 3 QCA team members, are able to unlock the exemption field.

The Department oversees two primary exemptions which are reviewed through an application process. The exemptions are Manufacturing/Research and Development, in compliance with Tax Property Article § 7-225, and Charitable/Educational, in compliance with Tax-Property Article § 7-202. Upon receipt, applications are logged and assigned to a member of the unit's QCA team for review within 30 days.

The Department requires that the application include all schedules, and if the exemption application is for Research and Development (R&D), market data is required. For a Charitable/Educational Exemption, the Department requests details surrounding the organization's poverty/charity policy and sources of income or funding. In the process of reviewing exemption applications, the Audit and Quality Control Team will occasionally seek and obtain advice from the Attorney General's office.

The QCA team reviews the exemption application and supporting documentation the entity is required to submit. Accounts granted BPP assessment exemptions are reviewed every year by the assessor when the annual BPP tax return is filed. Even if exempt from BPP tax, the entity must file the annual BPP tax return and provide the supporting IRS tax return schedules.

In addition, the QCA team review occurs two years after the initial exemption is granted in order to ensure protection of the customer's right to amend returns within 3 years, (Article-Tax-Property § 11-103). The QCA team uses a system generated MBES report that lists all active BPP accounts with an exemption code 7-202 for Charitable, Educational, Benevolent entities and 7-225 for Manufacturing and R&D entities.

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The exemption log maintained by the QCA team contains appropriate data to allow the Team to periodically review the entity's file, verify entities are correctly reporting, and determine whether the exemption is still warranted. A plan is in place to review exemptions biannually and thus allow for decisions to be appealed in a timely fashion as required by Tax-Property Article §11-103.

4c. SDAT agrees with the finding; corrective action has been completed.

In July 2017, the Department revised the first penalty letter, second late penalty delinquency letter, and added a third and final delinquency letter. In compliance with the COMAR 17.01.01.04 provision for the referral of delinquent debts, the Department refers business entities with unpaid liabilities over 90 days old to CCU. On the 21st of each month, the Department runs a report of any accounts with unpaid penalties over 90 days old. Prior to this report, the account will have already received their initial letter detailing the balance due, a 30-day letter, a 60-day letter and then a final letter at 90-days letting them know that their account was forwarded to the Central Collection Unit (CCU). All delinquency letters and the CCU referrals are automatically generated.

In addition, on June 30, 2017 the Department referred 1,253 accounts with approximately \$93,909 in delinquent penalties to CCU for collection. On July 21, 2017 the Department referred the remaining 2,090 accounts with approximately \$163,558 in delinquent penalties to CCU for collection. The Department is caught up and now refers delinquent accounts on a monthly basis in compliance with COMAR 17.01.01.04.

4d. SDAT agrees with the finding; corrective action has been completed.

A majority of the time, penalty fees are automatically applied by MBES at the time of assessment, even when a penalty is not actually warranted. For example, the business personal property tax return was postmarked on or before April 15th (or before June 15th if granted an extension), but due to State Center mailroom delivery delays, lockbox delays, keying, etc., the assessments are not processed in MBES until after the April 15th (or June 15th) deadline. The MBES system automatically applies penalty fees to the account even though no penalty is actually due. Penalties applied by MBES in these situations are waived by the assessor at the time the tax return is processed.

In compliance with the COMAR 18.03.03.01 provision for waivers of late filing penalties for good cause, an unjustly excessive penalty is defined as an amount greater than 20% of the taxes due for the same year. Unjustly excessive penalties can be recomputed or removed. As of June 2017, assessors have been required to note the reasons for penalty adjustments and abatements in the MBES comments field and in the Google drive stored Late Filing Penalties log sheet which is reviewed and approved by the Quality Control and Audit team.

As of June 2017, the business personal property Quality Control and Audit team runs a MBES system-generated monthly Penalty Report listing all of the revised and removed penalty fees. The Quality Control and Audit team reviews the monthly Penalty Report to verify that proper Department procedures were followed when penalties are removed or revised.

