

Audit Report

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**State Department of Assessments and Taxation**

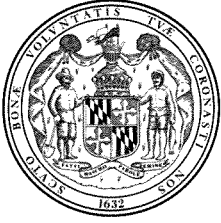
December 2013

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**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

Karl S. Aro  
Executive Director

December 16, 2013

Thomas J. Barnickel III, CPA  
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee  
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the State Department of Assessments and Taxation (DAT) for the period beginning August 21, 2009 and ending July 29, 2012. 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 various functions applicable to corporations.

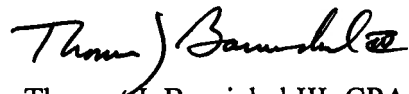
Our audit disclosed that DAT needs to formalize certain aspects of its quality assurance processes related to real property assessments to help ensure local assessment offices are complying with its policies. For example, DAT had not established written policies specifying the documentation to be prepared by local assessment supervisors evidencing their review and approval of assessment values. Furthermore, DAT policies lacked specificity regarding the documentation that should be maintained to support certain individual property assessments. Our tests disclosed variations in the assessment documentation maintained by the three local offices visited. Our audit also disclosed that DAT did not conduct physical exterior inspections of all properties every three years as required by State law, nor did it document the inspections that were performed. The total assessable real property tax base was valued at approximately \$690 billion.

DAT's centralized real property database system (Assessment Administration Valuation System – AAVS) had critical access vulnerabilities due to deficiencies in the AAVS program, and system software updates were not installed. For example, all system users (including those designated with read-only access) could perform unauthorized modifications to critical data via commonly used system functions without detection. Furthermore, DAT's network was not adequately secured because its firewalls and intrusion detection and prevention systems were not properly configured.

DAT also had not performed timely and comprehensive procedures to verify the accuracy of information on personal property returns and applications for homeowners' and renters' credits. Finally, DAT had certain internal deficiencies relating to payments to contractors and the processing of cash receipts.

An executive summary of our findings can be found on page 5. The response from DAT to our findings and recommendations is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by DAT.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas J. Barnickel III". The signature is written in a cursive style with a large initial "T" and a stylized "B".

Thomas J. Barnickel III, CPA  
Legislative Auditor

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

# Executive Summary

## Legislative Audit Report on the State Department of Assessments and Taxation (DAT) December 2013

- **Certain aspects of DAT’s quality assurance process for real property assessments need to be improved. For example, DAT oversight of the local assessment offices should be formalized to help ensure local assessment offices and their assessors are complying with DAT assessment policies. Furthermore, DAT policies lacked specificity regarding the documentation to be maintained to support certain assessment values and to evidence the review and approval of those values by local office supervisors (Finding 1).**

DAT should enhance its quality control process by formalizing policies pertaining to the oversight of local assessment offices performed by area supervisors, and the documentation to be maintained to support assessment values and to evidence those values were reviewed and approved by the local office supervisors.

- **Physical exterior inspections were not performed for all properties in accordance with State law and a record of inspections performed was not maintained (Finding 2).**

DAT should take appropriate actions to help ensure compliance with State law regarding the physical inspection of properties and should maintain records of inspections conducted.

- **The Assessment Administration and Valuation System (AAVS) had access vulnerabilities that placed critical assessment data at risk of unauthorized modification. For example, all AAVS users, including those with read-only access could modify critical data without a record identifying the changes being prepared. Furthermore, DAT did not establish procedures to ensure that certain data (such as property sales and permit information) received from local jurisdictions were properly recorded in AAVS (Findings 3 and 4).**

DAT should perform a full evaluation of AAVS to identify system access vulnerabilities and should ensure appropriate modifications are made. Also, DAT should establish procedures to ensure the completeness and accuracy of data input into AAVS.

- **Personal property returns submitted by businesses for calendar years 2008 through 2011 had not been reviewed to ensure the values reported to DAT were proper, and appropriate actions were not taken to identify businesses that failed to file or submitted returns late. DAT also had not completed audits of applications received from individuals who qualified for homeowners' and renters' tax credits during calendar years 2009 through 2011 (Finding 5).**

DAT should review personal property returns timely and enhance procedures to identify late or non-filers of returns. DAT should also perform timely audits of approved homeowners' and renters' tax credit applications, and take appropriate action to recover any tax credits that are determined to have been improperly granted to homeowners and renters.

- **Security and control weaknesses were noted with respect to DAT's information systems and network, and proper internal controls were not established for certain payments to contractors and for the processing of cash receipts (Findings 6 – 11).**

DAT should take the recommended actions to improve information security controls, to ensure the propriety of contractor payments and to verify all collections received were deposited.



