

Audit Report

**Comptroller of Maryland
Compliance Division**

December 2020



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

Victoria L. Gruber
Executive Director

Gregory A. Hook, CPA
Legislative Auditor

December 18, 2020

Senator Clarence K. Lam, M.D., Co-Chair, Joint Audit and Evaluation Committee
Delegate Carol L. Krimm, Co-Chair, Joint Audit and Evaluation Committee
Members of Joint Audit and Evaluation Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Comptroller of Maryland (COM) – Compliance Division for the period beginning March 16, 2016 and ending March 17, 2019. The Division is primarily responsible for enforcement of all tax laws administered by COM, including those relating to individual income taxes and business taxes such as corporate income, withholding, and sales and use taxes. The Division is also responsible for administering the Uniform Disposition of Unclaimed Property Act.

Our audit disclosed that the Division did not consistently perform three of its tax compliance programs, and did not maintain adequate documentation of management's analysis and reasoning for not performing these programs. For each of the most recent tax years that the three programs were performed, the programs collectively resulted in tax assessments totaling approximately \$459.8 million.

Our audit also disclosed that tax assessments for businesses that failed to file required tax returns were not always prepared and recorded timely in accordance with the Division's procedures, and critical adjustments to taxpayer accounts, such as adjustments affecting the taxpayer's liability, were not adequately controlled. Furthermore, the Division did not assess penalties, as required by law, when holders of unclaimed property failed to remit such property to the Division when required, and the Division did not ensure that manual calculations of interest and penalties included in sales and use tax assessments were accurate.

Finally, our audit included a review to determine the status of three of the four findings contained in our preceding audit report. Although the Division had

concurrent with all prior audit findings and recommendations, we determined that all three of these findings are repeated in this report. The remaining finding, which related to controls in the cash office located in Baltimore, was repeated in our audit report of COM – Revenue Administration Division.

COM's response to this audit, on behalf of the Division, is included as an appendix to this report. In accordance with State law, we have reviewed the response and, while COM generally agrees with the recommendations in this report, we identified certain instances in which statements in the response conflict with or disagree with the report findings. In each instance, we reviewed and reassessed our audit documentation, and reaffirmed the validity of our finding. In accordance with generally accepted government auditing standards, we have included "auditor comments" within COM's response to explain our position. We will advise the Joint Audit and Evaluation Committee of any outstanding issues that we cannot resolve with COM. We have also edited COM's response to remove certain contractor names, as allowed by our policy.

We wish to acknowledge the cooperation extended to us during the audit by the Division. We also wish to acknowledge COM's and the Division's willingness to address the audit issues and implement appropriate corrective actions.

Respectfully submitted,

A handwritten signature in black ink that reads "Gregory A. Hook". The signature is written in a cursive, flowing style.

Gregory A. Hook, CPA
Legislative Auditor

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Background Information

Agency Responsibilities

The Compliance Division's primary responsibilities include enforcement of all tax laws administered by the Comptroller of Maryland (COM), including those relating to individual income taxes, as well as business taxes such as corporate income, withholding, and sales and use taxes. Primary functions include conducting taxpayer audits and investigations, collecting delinquent taxes, and performing other taxpayer compliance activities. In conjunction with these functions, the Division levies tax assessments and processes tax appeals. Collection tools used by the Division include filing tax liens, issuing bank attachments, employing independent collection agencies, and other steps such as preventing the renewal of an individual's driver's license. The Division uses the COM's automated State of Maryland Tax (SMART) system to access, retrieve, and record tax data and other information as necessary. The Division is also responsible for administering the Uniform Disposition of Unclaimed Property Act.

According to the Division's records, as of June 30, 2019, outstanding individual income taxes (excluding interest and penalties) and business taxes that were subject to collection by the Division totaled approximately \$617.9 million and \$364.3 million, respectively. According to the State's records, during fiscal year 2019, the Division's operating expenditures totaled approximately \$34.7 million, and collections from its enforcement programs totaled \$689.3 million.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of three of the four findings contained in our preceding audit report dated April 10, 2017. As disclosed in the following table, we determined that all three findings are repeated in this report, although the Division took limited corrective action with certain elements of those prior findings. We did not follow up on the finding in our preceding audit report that related to controls in the cash office located in Baltimore; the status of this finding was repeated during our audit of COM – Revenue Administration Division.