In addition, in February 2016 the Deferred Data Report was implemented to provide a list of all the business personal property assessments keyed in MBES the day before. Beginning with assessments keyed on February 29, 2016, keyed assessments are placed on a 5 day hold; During this hold period, the Quality Control and Audit team reviews the assessment and physically examines the tax return to ensure the assessment is properly supported and ensures that, at the time the assessment is finalized, the data is accurately and correctly recorded in MBES.

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Some of the factors reviewed include, but are not limited to:

- a drop or rise in assessment values from the prior year;
- changes in certification locations; and
- changes in inventories for licensing purposes.

This 5 day hold also allows the Quality Control and Audit team to comply with Tax Property Article §8-417 Assessing of Escaped Property, which allows the Department to review up to three prior year tax returns. For 2017, that means the Quality Control and Audit team may review, adjust, and assess business personal property back to the 2014 assessment year. The Quality Control and Audit team records comments in MBES when reviewing each tax return.

Homestead Property Tax Credit

Finding 5

DAT did not effectively use various automated reports it created to help identify improper credits for review and follow-up.

Recommendation 5

We recommend that DAT

- a. perform an analysis of personnel and resource funding requirements and develop a comprehensive compliance program to help ensure that HPTCs are only granted for eligible properties (repeat); and**
- b. review reports of potentially ineligible accounts, including those noted above, and take appropriate corrective action (repeat).**

Department Response

5a. SDAT agrees with this finding; corrective actions are in progress.

The Department is in the process of analyzing the personnel and resources needed to develop a comprehensive and efficient Homestead Tax Credit compliance program.

SDAT's online process for filing Homestead applications efficiently performs verifications of the application information. The obstacle occurs when an applicant's information is just slightly different than his/her MVA record. For example, instead of a full middle name the applicant may only include a middle initial. Or if the applicant enters his/her street address just slightly different than IRS address data, for example using "Rd" instead of "Road". The automated Homestead Tax Credit application system will flag these applications and move them into pending status, requiring manual review and follow up. This is happening on a daily basis faster than the 3 person Homestead program staff, a supervisor and 2 auditors, can process.

The Department has already begun reorganizing and has established a clerical team to follow up with letters to applicants to obtain documentation that will resolve the following scenarios:

- Incomplete Application
- Invalid Social Security Number - occurs when the applicant or co-owner's social security number is not correct
- Application Information does not match the IRS data on file
- Co-Owner or Spouse Missing - occurs if a co-owner is listed on the deed or the applicant is married and information for the co-owner or spouse is not provided on the application
- Signature Missing

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- New Purchaser
- Driver/Motor Vehicle License Discrepancy
- Applicant answered NO to application question 2 - Is this real property address the location where the homeowner(s) expect to file their next federal and Maryland income tax return if one is filed?

If the homeowner does not provide the requested documentation within 60 days their Homestead application is denied.

5b. SDAT agrees with the finding; corrective actions are in progress.

In February 2017, the Department identified approximately 9,252 accounts in the Homestead Property Tax Credit Database approved because the homeowner had applied for a Homeowners' Tax Credit, but had not completed a Homestead Tax Credit application.

In compliance with Tax-Property Article §9-105(6)(i), the Department removed the Homestead Tax Credit from those 9,252 accounts in the Homestead Property Tax Credit Database. A notice and Homestead Tax Credit application was mailed to each homeowner stating the owner must submit a one-time Homestead Tax Credit application in order to receive future Homestead Tax Credits. The notice advised that the homeowner would not receive the Homestead Tax Credit on their 2017 tax bill unless a Homestead Tax Credit application was filed by May 15, 2017. As a result, as of February 2017, a one-time Homestead Tax Credit application has been filed for all real properties with a Homestead Tax Credit.

In March 2017, the Department revised the Conflict Report procedures. A weekly "data check" between Homestead Credit Application System (HCAS) Credit system and the AAVS system occurs when Homestead Tax Credit data is uploaded into the AAVS system each Monday evening. If the two systems are not in agreement, a Conflict Report is generated. The Conflict Report procedures utilize a Notes field in AAVS (AAVS CR) that was added to the AAVS database. Now, all Conflict Report items are stored in the new AAVS CR table and available for future reference and review.