## **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 as well as for various functions applicable to corporations (for example, issuing corporate charters and collecting certain taxes, such as gross receipts taxes). 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 it operates assessment and taxation offices in each of the State's 24 local subdivisions. According to the State's and DAT's accounting records, during fiscal year 2012, DAT's expenditures totaled approximately \$131.5 million and revenue collected totaled approximately \$232 million. DAT's 2011 annual report identified the total assessable real property tax base subject to State tax rates to be valued at \$690 billion consisting of 2,171,132 individual properties.

### **Baltimore City Historic Tax Credits**

The Tax Property Article of the Annotated Code of Maryland provides a property tax credit of up to 25 percent of properly documented expenses of a private owner taxpayer for the restoration and preservation of a structure that the Mayor and City Council of Baltimore City have determined to be of historic or architectural value. According to published reports, errors in the calculation of such Historic Tax Credits resulted in certain Baltimore City properties being granted excessive property tax credits.

The Baltimore City Director of Finance and the DAT Director, in a jointly issued letter to the Chairman of the Senate Budget and Taxation Committee dated October 17, 2013, provided an overview of the tax credit calculation problem and the related procedural solution. The directors indicated that the problem resulted from a change in computation methodology by the City that used assessments that had not been adjusted for certain situations, such as appeals. DAT and the City have now developed a new process whereby DAT will certify assessment amounts to the City for use in calculating the Historic Tax Credit. The directors believe the new process will lead to a more consistent and uniform calculation of the credit.

## **Status of Findings From Preceding Audit Report**

Our audit included a review to determine the status of eight of the nine findings contained in our preceding audit report dated August 4, 2010. We determined that DAT satisfactorily addressed four of the findings and four other findings were not resolved and are repeated in this report. These four repeated findings appear as three findings in this report. During this audit, we did not review the status of the one remaining finding because it was addressed in our February 2013 performance audit entitled *Department of Assessments and Taxation - Homestead Property Tax Credits*.

# **Findings and Recommendations**

## **Real Property Assessments**

### **Background**

The Department of Assessment and Taxation's (DAT) Real Property Valuation Division is responsible for assessing property on a three-year cycle by reviewing one-third of all property in Maryland every year and certifying the assessed value to the 24 local governments for each property within their respective subdivision. The valuation of property is conducted by assessors working in the 24 local assessment offices (one per county including Baltimore City), under the Division's direction and oversight. DAT maintains an Assessment Administration Valuation System (AAVS) as its primary database system. AAVS includes a wide range of information and history about individual properties, including assessed values. Under the provisions of the Tax-Property Article of the Annotated Code of Maryland, DAT is responsible for promoting fairness in taxation for Maryland property owners by uniformly assessing properties throughout the State at market value.

DAT has adopted national standards for assessing real property as issued by the International Association of Assessing Officers (IAAO). IAAO has issued technical standards for various topics related to property tax administration, property tax policy, and valuation of property including mass appraisal and related disciplines. The objective of IAAO standards, which represent a consensus in the assessing profession, is to provide a systematic means by which assessing officers can improve and standardize the operation of their offices. IAAO standards are advisory in nature and the use of, or compliance with, these standards is voluntary.

Annually, DAT prepares an Assessment Ratio Report to measure the quality of real property assessments as of January 1<sup>st</sup> by reviewing sales for the six-month period before and after January 1<sup>st</sup>. The Report is used to compare its assessed values with the sales values and evaluate the variation against standards developed by IAAO for ratio studies. According to DAT's 2012 Assessment Ratio Report, measured variation was within the acceptable ranges set forth by the IAAO for properties assessed at January 1, 2012.

According to DAT's 2011 State Department of Assessments and Taxation Report, the total assessable real property tax base subject to State and County tax rates was valued at approximately \$690 billion.

Per State law, DAT shall attempt to determine the most effective and equitable method to assess property. DAT uses several assessment methods to determine properties' assessed values. Commercial properties are primarily assessed using the Maryland value, income, and reconcile assessment methods. For residential properties, the primary assessment method used is the Maryland value method. The Maryland value method is based on market conditions and depreciation. The method establishes a market value index (MVI) adjustment factor to adjust the assessed value of the properties, primarily based on the analysis of sales data for comparable properties within a designated geographic area.

### **Finding 1**

**Certain aspects of DAT's quality assurance process for real property assessments and related documentation requirements were not formalized.**

#### **Analysis**

DAT needs to formalize certain quality assurance processes over real property assessments and to clarify the related documentation requirements. IAAO standards state that quality assurance is an important aspect of every valuation system, and the lack of effective quality assurance can result in minor or major gaps, ranging from loss of data to failure to recognize or correct inequities. IAAO standards also state that valuation procedures and models should be documented.