Status of Preceding Findings

| Preceding Finding | Finding Description | Implementation Status |
|-------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|
| Finding 1 | The Compliance Division did not consistently perform one of its annual compliance programs to identify and pursue certain individuals who failed to file required income tax returns, and there was a lack of documentation of the reasons and management’s approval for the related decisions. | Repeated (Current Finding 1) |
| Finding 2 | The Division did not ensure that tax assessments for businesses that failed to file required tax returns were prepared and recorded timely in accordance with its procedures. | Repeated (Current Finding 2) |
| Finding 4 | Critical adjustments to taxpayer accounts were not always reviewed and documented in accordance with the Division’s procedures as required. | Repeated (Current Finding 3) |

Findings and Recommendations

Taxpayer Compliance Programs

Finding 1

The Division did not consistently perform three of its available compliance programs designed to identify and pursue certain individuals who failed to file required income tax returns or report all income.

Analysis

The Division did not consistently perform three of its available tax compliance programs designed to identify and pursue certain individuals who failed to file required income tax returns or report all income. As a result, the Division lacked assurance that individuals specifically targeted by the programs, such as those who filed extensions but had not yet filed the related tax returns, eventually complied with the filing requirements and paid any resulting tax liabilities.

We reviewed six of the Division's tax compliance programs and noted that three of the programs targeting certain non-filers, had not been performed for between two and four tax years as of July 2019. Tax data for these three programs was available for tax years through tax year 2016. However, one program was last performed for tax year 2012, another for tax year 2013, and the third for tax year 2014 with no documented explanation for not performing these programs. For each of the most recent tax years that the aforementioned three programs were performed, the programs collectively resulted in tax assessments totaling approximately \$459.8 million. Collections associated with these programs during fiscal years 2016 through 2019 totaled \$58.7 million¹.

Division management advised us that these programs were not performed for the aforementioned tax years in order to allocate resources for other compliance programs. While we recognize the need to consider available resources and potential collection results, other considerations, such as the need to enforce compliance with filing requirements, are important as well. Therefore, decisions to forgo programs should be formally justified, including the supporting data analyses.

¹ Tax data necessary to perform a compliance program for a particular tax year may not be available for up to two years after that tax year. Consequently, collections relating to the performance of a particular program may be received several years after the tax year in question. Program collections received are often less than the corresponding assessment for several reasons, including, for example, those cases in which the taxpayer files a return and provides documentation supporting an amount due less than the assessment.

Similar conditions were commented upon in our preceding audit report. In response to our prior report, beginning in fiscal year 2018 the Division began preparing an annual schedule of compliance programs to be completed for the year, which is approved by management personnel. Although in response to our prior finding the Division had agreed to document the determination and reasoning for not completing an established compliance program, this was not completed for fiscal years 2018 and 2019. Specifically, the current schedule does not include the Division's analysis and reasoning when an established compliance program is not completed for a particular tax year, such as those noted above, as recommended in our preceding audit report.

Recommendation 1

We recommend that for available non-filer compliance programs not conducted each year, the Division prepare and maintain adequate documentation containing the Division's analysis and reasoning for that determination (repeat).

Business Tax Assessments

Finding 2

The Division did not ensure that tax assessments for businesses that failed to file required tax returns were prepared and recorded timely in accordance with its procedures.

Analysis

The Division's business tax collection unit did not ensure that tax assessments were prepared and recorded in the Comptroller of Maryland's automated State of Maryland Tax (SMART) system on a timely basis when businesses failed to file required business tax returns, such as for sales and use taxes and withholding taxes. The recordation of an assessment initiates the billing process. During fiscal year 2019, assessments against businesses that failed to file required returns for those two tax types totaled approximately \$7.5 million according to the Division's records. However, collection efforts cannot begin until tax assessments are prepared and posted to taxpayer accounts.