As a result of the report redesign and consistent cooperation from all 24 local offices, the Department is up-to-date on reviewing and resolving Homestead eligibility conflicts. The backlog of accounts with an owner occupancy eligibility conflict has been fully resolved.

Regarding the jurisdiction cited in the finding discussion above, the number of eligibility conflicts has **decreased by 85%** from a May 2016 high of 2,854 accounts with eligibility conflicts to 441 accounts as of February 1, 2018. All eligibility conflicts are now resolved within 30 days.

The total number of accounts with eligibility conflicts **State-wide has decreased by 89%** from a November 2016 high of 4,578 accounts with eligibility conflicts to 572 accounts as of February 1, 2018. All account eligibility conflicts are resolved within 30 days.

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Homeowners' Tax Credit

Finding 6

DAT had not performed timely and comprehensive verification procedures to help ensure the accuracy of HTCs awarded, and did not verify the propriety of redeemed HTCs and related reimbursement requests from local jurisdictions.

Recommendation 6

We recommend that DAT

- a. perform timely audits of HTC applications (repeat);**
- b. develop output reports of manually processed HTCs and perform independent reviews of manually processed HTCs, including those noted above;**
- c. take appropriate action to recover HTCs that are determined to be potentially improper; and**
- d. ensure local jurisdictions submit monthly files of redeemed HTCs, review differences between the amounts of redeemed HTCs and those authorized by DAT, and use the files to verify the propriety of reimbursement requests (repeat).**

Department Response

6a. SDAT agrees with this finding; corrective actions are in progress.

The Audit group now uses the ADC to track audited accounts and perform correction calculations. In June 2017, the Department completed a workflow study, and as a result implemented a two-tier review approach to quickly evaluate and identify the tax credit applications that must be audited verses the applications that can reviewed and resolved by an Office Services Clerk. As a result of this two-tier approach, the Department has made significant progress in reducing the backlog of the tax credit audits.

The Tax Credit Program has completed the IRS audits and reviews for 2012 and 2013 and is expected to begin 2014 IRS audits by March 15, 2018. The 20% audits for 2012/2013 and 2013/2014 have been completed, and audits of the 2015/2016 are expected to begin by March 30, 2018.

6b. SDAT disagrees with this finding; independent reviews of manual tax credits have been in place since 2001.

The independent review, verification, and approval process for manual tax credits was established and implemented in June 2001. This standard office procedure was in place during the audit period of 7/30/2012 to 11/11/2015, for all of FY2016, and remains in place now.

Homeowner Tax Credits that require manual calculations are completed by a Tax Credit Supervisor and then independently reviewed by the Tax Credit Program Manager. The Program Manager independently reviewed all 517 manually calculated Homeowner Tax Credits processed during fiscal year 2016, totaling \$421,253, for propriety before the tax credits were issued. The manual tax credits were processed by the Supervisor and then submitted to the Program Manager for review and approval. The Program Manager reviewed and verified the calculation of each manual tax credit for accuracy. The Program Manager submits all manual tax credits directly to the SDAT Accounting Division; as a result, the Supervisor that prepares the manual tax credits does not have the ability or opportunity to process improper manual tax credits.

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Beginning in July 2017, the Department established a separate PCA, 6110, in the FMIS accounting system to track the number and amount of manually calculated tax credits. In addition, to eliminate the possibility of mathematical errors, the Department created an Excel spreadsheet with locked formulas.

Auditor's Comment: The procedures to review manually processed HTC's as described in DAT's response does not ensure that all of these HTC's are subject to an independent review. As stated in the audit report, unauthorized HTC's could be added to the authorizing memo submitted to accounting for processing and would not be detected. An output report of manually processed credits was not generated to identify these credits for review purposes. The establishment of a separate PCA, which DAT's response states it has now established, would allow DAT to generate output reports of these manually processed HTC's for verification by someone not involved in the process.

6c. SDAT agrees with this finding; corrective actions are in progress.