DAT has instituted certain aspects of a comprehensive quality assurance program, such as conducting ratio studies (for example, the Annual Assessment Ratio report required by State law). DAT also employs residential and commercial property area supervisors to oversee the local assessment offices. However, written guidance was not established regarding certain oversight and supervision performed by area supervisors and local office supervisors to help ensure compliance with DAT assessment policies and IAAO standards. Furthermore, our review of the assessment practices at three local assessment offices identified variations in the documentation maintained to support property assessment values. Specifically, we noted the following conditions:

- DAT's independent review processes involving area supervisors were not formalized. While area supervisors are responsible for oversight of the local assessment offices, the extent of area supervisor's reviews, the method for communicating the related findings and corrective actions, and the documentation requirements related to such reviews, were not established in DAT policy. Consequently, DAT had no formal mechanism for assessing the effectiveness of the reviews or the level of compliance of local assessment offices with assessment policies.

At one local office, we noted widespread reductions in assessed land values (which is separate from the values for the dwellings) for residential properties. Specifically, our extraction of data from AAVS indicated that 16,948 of 60,199 accounts for which valuations were performed for the 2012 – 2013 tax year received land value reductions ranging from 20 percent to 43 percent. These reductions decreased the assessable base of these properties by approximately \$285.5 million. While local assessment office personnel could not provide the rationale or documentation to support the reductions (for example, sales analysis), management personnel at DAT headquarters advised us that the reductions were likely done to take into account declining sales in the jurisdiction. Furthermore, DAT advised us that it believed large adjustments such as these would have been discussed with an area supervisor. However, no documentation was provided to substantiate the area supervisor had reviewed and agreed with the reductions.

- DAT had not established written policies delineating the responsibilities of local assessment office supervisory personnel regarding the documentation to be maintained to evidence their review and approval of assessment values. For example, the primary basis for residential assessments is the computation of a market value index (MVI) by assessors that considers property sales in certain geographic areas (such as a neighborhood) to compute a factor used to adjust values for properties with similar characteristics. Although the factors computed by assessors are entered into AAVS by supervisors, there was no requirement that supervisors review the computations for reasonableness and document their approvals before entry into AAVS.

We were advised by DAT management that local office supervisors performed “spot checks” of work performed by assessors by reviewing sales ratios analysis and percentage change reports generated from AAVS. However, there was no formal policy requiring the performance of spot checks, the nature or extent of the spot checks, or the documentation to be maintained evidencing that the spot checks were performed. IAAO standards state that every assessment jurisdiction should establish procedures for internal review of work product, including supervisory review of appraisal and assessment work.

- DAT’s policies lacked specificity regarding the documentation that should be maintained to support individual property assessments under each assessment method. In this regard, our review disclosed variations in the nature and level of documentation maintained by the three local offices to support real property assessments recorded in AAVS for certain commercial and residential properties.

Specifically, our review of 39 commercial real property assessments (with values totaling of approximately \$700 million) disclosed that 12 properties (with assessed values of \$161 million) lacked certain information substantiating the recorded values. For example, 8 of these properties, located in two jurisdictions, were assessed under the income capitalization method (which uses the property's income stream as the basis for determining the assessed value). For 4 of these properties with assessed values totaling \$58 million, DAT lacked current information on which to base the assessments (for example, income information obtained during a prior assessment period was used in calculating the assessment). IAAO standards state that the income approach is the preferred method in valuing commercial property if sufficient income data are available. For the other 4 properties, the assessed values recorded in AAVS (\$91 million) did not agree with the supporting documentation prepared by assessors (\$106 million). Consequently, for these properties, it is unclear which valuation amounts were the appropriate values to use for assessment purposes.

Our review of six residential properties with a total assessable base of \$1.5 million in one jurisdiction disclosed that the local office did not retain documentation supporting the MVI used to adjust the assessed values for five of those properties having an assessable basis of \$1.3 million. We requested support for the MVIs calculated for other properties in the applicable geographic locations (wards); however, the local office could not provide us any documentation to support the MVIs. There were approximately 9,400 properties assessed using the Maryland value method in those wards. We noted that another local assessment office maintained documentation of the sales that were considered in developing the MVIs for its neighborhoods and explanations were on file to support the MVI used in performing the assessment, including when the MVI was not based on comparable sales due to the lack of sales activity in the area.

### **Recommendation 1**

**We recommend that DAT formalize certain aspects of its quality assurance process by**

- a. specifying the nature and extent of the reviews to be conducted by area supervisors, including the method for communicating the findings and corrective actions and the related documentation requirements;**
- b. establishing the responsibilities of local office supervisory personnel and related documentation requirements regarding their review and approval of assessors' work and the resulting assessment values; and**
- c. specifying the documentation to be maintained to support assessment values for commercial and residential properties under each assessment method.**

**Finding 2****Physical exterior inspections were not performed for all properties in accordance with State law.****Analysis**

DAT does not perform physical exterior inspections for all properties due for reassessment during the three-year assessment cycle as required by State law. Furthermore, DAT lacked policies governing how physical inspections should be documented. DAT is responsible for valuing all real property in the State triennially based on an exterior physical inspection of the property in accordance with Title 8 of the Tax-Property Article of the Annotated Code of Maryland.