The Division's procedures specify that, when these accounts are identified, a notice and demand letter for each outstanding return is sent to the taxpayer who is provided 10 days to respond. If the taxpayer fails to satisfactorily respond to the demand letter within 10 days, the account is flagged for a tax assessment and, within 30 days, an assessor should calculate and prepare the assessment, including penalties and interest, based on historical data for the delinquent business or

industry-wide data for like companies. Subsequently, the tax assessment is approved by supervisory personnel, which serves as authorization to post the assessment to the taxpayer's account in SMART and automatically bill the taxpayer.

Our test of 25 large dollar assessments totaling approximately \$7.4 million and prepared during fiscal years 2017 through 2019 disclosed that, for 10 assessments totaling \$4.3 million, the assessments were prepared 2 to 5 months after the notice and demand letters had been sent to the taxpayers. Also, for 9 assessments totaling \$2.2 million, the assessments were not entered into SMART until 31 to 203 days after the assessment calculations were prepared. A similar condition was commented upon in our two preceding audit reports. Although the range of the delay in preparing the assessments noted in the prior audit report was more extensive, improvement is still warranted given the significance of the process.

Recommendation 2

We recommend that the Division adequately monitor to ensure that business tax assessments are prepared and recorded on a timely basis (repeat).

Adjustments to Taxpayer Accounts

Finding 3

The Division did not adequately control critical adjustments to taxpayer accounts in SMART.

Analysis

The Division did not adequately control critical adjustments to taxpayer accounts in SMART. Critical adjustments, which were processed primarily by four units, include, for example, financial adjustments that affect taxpayer liabilities, such as abatements resulting from taxpayer appeals, changes due to settlements, and adjustments necessary as a result of error corrections. Due to limitations on the SMART system, the Division cannot establish online controls over critical adjustments, and instead relies on supervisory reviews of output reports of critical transactions.

- The Division did not document supervisory review of output reports of certain critical adjustments made by one unit to taxpayer accounts as required by established policies and procedures. For example, our review of 22 adjustments processed by one Division unit that were listed on output reports during fiscal years 2016 through 2019, disclosed that 4 adjustments did not have documentation of the required supervisory review. These 4 adjustments

decreased taxpayer liabilities by approximately \$1 million, and decreased collections recorded in taxpayer accounts by \$5.9 million. We noted that the adjustment amounts processed in SMART agreed to the amounts that had been approved prior to processing. Similar conditions regarding the lack of documentation of supervisory review of processed adjustments were commented upon in our preceding audit report.

- Output reports for adjustments processed by two units we reviewed excluded certain types of adjustments to write off or otherwise reduce taxpayer liabilities. For example, according to the Division's records, the output reports generated for one of these two units excluded approximately \$16 million in adjustments. Consequently, these adjustments would not be subject to the units' supervisory reviews.
- Our review of SMART access for four Division units disclosed that access to process critical adjustments for 10 users within three units was not terminated when they moved to other positions within the Division. We verified that these 10 users did not process critical adjustments during our audit period.

The State of Maryland *Information Technology Security Manual* requires agencies to enforce access controls that provide separation of duties, and to monitor the controls over their information systems, including assigning appropriate system permissions and responsibilities for agency system users. In addition, the Division's policies and procedures require documentation of supervisory reviews for certain critical adjustments.

Recommendation 3

We recommend that the Division adequately control critical adjustments in SMART. Specifically, we recommend that the Division ensure that

- a. critical adjustments to taxpayer accounts identified on output reports are reviewed by an independent supervisor in accordance with established procedures, and that adequate documentation supporting the adjustments and their independent review and approval is maintained (repeat);**
- b. output reports used by supervisors to ensure the propriety of transactions include all critical adjustments;**
- c. the adjustments excluded from output reports were valid, by examining related supporting documentation on a test basis; and**
- d. access to process critical transactions is removed when it is no longer needed, including access for the aforementioned 10 users.**

Unclaimed Property

Finding 4

The Division did not assess penalties, as required by law, when holders of unclaimed property failed to remit such property to the Division.