As stated in 6b above, in compliance with COMAR 18.07.02(G)(02), when a tax credit audit determines a homeowner received a tax credit greater than he/she was eligible for, the homeowner is sent an initial invoice for the overpayment. The homeowner may make a lump sum payment or may make payment arrangements. If payment is not received, either lump sum or via a payment plan, the homeowner is sent 3 delinquent notices at 30, 60, and 90 days. Since June 2016, the Tax Credit Program has been referring accounts over 90 days delinquent to CCU for collection.

6d. SDAT agrees with this finding; complete corrective actions are in development.

Nineteen (19) counties do submit electronic files of redeemed Homeowners' and Renters' Tax Credits monthly. The SDAT Tax Credit Audit Team does review and verify recaptured tax credits for counties with electronic reports. In July 2017, the Department changed from a monthly review to a semi-annual review due to timing delays between when the tax credits are authorized verses when the tax credits are redeemed.

Currently, the Department's OIT team is evaluating the existing format and data requested to determine how to simplify the reporting requirement for local jurisdictions. The Department anticipates the new reporting tool will be ready for delivery to the local jurisdictions by April 1. At that point, the Tax Credit Management Team will meet with the finance personnel in each jurisdiction to explain the reporting process in detail and provide an implementation demonstration.

Information Systems Security and Control

Finding 7

DAT's procedures for logging and monitoring critical database and mainframe security events were not sufficient.

Recommendation 7

We recommend that DAT

- a. log all critical database security and audit related events, regularly generate reports of these logged events, review these reports on a timely basis, document these reviews, and retain the documentation for future reference; (repeat) and**
- b. generate reports of critical mainframe security events and transactions, perform reviews of these reports (including examination of supporting documentation), document these reviews and retain the documentation for future reference.**

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Department Response

7a. SDAT agrees with the finding; corrective action has been completed.

All critical database security and audit related events are logged in the mainframe's security software file access journal. This journal is reviewed on a daily basis by the IT Security Officer. Any unusual or suspicious activity is investigated by the Security Officer and a screenshot is taken to show the User ID and Dataset involved in the activity. An email is sent to the User (if available) and/or the User's Supervisor asking for a response. A copy is sent to the Data Processing Manager. The response is noted for reference. Lack of response from the user and user's supervisor would result in further investigation, discovery, and senior management action.

All documentation is kept in folders in the Security Officer's and Data Processing Manager's Email, as well as noted in the mainframe security software Daily Log Spreadsheet, which is linked to the security software User Account Database and available to the Compliance Director.

7b. SDAT agrees with the finding; corrective action has been completed.

The database Trace Report of mainframe login id modifications, rule modifications, and access logs for specific tables and datasets is reviewed on a monthly basis by both the Database Administrator for the MBES system and the Data Processing Programmer Manager. Each report is checked for unusual or suspicious activity, and then initialed and dated. These reports are then maintained for later review and future reference.

Finding 8

IDPS protection did not exist for untrusted traffic entering the DAT network and numerous DAT workstations were running an outdated and unsupported operating system.

Recommendation 8

We recommend that DAT, in conjunction with DoIT,

- a. perform a documented review and assessment of DAT network security risks and identify how IDPS coverage should be best applied to the DAT network to include IDPS coverage to all inbound untrusted traffic, (repeat) and**
- b. ensure that all workstations run operating system software that is currently supported by the related manufacturer.**

Department Response

8a. SDAT agrees with the finding; corrective action is in progress.

SDAT is working through DoIT to address this IDS/IPS finding. SDAT firewall policies are being reviewed and updated to ensure compliance with the DoIT Rev0 firewall baseline policy. DoIT anticipates completing this comprehensive firewall policy review by April 2018. The changes made will include modifying security profiles and cleanup of secondary rules in use on SDAT's virtual firewall to block all traffic for threats that pose a medium or greater risk and ensure these profiles are applied to all outbound and inbound policies with security policies that include specified application-defaults for the service settings as detailed in the Section 4 of the DoIT Security Configuration Standard for Enterprise Perimeter Firewalls.

8b. SDAT agrees with the finding; corrective action has been completed.

All of SDAT's workstations have been replaced and now run on a supported operation system.