We were advised by DAT that the physical inspections of properties, as required by State law, have not been conducted for many years primarily because of staffing shortages. Per DAT records, as of fiscal year 2012, 152 field assessors were responsible for assessing 2,171,132 statewide accounts over the three-year cycle, which represents a reduction of 78 assessors since fiscal year 2002. Consequently, DAT only required inspections when certain significant events occurred such as when a property was sold during the assessment period, when a new building was constructed or, at a minimum, every nine years. In addition, DAT personnel advised us that they were able to rely on property sales and permit data received from the local governments to obtain updated property information. However, as noted in Finding 4, sufficient controls were not established over data received from the local governments.

DAT management advised us that it has received 22 additional assessor positions during fiscal years 2013 and 2014, but that those positions are not sufficient to enable it to comply with the physical inspection law. DAT management further advised us that a law change may be necessary. In this regard, IAAO standards indicate that a physical review including an on-site verification of physical characteristics should be conducted at least every four to six years. In addition, other techniques that employ digital imaging technology may be available to assist in identifying changes in property characteristics.

The number of physical inspections conducted by the local offices could not be determined by DAT, since documentation requirements were not established and a record of all inspections was not maintained. AAVS has the capability to record inspection data, including storing photographs; however, the system generally was not used for this purpose or required to be used by DAT.

## **Recommendation 2**

**We recommend that DAT**

- a. take appropriate actions (such as requesting a law change, using technology) to help ensure compliance with State law regarding the physical inspection of properties;**
- b. establish documentation requirements for inspections conducted; and**
- c. maintain records of property inspections conducted and the results.**

## **Assessment Administration and Valuation System**

In October 2006, the Board of Public Works approved a multi-year contract totaling approximately \$7.6 million with a vendor to develop and implement an Assessment Administration and Valuation System (AAVS). AAVS provides DAT with a centralized database, which performs real property valuations and other assessment administration functions such as appeal processing and the generation of assessment notices. On December 31, 2008, the original vendor was purchased by a new vendor, effectively assigning all interests and obligations under the contract to the new vendor. As of October 2012, DAT had paid the vendors a total of approximately \$6.9 million for AAVS. AAVS was accepted in April 2011 when it went operational in all 24 local assessment offices and at DAT's headquarters location.

### **Finding 3**

**AAVS had access vulnerabilities that placed critical assessment data at risk of unauthorized modification and certain historical data was not archived.**

### **Analysis**

AAVS had critical access vulnerabilities and vendor software updates were not installed. Additionally, DAT did not maintain a historical record of assessment data changes for one assessment tax year nor maintain certain documentation pertaining to system conversion. Specifically, we noted the following conditions:

- Due to deficiencies in the AAVS program, system users could perform unauthorized modifications to critical data via commonly used functions without detection. We noted all users (including read-only users) could modify critical server data, application data, and database data without detection, because the modifications made in this manner would not be recorded by the system. The system developer's technical proposal for the implementation of AAVS indicated users would not be able to modify certain critical database files. Upon OLA bringing this matter to its attention DAT notified the AAVS vendor and DAT advised us that the vendor was working



to resolve the issue. At the time of our audit, there were 424 active AAVS user accounts, 50 of which were read-only.

- As of February 27, 2013, we noted DAT was running a version of AAVS that was eight versions behind the currently available version. Although we could not readily determine the nature of the changes in each version, we did note that each version of AAVS had multiple software updates associated with it.
- DAT did not ensure a historical record of changes to AAVS data pertaining to assessments for the 2012 - 2013 tax year was maintained. For each assessment year, shortly after assessment notices are mailed, the production database for the year is copied to a separate database for archiving; however, a historical record of changes was not maintained for the assessments prepared for the 2012 - 2013 tax year. DAT officials advised us that they mistakenly did not copy this data when archiving the database. As a result, the trail of assessment changes or other supporting data recorded in AAVS for that year is no longer available.
- DAT did not maintain complete records of the automated real property system conversion to ensure all property details were properly transferred. While DAT did maintain some preliminary reports on the conversion process and had control totals, no documentation was maintained to show control totals after the conversion. We were advised by DAT management that it believes the process of transferring records from the previous system to AAVS was complete and accurate, as local jurisdictions and other parties (two years later) have not noticed any issues with the data that had been received from AAVS. Nevertheless, DAT should have retained documentation to substantiate the conversion results in case problems subsequently arose.