Analysis

The Division did not assess required penalties when holders of unclaimed property, such as financial institutions and insurance companies, failed to report and remit the property to the Division. State law provides that unclaimed property, such as savings accounts, shall be reported and remitted by the property holder to the Division annually. In general, property is assumed to be abandoned when there is no owner contact with the holder regarding the property for three years. If unclaimed property is not remitted by the holder when required, a financial penalty equal to 15 percent of the property value is to be imposed on the holder. However, we were advised by Division management that the Division's policy has been to not assess this penalty in order to maintain a positive working relationship with property holders.

The Division uses several independent contractors to perform nationwide audits to help identify and recover unreported unclaimed property owned by Maryland residents. However, when the contractors identified unclaimed property not previously reported and remitted, the Division did not assess the required penalties on the property holder for failing to report and remit the unclaimed property on their own. For example, for 15 of the audits conducted in fiscal year 2018, we noted unreported unclaimed property totaling approximately \$5.9 million identified by the contractors that was subsequently to be transferred to the State. Because of the Division's practice of not assessing penalties, the State will not receive approximately \$885,000 (15 percent of the value of the property) from the related property holders for failing to submit the unclaimed property.

Timely submission by holders of unclaimed property is critical to ensure the Division can facilitate the return of the funds to the rightful owner. Furthermore, the Division paid commissions totaling \$8.1 million (6 to 12 percent of the identified amount remitted to the State) to the aforementioned contractors between April 2016 and February 2019. Since these commissions are paid using State funds, the assessment of penalties would help to offset the audit costs to the State.

Recommendation 4

We recommend that the Division

- a. assess required penalties when unclaimed property is not reported and remitted to the Division when required, and**
- b. consult with legal counsel to determine the feasibility of retroactively assessing fees for unclaimed property previously identified and already remitted to the State.**

Calculations of Penalties and Interest on Assessments

Finding 5

The Division did not ensure that manual calculations of interest and penalties included in sales and use tax assessments were accurate, which resulted in incorrect interest and penalties being assessed on certain taxpayers.

Analysis

The Division did not ensure that manual calculations of interest and penalties included in sales and use tax assessments were accurate. We reviewed procedures for two units that manually calculated and recorded interest and penalties totaling approximately \$24.4 million and \$13.8 million, respectively, during fiscal years 2018 and 2019 (as of March 2019). One unit was responsible for calculating interest and penalties for entities that did not file a required sales tax return timely and the other calculated interest and penalties that resulted from unpaid taxes identified during certain audits. Although supervisory personnel reviewed the interest and penalties recorded in SMART, they did not review the underlying manual calculations, which included the use of spreadsheet formulas, to ensure that the calculations were accurate.

Our test of 6 assessments prepared by one of the units, which included interest totaling \$261,023, disclosed that the interest calculation for each of the 6 was incorrect, resulting in overcharges totaling \$13,314. In addition, our test of 15 assessments prepared by the other unit, with penalties totaling approximately \$11 million, disclosed that for one assessment the penalty amount was understated by \$429,528. The Division was not aware of these errors until we brought them to their attention.

Recommendation 5

We recommend that the Division

- a. ensure that manual calculations of interest and penalties are reviewed for propriety and accuracy, and**

- b. correct the interest calculation and penalty errors noted in our finding and recover or return any amounts improperly assessed on the taxpayer.**

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Comptroller of Maryland (COM) – Compliance Division for the period beginning March 16, 2016 and ending March 17, 2019. 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 the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the Division’s financial transactions, records, and internal control, 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 the identification, assessment, and collection of individual income taxes and various business taxes; and the identification, collection, and distribution of unclaimed property. We also determined the status of three of the four findings contained in our preceding audit report. The remaining finding was followed up in our audit of COM – Revenue Administration Division.