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Finding 9

Controls over the services provided by DoIT were not sufficient to properly secure the DAT network.

Recommendation 9

We recommend that DAT, in conjunction with DoIT

- a. fully utilize the expanded capabilities of the advanced security appliances to properly secure the DAT network;**
- b. jointly perform regular (at least annual) reviews of the DAT firewalls' rules to ensure that only necessary and properly defined rules are active, document these reviews, and retain such documentation for audit verification;**
- c. develop and maintain written official procedures for appliance/firewall changes which include an official change request form; and**
- d. obtain read access to its appliance/firewall configuration, independently verify that all appliance/firewall change requests have been appropriately made, and retain documentation supporting these verifications for future reference.**

Department Response

9a. SDAT agrees with the finding; corrective action is in progress.

SDAT is working through DoIT to address network security. As discussed in 8a above, the current DoIT review and update of SDAT firewall policies to ensure compliance with the DoIT Rev0 firewall baseline policy will resolve this finding by April 2018. Updated security policies specifying application-default for service settings and the specific ports desired will utilize advanced security appliances with expanded capabilities.

9b. SDAT agrees with the finding; corrective action has been completed.

SDAT CIO did perform an initial firewall review with DoIT in October 2017. Going forward, the SDAT CIO will request annual joint reviews of firewalls and appliance settings in April of each year.

9c. SDAT agrees with the finding; corrective action has been completed.

SDAT established written firewall procedures in September 2016. These procedures required the submission of a firewall change request form and CIO approval before any firewall changes are implemented.

9d. SDAT agrees with the finding; compensating corrective action has been implemented.

DoIT is not able to grant SDAT read-only access to its firewall at this time. DoIT has agreed to provide any screenshots of the firewall as needed. SDAT CIO submits a service desk ticket if a configuration change is needed for a firewall or appliance. The DoIT Security Operations Center make the requested change and DoIT provides SDAT before and after screenshots to document the change was made and this allows SDAT to verify the change is correct.

Finding 10

Controls were not in place to ensure that personal property filing fee collections were properly accounted for, secured, and deposited.

Recommendation 10

We recommend that DAT

- a. restrictively endorse and record all checks immediately upon receipt, and safeguard and document the disposition of all checks received; and**

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- b. **perform independent and proper deposit verifications, including using the original record of checks received (repeat).**

Department Response

10a. SDAT agrees with the finding; corrective action has been completed.

The first paragraph and first bullet are discussing multiple processes.

Restrictive endorsements - In February 2017, in response to the audit fieldwork, all Charter Filing employees were provided a restrictive State of Maryland “for deposit only” endorsement stamp. Mail is now opened by the Charter Filing clerk that will process the filing. If there is a check or checks in the envelope, the clerk immediately stamps the restrictive endorsement on the back of the check and date stamps the documents. Checks are bundled and picked-up by an SDAT Accounting employee and deposited the next business day. Checks received late in the day, or those that cannot be processed by the close of business, are dropped in the Charter safe.

Additional corrective action is in progress. The State is in process of transitioning to a new lockbox vendor, Wells Fargo. Wells Fargo is offering new technology that will allow Charter staff to deposit checks contemporaneously with the processing of Charter documents and filings, resulting in same day deposit into the SDAT Wells Fargo lockbox. SDAT plans to have this technology implemented by July 1, 2018.

Regarding the statement that “*checks were kept in plain view on employee desks and were accessible to the public and to the contractual custodial staff prior to deposit*”, **corrective action has been implemented.** The SDAT Compliance Director completes random walkthroughs of the Charter Division during and after working hours to verify no checks are left unattended and no checks are left out at the end of the business day.

Regarding the statement that “*DAT personnel routinely removed checks from the deposit*”, this occurs if in processing a business filing or document an error is identified, the document with the check must be returned to the customer. **In this regard, corrective action has been implemented.** In July 2017, the Department ordered stamps that imprint “**Enclosed is your check # _____ in the amount of \$ _____**”. Now, if a document is rejected and must be returned to the customer with the check, a letter stating why the document was rejected is stamped with “**Enclosed is your check # _____ in the amount of \$ _____**”. The Charter employee fills in the check information, and scans the letter to the Returned Letters folder (saved in files by date of letter) on the Charter common drive.