### **Recommendation 3**

**We recommend that DAT**

- a. perform a full evaluation of AAVS to identify access vulnerabilities and ensure appropriate modifications are made;**
- b. ensure that the most current version of AAVS is being used and implement all software updates in a timely manner;**
- c. maintain historical records of changes to AAVS data; and**
- d. in the future, maintain complete records of the results of any system conversions.**

**Finding 4****DAT procedures did not ensure that certain data recorded in AAVS were complete and accurate.****Analysis**

DAT procedures did not ensure that certain data recorded into AAVS were complete and accurate. Specifically, procedures were not formalized to ensure all relevant data from local county government offices were received and accurately entered into AAVS at any of the three local assessment offices we reviewed. Specifically, our review noted the following conditions:

- For two local offices, critical information (real property sales, transfers, and permit improvement data) was entered into AAVS via a manual process based on paper documents received from local government agencies. However, a receiving log of such documents was not prepared to establish initial accountability and control to ensure all information received was entered into AAVS. This is significant because permits issued which result in \$100,000 or more in improvements require the completion of an assessment at that time. Furthermore, there were no documented supervisory reviews to ensure all data recorded in AAVS, such as sales activity and construction permit information, was properly supported. DAT advised us that supervisors perform “spot checks” of keyed data. Nevertheless, as previously mentioned, these spot checks were not documented.
- In the third local assessment office, data were received electronically from the local government and used to update AAVS. However, there was no verification that data entered to AAVS were properly processed. We noted that for this electronically received data, there were system-generated reports of data processed, including processing errors. While DAT headquarters personnel advised us that the local assessment office was responsible for reviewing these reports, the local office’s supervisor advised us that they lacked sufficient knowledge to review and interpret the reports. Consequently, errors were not corrected. DAT headquarters’ personnel further advised us that they were working to change this report so it would be more reader friendly.

According to the IAAO standard on mass appraisal related to quality control over data collection, a quality control program should review samples of finished work for completeness and accuracy, and keep tabulations of items coded correctly or incorrectly.

#### **Recommendation 4**

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

- a. establish a log to provide initial accountability and control over all property transaction documents received from local governments;**
- b. ensure that the pertinent information from documents or electronic data received are properly recorded in AAVS and any data entry errors are resolved; and**
- c. ensure that supervisors verify that critical data recorded in AAVS are properly supported, and that this verification is documented.**

### **Administration of Certain Tax and Credit Programs**

#### **Background**

DAT is responsible for administering programs related to assessing the personal property of certain entities, granting tax credits to eligible homeowners and renters, and collecting franchise taxes from certain companies.

Annually, DAT assesses 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. Personal property assessments 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. According to its records, as of May 31, 2013, DAT had processed 306,355 accounts related to the filing of personal property returns for the calendar year ended 2011 providing the local subdivisions with a personal property assessable taxable base of \$11.6 billion.

Homeowners and renters are eligible for tax credits based on meeting certain income eligibility requirements. In addition, eligible renters must be over the age of 60, disabled, or under the age of 60 with dependent children. The homeowners' credit limits the property tax paid based on household income up to \$60,000 combined household income. The renters' credit is calculated based on income with the maximum credit being \$750. DAT pays local jurisdictions for homeowners' credits and individual renters for renters' credits. During fiscal year 2012, DAT approved homeowners' tax credits totaling approximately \$62.6 million to 52,594 taxpayers and renters' tax credits totaling approximately \$2.7 million to 8,316 taxpayers.

State law requires telephone, electricity, and natural gas providers to file a franchise tax return by March 15<sup>th</sup> following the end of the calendar year and pay DAT a franchise tax on gross receipts for the year. During fiscal year 2012, DAT's franchise tax collections totaled approximately \$127.1 million.

**Finding 5**

**DAT had not performed timely and comprehensive verification procedures to help ensure the accuracy of information on certain returns and tax credit applications.**

**Analysis**

Certain verification procedures established by DAT were not performed timely or were not comprehensive. These procedures were designed to help ensure the accuracy of information submitted on personal property returns, franchise tax returns, and applications for homeowner's and rental tax credits. Specifically, our review disclosed the following conditions:

- As of March 2013, DAT's procedure to audit selected personal property returns had not been performed for returns submitted for calendar years 2008 through 2011 (the latest tax year completed at the time of our audit). Such audits verify the propriety of the reported personal property values and ensure the return information was accurately recorded into DAT's personal property assessment system for certification purposes. Our test of 20 personal property returns submitted for calendar years 2010 and 2011 disclosed that due to a data entry error made for one return, the combined assessed value of personal property in two jurisdictions should have been recorded as \$36,500 but, instead, no value was recorded. We were advised by DAT these audits of personal property returns were not completed due to staffing issues and the significant amount of time required to manually enter personal property data into the assessment system. Although reviews of returns would still be necessary, DAT should determine the feasibility of instituting electronic filing of the returns to improve overall efficiency and accuracy.