Our audit did not include certain support services provided to the Division by COM – Office of the Comptroller. These support services (such as processing of invoices, maintenance of accounting records, human resources, related fiscal functions, and payroll processing prior to January 1, 2018) are included within the scope of our audits of the Office of the Comptroller. In addition, our audit did not include certain support services provided to the Division by COM – Central Payroll Bureau, effective January 1, 2018. These support services (payroll processing) are included within the scope of our audits of the Central Payroll Bureau since that date. Furthermore, our audit did not include certain support services provided to the Division by COM – Information Technology Division related to the procurement and monitoring of information technology equipment and services and the operation of the Annapolis Data Center. The operation of the Annapolis Data Center includes the development and maintenance of Division applications and maintenance of the operating system and security software environment. These support services are included in the scope of our audits of the Information Technology Division.

Our assessment of internal controls was based on agency procedures and controls in place at the time of our fieldwork. Our tests of transactions and other auditing procedures were generally focused on the transactions occurring during our audit period of March 16, 2016 to March 17, 2019, but may include transactions before or after this period as we considered necessary to achieve our audit objectives.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of the Division'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 also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure 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 Comptroller's automated State of Maryland Tax system, and the systems used by the Division to account for and monitor unclaimed property and business tax collections for the purpose of testing certain areas, such as collection activity and the disposition of unclaimed property. 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.

The Division'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. As provided in *Government Auditing Standards*, there are five components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring. Each of the five components,

when significant to the audit objectives, and as applicable to the Division, were considered by us during the course of this audit.

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 the Division'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 the Division that did not warrant inclusion in this report.

The response from COM, on behalf of the Division, 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 COM regarding the results of our review of its response.

APPENDIX



Peter Franchot
Comptroller

Sharonne R. Bonardi
Deputy Comptroller

November 24, 2020

Mr. Gregory A. Hook, CPA, Legislative Auditor
300 West Preston Street
Room 1202
Baltimore, Maryland 21201

Dear Mr. Hook:

Enclosed is the Comptroller's response to your report on the Compliance Division for the period beginning March 16, 2016 and ending March 17, 2019.

We have carefully reviewed each finding, and we believe that our responses fully address each recommendation contained in the report. Should you need additional information or clarification, please contact Lindsay Welsh, External Audit Manager, Office of Risk Management by email at lwelsh@marylandtaxes.gov or by telephone at 410-260-6156.

The Comptroller appreciates your objective appraisal of our operations and your recommendations for continuous improvement and commends your auditors for their professionalism and thorough review.

Sincerely,



Sharonne R. Bonardi
Deputy Comptroller



Daniel C. Riley, Jr.
Director, Compliance Division

Cc: Honorable Peter Franchot, Comptroller

**Compliance Division
March 16, 2016 through March 17, 2019**

Agency Response Form

Background Information

| Agency Response | |
|-----------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Agency Responsibilities | Factually Accurate |
| Please explain any concerns with factual accuracy. | It is our understanding that OLA prefers not to include the Division's performance measures for Fiscal Year 2019: Personal Income Tax Collections, \$427.5 million Business Tax Collections, \$261.7 million Business Tax Audit Assessments, \$67.6 million Unclaimed Property paid 43,752 claims in the amount of \$71.2 million |

**Compliance Division
March 16, 2016 through March 17, 2019**

Agency Response Form

Finding 1
The Division did not consistently perform three of its available compliance programs designed to identify and pursue certain individuals who failed to file required income tax returns or report all income.

We recommend that for available non-filer compliance programs not conducted each year, the Division prepare and maintain adequate documentation containing the Division’s analysis and reasoning for that determination (repeat).

| Agency Response | | | |
|-----------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|---------|
| Background / Analysis | Factually Accurate | | |
| Please explain any concerns with factual accuracy. | <p>As a result of the preceding audit report in April 2017, the Compliance Division instituted a procedure of discussions between the Manager of the Compliance Programs Section and Division Management when the schedule of annual audit programs to be run was requested to be changed. As a result of those discussions, the Division Director “signed off” on those changes. The Division has provided a copy of those “sign offs” from August 30, 2017, April 25, 2018, May 17, 2019 and October 29, 2019. While it is indicated that OLA was expecting a more detailed analysis to be provided and documented, the Division had been made aware of changes to the Compliance Programs annual audit program and had agreed to the changes.</p> <p>The OLA audit notes three non-filer programs that had not been run. As had been discussed during the previous audit, the Information Technology Division (ITD) resources are stretched to capacity and in some instances resources are not available with a working knowledge of audit programs and the underlying programming. Those same resources are also utilized to work on current year filing season preparation. Changes to audit programs that are not properly executed and then later fully tested can result in errors in liabilities and potential false positives that create taxpayer dissatisfaction and ultimately more work for the Division. The result is that all audit programs anticipated to be run on an annual basis may not be. The Compliance Division has no reason to believe that statute or revenue has been lost.</p> | | |
| Recommendation | Agree | Estimated Completion Date: | 12/2020 |