10b. SDAT agrees with the finding; corrective action has been completed.

Independent reconciliations of collections occurs on a daily and monthly basis. Daily revenue received in the lockbox account (Citi Bank) is reconciled to the funds wired to the State Treasurer’s Office (*via* R*STARS) to the receipts posted in MBES. Daily Customer Counter receipts (cash credit cards and checks) are reconciled to R*STARS deposits.

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On a monthly basis:

- Charter Customer Counter cash receipts are reconciled to bank deposits (*via* R*STARS) and cash receipts posted in MBES Revenue Received Report.
- Charter Customer Counter checks received are reconciled to (BofA CashPro) deposits, to R*STARS record of deposits, and to check receipts posted in MBES Revenue Received Report.
- Maryland Business Express receipts are reconciled to funds wired to the State Treasurer's Office (*via* R*STARS), to credit card and eChecks posted in the MBES Revenue Received Report.
- Lockbox receipts (Citi Bank Statement) are reconciled to the funds wired to the State Treasurer's Office (*via* R*STARS), to the MBES Revenue Received Report.

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Attachment 1

Discovery Audit Analysis Cost Calculations

Printing & Postage Costs Details

	Total # of Letters per Year	Cost of Printing Letters	Cost of Postage	Total Cost of Letters	Combined Cost per Letter
Initial Letters Mailed	600	\$60.00	\$222.00	\$282.00	\$0.47
Follow-Up Letters Mailed	300	\$30.00	\$111.00	\$141.00	\$0.47
Total	900	\$90.00	\$333.00	\$423.00	

The printing cost of \$0.10 per page includes paper, envelopes, toner, replacement drums, Xerox printing production contract all in 2013 rates. This calculation does not include the Annapolis Data Center charges the Department incurred for access to the data. The postage cost of \$0.37 per letter was the postage rate paid in 2013.

Labor Cost Details

SDAT Personnel Required	Salary per Week	Salary per Day	Number of Days per Month	Personnel Cost per Month	Annual Total Cost before Benefits	Total Cost per Letter before benefits	Personnel Benefits Expense / Mo	Annual Benefits Cost	Annual Total Cost Personnel Benefits	Total Cost per Letter
Database Administrator/ Programmer programming to: create job to gather data create job to run a match execute jobs & create 1 reports per month	\$1,752.06	\$350.41	0.5	\$175.21	\$2,102.47	\$2.34	\$52.56	\$630.74	\$2,733.21	\$4.56
Charter Filing Supervisor to review reports, generate & mail letters track responses, follow up review, generate & mail follow up letters	\$941.92	\$188.38	5	\$941.92	\$11,303.04	\$12.56	\$282.58	\$3,390.91	\$14,693.95	\$24.49
						\$14.90				\$29.05

Labor cost based on actual positions that prepared and sent letter and salary in 2013. Cost of benefits is estimated at 30% of salary. SDAT IT spent a week writing the program to create two computer jobs, (1) to the gather data and (2) to run a match and generate a report, then a few minutes to run an updated report of responses received on a monthly basis. Please note the costs above do not include the Annapolis Data Center fees billed every time data is gathered and matched.

Cost Details for First Letter Mailing

Type of Response	Number of 1st Letter Responses	% of Response vs Letters Sent	Printing & Postage Cost per Letter	Total Cost of Letters w/ Print & Postage by Category	Labor Cost per Letter	Total Cost of Letters w/Labor by Category	Total Cost of Letters by Category	Cost per Letter
No Response	171	29%	\$0.47	\$80.37	\$29.05	\$4,967.55	\$5,047.92	
Bad Address	20	3%	\$0.47	\$9.40	\$29.05	\$581.00	\$590.40	
Returned Mail	63	11%	\$0.47	\$29.61	\$29.05	\$1,830.15	\$1,859.76	
No longer does business in Maryland	61	10%	\$0.47	\$28.67	\$29.05	\$1,772.05	\$1,800.72	
Filed under a different entity	71	12%	\$0.47	\$33.37	\$29.05	\$2,062.55	\$2,095.92	
Total Cost - No Revenue	386	64%		\$181.42		\$11,213.30	\$11,394.72	
Need to Requalify by filing an Annual Report No fees.	125	21%	\$0.47	\$58.75	\$29.05	\$3,631.25	\$3,690.00	
							\$3,690.00	
Revived Filed Annual Report & paid fees.	89	15%	\$0.47	\$41.83	\$29.05	\$2,585.45	\$2,627.28	
Total Letters Sent	600						\$2,627.28	
Total Cost				\$282.00		\$17,430.00	\$17,712.00	\$29.52