Similarly, as of March 2013, DAT had not completed audits of the selected applications received from homeowners and renters who were granted tax credits for calendar years 2009 through 2011. At that time, DAT advised that it was reviewing credits granted in 2009. For example, one type of audit involves the random selection of five percent of approved applications to ensure the taxpayer qualified for the credit, that proper supporting documentation (such as a federal income tax return) was submitted, and that the related data were recorded properly in DAT's automated system. This condition was commented upon in our preceding audit report. Our test of 15 homeowners' credits processed during the period of February 2012 to March

2013 for a total of approximately \$69,000, disclosed that supporting documentation for 5 credits totaling approximately \$16,600 was not on file. In addition, one applicant received a credit of \$529 more than they should have due to a data entry error.

Additionally, as of January 2013, DAT could not substantiate the extent to which franchise tax returns dating back to calendar year 2007 had been reviewed. Although DAT indicated that some, but not all returns for each year had been reviewed, a record of the specific returns reviewed and the results was not maintained. DAT requires that every franchise tax return (approximately 290 for calendar year 2010) be reviewed to verify mathematical accuracy and to validate certain information reported on the tax return (such as, the gross operating revenues earned by the companies). Similar conditions regarding the backlog of franchise tax returns to be reviewed were commented upon in our preceding audit report.

- Data matches to identify entities that failed to file personal property returns as required were conducted on a very limited basis. As of January 2013, the latest match between DAT's records and the Comptroller of Maryland's State vendor payment records and active sales tax accounts records was conducted for the calendar year 2009 filings. Furthermore, the match only included the entities located in one county. That match identified 1,227 potential non-filing entities. Based on DAT's records, we noted that as of the 2011 filing year, businesses operating in seven counties have not been subject to any match processes dating back to 2005. State law requires DAT to place businesses in forfeited status, which provides that the business should be prohibited from conducting business in the State, when the business fails to file at least one annual personal property return and remit the related filing fee (generally \$300 annually).
- DAT did not ensure all jurisdictions submitted electronic files of homeowners' tax credits redeemed on the paid property tax bills. During our audit period, 11 jurisdictions had not submitted any of the required monthly electronic redemption reports, which would enable DAT to determine if excess credits were claimed and consequently funds were owed to the State. Differences may occur due to a property being transferred, thus altering the allowable tax credit. DAT approved homeowners' credits totaling \$18.9 million for these 11 jurisdictions in fiscal year 2012. For the 13 jurisdictions that submitted the files, we noted there was no documentation that DAT reviewed the results of the electronic matches for 5 jurisdictions.

## **Recommendation 5**

**We recommend that DAT**

- a. perform timely verifications of personal property tax returns, approved homeowners' and renters' tax credit applications, and franchise tax returns (repeat);**
- b. expand its data matches to identify entities that did not file personal property returns, and consider a risk-based approach for following up on non-filing entities;**
- c. ensure that local jurisdictions submit monthly electronic redemption reports and generate exception reports of redeemed credits versus approved credits and perform documented reviews of the exceptions; and**
- d. determine the cost benefits of instituting electronic filing for personal property tax returns.**

## **Information Systems Security and Control**

### **Background**

DAT operates several critical computer applications and databases on its internal network and on the Comptroller of Maryland's Annapolis Data Center (ADC) mainframe. These include the server based AAVS, property tax credit databases, and the mainframe based Maryland Business Entity System, which contains registrations of business entities and related filings and assessments. DAT also operates a statewide network that connects its local offices and the DAT headquarters' internal network. DAT's statewide network provides users' access to various information technology services including the AAVS system, ADC mainframe based applications, a database management system, network services, email services, and Internet access.

### **Finding 6**

**Access and monitoring controls over the AAVS database were not sufficient to protect critical data.**

### **Analysis**

Access and monitoring controls over the AAVS database were not sufficient to protect critical data. Specifically, we noted the following conditions:

- A default administrative database account unnecessarily had full access to the AAVS database. Since this account included local server administrators by default, all local administrators on the database server had full administrative access to this database. Also, anyone able to achieve local administrator

privileges would automatically have full administrative access to this database and could perform unauthorized modifications to critical data.

- Numerous critical security related events for the AAVS database were not logged. In addition, although the database was set to record failed login attempts, we were advised that these failed login attempts were not reviewed. Finally, for security events that were logged, documented reviews of logged activity did not exist.

The State of Maryland Department of Information Technology (DoIT) *Information Security Policy* states that each agency must establish an authorization process which specifically grants access to information ensuring that access is strictly controlled, audited, and that it supports the concepts of “least possible privilege”. This *Policy* also requires that procedures 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 6**

**We recommend that DAT**

- a. limit access to all critical databases to personnel whose job duties require such access; and**
- b. log critical security events for the AAVS database, regularly review these logs, investigate unusual or questionable items and document and retain these reviews and investigations.**

#### **Finding 7**

**The DAT network was not adequately secured.**

#### **Analysis**

The DAT network was not adequately secured. DAT operated virtual private network connections to its network, a firewall at its network interfaces, and a network-based intrusion detection and prevention system (IDPS). Specifically, we noted the following conditions:

- DAT improperly allowed two untrusted third parties with the capability to access its entire internal network by use of virtual private network connections. For example, one vendor could access the entire DAT internal network over all ports via virtual private networks. Consequently, such access could allow the vendors to conduct unauthorized and inappropriate activities on DAT’s systems.