Compliance Division
March 16, 2016 through March 17, 2019

Agency Response Form

| | |
|-----------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Please provide details of corrective action or explain disagreement. | The Division realizes the importance of the Compliance Program Section's annual audit programs and works within its resources and those of the agency to manage the annual audit programs. As requested, the Division will better document its reasoning and analysis for changes made to the annual audit program on a quarterly basis. |
|-----------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

**Compliance Division
March 16, 2016 through March 17, 2019**

Agency Response Form

Finding 2

The Division did not ensure that tax assessments for businesses that failed to file required tax returns were prepared and recorded timely in accordance with its procedures.

We recommend that the Division adequately monitor to ensure that business tax assessments are prepared and recorded on a timely basis (repeat).

| Agency Response | | | |
|----------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|------------|
| Background / Analysis | Factually Accurate | | |
| Please explain any concerns with factual accuracy. | <p>OLA acknowledged improvement in this area from their last audit. During the fiscal years referenced in this finding, the Compliance Division generated the following estimated assessments: FY 2017, 109 assessments totaling \$3,861,529 FY 2018, 96 assessments totaling \$4,951,685 FY 2019, 121 assessments totaling \$7,316,406</p> <p>While the Compliance Division does acknowledge that there was a delay of 2-5 months in preparing 10 assessments and while collection efforts cannot begin until these assessments are posted and declared final, the Division <u>did not lose any statutory authority</u> to effect collection of these 10 assessments. During this same time period, the Division did produce 326 estimated assessments.</p> <p>The delay in entering 9 assessments into SMART also did not impact the statutory authority to effect collections</p> | | |
| Recommendation | Agree | Estimated Completion Date: | 07/15/2020 |
| Please provide details of corrective action or explain disagreement. | <p>Correctively the Division has changed their procedures to identify, process and enter estimated assessments into SMART within 120 days that the case is routed to the Estimated Assessment work group.</p> | | |

**Compliance Division
March 16, 2016 through March 17, 2019**

Agency Response Form

Finding 3
The Division did not adequately control and approve critical adjustments to taxpayer accounts in SMART.

We recommend that the Division adequately control and approve-critical adjustments on SMART. Specifically we recommend that the Division ensure that

- a. critical adjustments to taxpayer accounts are reviewed and approved in accordance with established procedures, and that adequate documentation supporting the adjustments and their independent review and approval is maintained (repeat);**
- b. output reports used by supervisors to ensure the propriety of transactions include all critical adjustments;**
- c. the adjustments excluded from output reports were valid, by examining related supporting documentation on a test basis; and**
- d. access to process critical transactions is removed when it is no longer needed, including access for the aforementioned 10 users.**

| Agency Response | |
|-----------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Background / Analysis | Factually Accurate |
| Please explain any concerns with factual accuracy. | <p>Critical adjustments were documented. The adjustment for \$5.7 million was miscategorized by the auditors as an adjustment requiring approval. The Manager of Business Tax Collections is responsible for monitoring business tax accounts receivables and delinquencies. The Manager identified a misapplied Sales Taxpayment made by a business taxpayer’s account which posted to the incorrect period. The Manager requested, within their authority, to move the payment to the correct period. This action resolved a delinquency and brought the taxpayer’s account into balance. This corrective action did not result in any receivable loss or any tax benefit for the taxpayer. See the attached documentation tracing this adjustment request.¹ The other (3) adjustments were also properly documented. Two (2) adjustments for Write- Off were approved by our Case Review Board and the third adjustment was also authorized and approved as noted in SMART and involved the removal of an out of statute credit which did not affect receivables or impact any collection effort. See attachments for these items also.</p> |

¹ OLA received no “attached documentation” from the Comptroller of Maryland with its response to this audit report finding.