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Attachment 1 (continued)

Cost Details for Second Letter Mailing

Type of Response	Number of 2nd Letter Responses	% of Response vs Letters Sent	Printing & Postage Cost per Letter	Total Cost of Letters w/ Print & Postage by Category	Labor Cost per Letter	Total Cost of Letters w/Labor by Category	Total Cost of Letters by Category	Cost per Letter
No Response	188	63%	\$0.47	\$88.36	\$29.05	\$5,461.40	\$5,549.76	
Bad Address	1	0.3%	\$0.47	\$0.47	\$29.05	\$29.05	\$29.52	
Returned Mail	19	6%	\$0.47	\$8.93	\$29.05	\$551.95	\$560.88	
No longer does business in Maryland	25	8%	\$0.47	\$11.75	\$29.05	\$726.25	\$738.00	
Filed under a different entity	25	8%	\$0.47	\$11.75	\$29.05	\$726.25	\$738.00	
Total Cost - No Revenue	258	86%		\$121.26		\$7,494.90	\$7,616.16	
Need to Requalify by filing an Annual Report No fees.	29	10%	\$0.47	\$13.63	\$29.05	\$842.45	\$856.08	
							856.08	
Revived Filed Annual Report & paid fees.	13	4%	\$0.47	\$6.11	\$29.05	\$377.65	\$383.76	
Total Letters Sent	300						383.76	
Total Cost				\$141.00		\$8,715.00	\$8,856.00	\$29.52

Discovery Audit Analysis Revenue Calculations

Revenue Details for First Letter Mailing

Type of Response	Number of 1st Letter Responses	% of Response vs Letters Sent	Required to pay \$100 Requalification Fee	Required to pay \$300 Annual Report Filing Fee	Total SDAT Revenue Generated	Less Total Cost	Net SDAT Revenue Generated
No Response	171	29%					
Bad Address	20	3%					
Returned Mail	63	11%					
No longer does business in Maryland	61	10%					
Filed under a different entity	71	12%					
Total Cost - No Revenue	386	64%	no	no	\$0.00	\$11,394.72	-\$11,394.72
Need to Requalify by filing an Annual Report No fees.	125	21%	no	no	\$0.00	\$3,690.00	-\$3,690.00
Revived Filed Annual Report & paid fees.	89	15%	yes	yes	\$35,600.00	\$2,627.28	\$32,972.72
Total Letters Sent	600						
Revenue Created - Cost					\$35,600.00	\$17,712.00	\$17,888.00

Revenue Details for Second Letter Mailing

Type of Response	Number of 2nd Letter Responses	% of Response vs Letters Sent	Required to pay \$100 Requalification Fee	Required to pay \$300 Annual Report Filing Fee	Total SDAT Revenue Generated	Less Total Cost	Net SDAT Revenue Generated
No Response	188	63%					
Bad Address	1	0.3%					
Returned Mail	19	6%					
No longer does business in Maryland	25	8%					
Filed under a different entity	25	8%					
Total Cost - No Revenue	258	86%	no	no	\$0.00	\$7,616.16	-\$7,616.16
Need to Requalify by filing an Annual Report No fees.	29	10%	no	no	\$0.00	\$856.08	-\$856.08
Revived Filed Annual Report & paid fees.	13	4%	yes	yes	\$5,200.00	\$2,627.28	\$2,572.72
Total Letters Sent	300						
Revenue Created - Cost					\$5,200.00	\$11,099.52	-\$5,899.52

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