- DAT's firewall was not properly configured to send all critical network traffic to the network-based IDPS for analysis. Specifically, the firewall was not configured to send any traffic from outside of the DAT network (for example, Internet traffic) to the IDPS for analysis.
- Due to improper configuration, the IDPS did not analyze any network traffic sent by the firewall. Therefore, the network-based IDPS device was not providing any intrusion detection protection for the DAT network.
- DAT did not use Host-based Intrusion Protection Systems (HIPS) on critical web servers that processed encrypted traffic. The absence of HIPS coverage for such traffic created network security risk in that DAT's network-based IDPS cannot read encrypted traffic flowing into its network whereas HIPS can read and analyze such traffic and protect critical web servers from malicious traffic.
- Remote administrative access to the network-based IDPS module was not adequately restricted to only those users who required such access. For example, through connections with the Internet, individuals could make a remote management connection to the IDPS module.

DoIT's *Information Security Policy* requires that agency systems be configured to monitor and control communications at external boundaries. Strong network security uses a layered approach, relying on various resources, and is structured according to assessed network security risk. Properly configured IDPS protection can aid significantly in the detection/prevention of and response to potential network security breaches and attacks. Furthermore, without proper monitoring, critical network security breaches may occur that could otherwise possibly be detected and prevented.

### **Recommendation 7**

**We recommend that DAT**

- a. configure its firewall and virtual private networks to achieve a "least privilege" security strategy giving individuals and devices only those privileges needed to perform assigned tasks;**
- b. modify the network-based IDPS and firewall configurations to ensure that all critical network traffic is sent to and reviewed by the IDPS module;**
- c. perform a documented review and assessment of its network security risks, identify how IDPS and HIPS coverage should be best applied to its network, and implement such coverage for all critical portions of its network; and**



- d. **restrict remote access to the network-based IDPS module to only those users requiring such access.**

#### **Finding 8**

#### **Malware protection on DAT workstations and servers needs improvement.**

##### **Analysis**

Malware protection on DAT workstations and servers needs improvement. Specifically, our review disclosed the following conditions:

- DAT did not ensure that malware protection software was installed on all DAT servers. Although DAT had procedures for configuring workstations with malware protection software, similar procedures did not exist for servers.
- DAT was not using an enterprise-wide management tool to monitor and manage the use of malware protection software on its workstations and servers. Therefore, DAT could not effectively and efficiently monitor its deployed malware protection software to ensure that such software was always installed and operating properly on all DAT workstations and servers. Furthermore, DAT did not verify that malware protection software and the related definition files were kept up-to-date on all DAT workstations and servers.
- Certain workstations were configured with users having administrator rights. Administrator rights are the highest permission level that can be granted to users and allow users to install software and change configuration settings. Our testing of eight workstations disclosed that employees' user accounts were all defined with administrator rights rather than with user rights. As a result, if these workstations were infected with malware, the malware would run with administrative rights and expose these workstations to a greater risk of compromise than if the workstations' user accounts operated with only user rights.

Industry best practices recommend that organizations should employ automated tools to continuously monitor workstations, servers, and mobile devices for active, up-to-date anti-malware protection. Furthermore, the DoIT *Information Security Policy*, states that agencies should configure security settings of information technology products to the most restrictive mode consistent with operational requirements.

### **Recommendation 8**

**We recommend that DAT develop and implement enterprise-wide automated procedures to**

- a. ensure that all workstations and servers are configured with anti-malware software that is operating properly,**
- b. regularly confirm that anti-malware software and the related definition files are properly updated on its workstations and servers, and**
- c. limit local administrative rights on user workstations to only personnel that require such access for their job duties.**

### **Finding 9**

**An up-to-date and comprehensive disaster recovery plan did not exist.**

### **Analysis**

DAT did not have an up-to-date and comprehensive information technology disaster recovery plan (DRP) for recovering from disaster scenarios (for example, a fire). Specifically, the DRP did not address certain required provisions such as an alternate site, complete listings of hardware and software components, and restoration of network connectivity. At the time of our review, the plan had not been updated for five years. Without an up-to-date and comprehensive DRP, a disaster could cause significant delays (for an undetermined period of time) in restoring operations for information systems, such as AAVS, beyond the expected delays that would exist in a planned recovery scenario. The State of Maryland *Information Technology (IT) Disaster Recovery Guidelines* provide information on the minimum required elements needed for a complete information system DRP.