Compliance Division
March 16, 2016 through March 17, 2019

Agency Response Form

Auditor's Comment: The Division disagrees with one of the four adjustments which we stated in our finding did not have documentation of the required supervisory review. The Division contends that supervisory review was not required because the adjustment, which totaled \$5.7 million, only moved a tax payment from one tax period to another tax period for the same taxpayer. However, the fact that an adjustment reduces a payment applied to one period and applies it to another does not mitigate the risk that the adjustment is erroneous or otherwise improper. We believe that the fact that an employee can move and reapply tax payments, even if within the same taxpayer account, warrants documented independent supervisory review and approval.

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| Recommendation a | Agree | Estimated Completion Date: | 04/2020 |
| Please provide details of corrective action or explain disagreement. | Each of the adjustments referenced in this finding by OLA have the necessary documentation. As noted above, the Division strongly disagrees that \$5.7 million adjustment which neither increases or decreases receivables is warranted mention here as it was performed under the purview of the Manager of Business Tax Collections. The Division believes this correction has the necessary audit trail which is provided in the attachment to reflect the request by the Manager and trace this correction in SMART. The Division agrees that these adjustments were not subsequently reviewed by a supervisor to ensure they were correctly entered into the system. An output report of adjustments now includes all users to ensure a review. | | |
| Recommendation b | Agree | Estimated Completion Date: | 04/2020 |
| Please provide details of corrective action or explain disagreement. | The output reports have been changed to identify adjustments based on user logon ID#s. This will ensure that all adjustments are captured on the report regardless of the adjustment type. | | |
| Recommendation c | Agree | Estimated Completion Date: | N/A |
| Please provide details of corrective action or explain disagreement. | As noted by OLA, the testing of adjustment types that were previously excluded from the output report were valid. The Division action on adjustment reports is noted in the action indicated in Finding 3 (b) above. | | |
| Recommendation d | Agree | Estimated Completion Date: | 06/01/2020 |
| Please provide details of corrective action or explain disagreement. | As noted by OLA, none of the (10) users performed any adjustments in SMART. All access has been removed for these (10) users and the Division has implemented a policy in which SMART access by an employee is removed when an employee is assigned to another section within the Compliance Division. | | |

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Finding 4
The Division did not assess penalties, as required by law, when holders of unclaimed property failed to remit such property to the Division.

We recommend that the Division

- a. assess required penalties when unclaimed property is not reported and remitted to the Division when required; and**
- b. consult with legal counsel to determine the feasibility of retroactively assessing fees for unclaimed property previously identified and already remitted to the State.**

| Agency Response | |
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| Background / Analysis | Not Factually Accurate |
| Please explain any concerns with factual accuracy. | <p>The Comptroller’s Office assesses penalties on assessments for unclaimed property on audits that are performed by auditors of the Business Tax Audit Section.</p> <p>The OLA finding addresses audits undertaken by outside contractors on behalf of the Comptroller of Maryland (Comptroller). These audits are performed on holders of unclaimed property that are not previously known to the Comptroller’s Office and are not remitting unclaimed property to the Comptroller’s Office. Since the last OLA review, these audits have realized \$80.6 million dollars of unclaimed property, including liquidated securities, for the periods of FY17-FY19. One contractor has accounted for approximately 91% of that total. While not the only outside contractor auditing on behalf of the Comptroller, they are the largest and representative of the other outside contractors. This contractor currently performs unclaimed property audits on behalf of 47 states and the District of Columbia. While this contractor is highly successful in identifying companies that are holders of previously unreported unclaimed property, they also educate these companies in reporting requirements for each state and the District of Columbia and resolve these audits with the companies eliminating the need for any dispute resolution or collection activity by the Comptroller’s Office. This contractor indicates that no state or the District of Columbia applies penalties or interest to the amount of unreported unclaimed property for audits that they perform. This contractor also indicates that since penalties and interest are not applied it is tremendously beneficial in the quick resolution and payment of the value of unclaimed property found due. The lack of dispute resolution or collection action is critical in</p> |

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| | returning the unclaimed property to the Comptroller's Office and ultimately to the rightful owners quickly. | | |
| | Ultimately, companies audited by the outside contractors then become holders that remit to the Comptroller moving forward and are subject to penalties as appropriate in the future. | | |
| Recommendation a | Choose an item | Estimated Completion Date: | 04/30/2021 |
| Please provide details of corrective action or explain disagreement. | We will consult with counsel and seek legislative sponsorship to amend Title 17 of the Maryland Uniform Disposition of Abandoned Property Act to authorize the Comptroller to exercise discretion in waiving the 15% penalty. | | |
| Recommendation b | Choose an item | Estimated Completion Date: | 06/2021 |
| Please provide details of corrective action or explain disagreement. | We will consult with counsel to determine the feasibility of retroactively assessing penalties for unclaimed property previously identified and already remitted to the State. | | |

Auditor's Comment: The Division's response states that the finding is not factually accurate, but does not in its narrative dispute the facts addressed in the finding. Rather, the response presents an argument for not assessing required penalties in the case of audits undertaken by outside contractors. However, the law does not provide for not assessing required penalties when unreported property is detected through such audits. Further, since the Division notes that penalties are applied when its auditors identify unreported property, there appears to be no legal basis for the distinction between contractor versus in-house staff induced penalties made by the Division in its response. Seeking a law change is an option that the Division is free to pursue and that approach appears to be a tacit acknowledgement of the validity of our finding and recommendation under the present circumstances.

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Finding 5

The Division did not ensure that manual calculations of interest and penalties included in sales and use tax assessments were accurate. As a result, the Division did not identify certain errors in the calculations that resulted in incorrect interest and penalties being assessed on taxpayers.

Recommendation 5

We recommend that the Division

- a. ensure that manual calculations of interest and penalties are reviewed for propriety and accuracy; and**
- b. correct the interest calculation and penalty errors noted in our finding and recover or return any amounts improperly assessed on the taxpayer.**

| Agency Response | | | |
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| Background / Analysis | Factually Accurate | | |
| Please explain any concerns with factual accuracy. | | | |
| Recommendation a | Agree | Estimated Completion Date: | 05/01/2020 |
| Please provide details of corrective action or explain disagreement. | Procedures have been changed requiring an Assistant Manager to conduct a secondary review of the calculations of interest and penalty on Sales Tax Assessments performed by Business Tax Collections. | | |
| Recommendation b | Agree | Estimated Completion Date: | 05/01/2020 |
| Please provide details of corrective action or explain disagreement. | The one assessment that was referenced with an understated penalty amount of \$492,528 was a Field Audit assessment wherein our Case Review Board (CRB) determined that a fraud penalty should be applied. This action was documented with signatures from the CRB and the Chief Auditor. The employee responsible for entering this assessment admittedly did not enter the proper penalty amount. This assessment was entered into the SMART system on 4/13/17 and the audit period was 7/2008 through 12/2016. This business has been closed since 12/31/16 and to date has been uncollectible. Administratively, we have determined that is not beneficial to increase our accounts receivable balances to correct this penalty amount. | | |

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| | <p>All (6) of the assessments where the interest was calculated incorrectly have been corrected along with the interest calculator updated to reflect the declining interest rates on delinquencies that were legislatively passed by the Maryland General Assembly beginning in 2017 and end in 2020. There was no instance whereby the corrections on interest required the taxpayers affected to be reimbursed.</p> |
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AUDIT TEAM

Michael J. Murdzak, CPA
Audit Manager

Richard L. Carter, CISA
Information Systems Audit Manager

Abdullah I. Adam, CFE
Senior Auditor

Roman J. Gouin
Information Systems Senior Auditor

Anthony V. Calcagno
Keli R. Edmonds
Lindsay M. Fertig, CPA
Staff Auditors