### **Recommendation 9**

**We recommend that DAT maintain a comprehensive disaster recovery plan, which is updated at least annually, in accordance with the aforementioned *IT Disaster Recovery Guidelines*, with update efforts being documented.**

## Contract Monitoring

### **Finding 10**

#### **DAT did not adequately monitor certain contract billings.**

#### **Analysis**

DAT did not monitor certain payments to contractors or otherwise verify that contractor-submitted billings were proper prior to payment resulting in potential overpayments. Our review of 19 billings totaling approximately \$1.3 million during fiscal years 2011 through 2013 made by four contractors disclosed the following conditions related to two contractors:

- DAT was charged incorrect rates for three fiscal year 2012 billings totaling approximately \$228,300 from one contractor resulting in potential overpayments of approximately \$5,000. The contractor provided lock box services, under a statewide contract procured by the State Treasurer's Office (STO). Although we were advised by STO personnel that the applicable contract had expired in June 2011, STO was in the process of obtaining a new contract and the rates from the previous contract were to remain in effect for fiscal year 2012. However, the rates billed to DAT did not agree with the previous contract rates, resulting in the aforementioned potential overpayments. Payments to this contractor totaled approximately \$302,000 for services received during fiscal year 2012. Similar conditions were commented upon in our preceding audit report.
- DAT did not verify the contractor-reported level of services for document preparation and imaging services. The contract, which was effective October 2010, provided that the contractor would bill DAT a standard monthly fee based on an estimated annual total of images it scanned. The contract provided for an annual payment settlement based on an audit performed by the contractor to determine the actual number of images scanned. The contractor was paid approximately \$498,000 during the period October 2010 through May 2012.

DAT did not maintain its own record of images scanned per month to independently verify the contractor's monthly reported activity. Our tally of scanned batch totals for one month (93,000 images) differed with the contractor's report of activity for that month (120,000 images) by approximately 27,000, which under the contract rates would have a value of approximately \$6,900.

Furthermore, an annual settlement had not occurred even though the contractor reported fewer scanned images than the number specified for the monthly fee that was charged. The vendor reported to DAT that it scanned approximately 553,000 fewer images than were billed, which represented potential overpayments to the contractor of approximately \$139,500 for the period October 2010 through August 2012.

#### **Recommendation 10**

**We recommend that DAT establish procedures to ensure the propriety of contractor billings. Specifically, we recommend that DAT**

- a. maintain records necessary to perform verifications of contractor billings,**
- b. verify that billed costs agree with contractual terms and conditions (repeat), and**
- c. seek recovery of any overpayments identified including those mentioned above (repeat).**

## **Cash Receipts**

### **Finding 11**

**Sufficient controls were not established over certain collections.**

#### **Analysis**

DAT had not established adequate accountability and control over cash and check collections received at DAT's headquarters office (such as, filing fees and recoveries of excess tax credits from the counties). Cash collections are initially recorded on a cash register and subsequently posted to an automated system or on a manual check log. According to DAT's records, during fiscal year 2012, cash and check collections at the headquarters location totaled approximately \$23.5 million (approximately \$2.5 million in cash and \$21 million in checks). Our review disclosed the following control deficiencies:

- For certain collections, documentation was lacking to substantiate that independent verifications were performed to ensure that cash and check collections received were recorded in the automated system and were deposited. Our test of collections from 24 days totaling approximately \$4.7 million received during fiscal years 2011 and 2012 disclosed collections from 20 days totaling approximately \$1.5 million for which there was no documentation that DAT had performed the verifications.

- Recordation of “no fee” transactions was not adequately controlled. Since State law prohibits DAT from charging a fee for services provided to certain entities (such as, non-profit organizations), the automated system permits the recording of a no fee transaction to account for such services. However, we noted that 14 employees who had access to collections could also record a no fee transaction in DAT’s automated system. Additionally, 8 employees with access to collections had the ability to remove a payment transaction recorded in the automated system and record a no fee transaction in its place. This capability is needed, for example, in the case of cashier error. Yet, output reports of no fee transactions recorded in the automated system were not generated and reviewed by supervisory personnel. As a result, collections could be misappropriated without detection. According to DAT records, a total of 1,309 no fee transactions were recorded in DAT’s automated system during fiscal year 2012, and 391 payments totaling approximately \$86,700 were removed from the system during fiscal years 2011 and 2012.

Similar conditions were commented upon in our preceding audit report. According to the Comptroller of Maryland—General Accounting Division’s *Accounting Procedures Manual*, a verification of cash receipts from initial recordation to deposit is to be performed by an employee independent of the cash receipts function. The *Manual* also requires supervisors to review and approve adjustments to cash receipts.

### **Recommendation 11**

**We recommend that DAT**

- a. document the performance of independent verifications of recorded collections to deposit (repeat); and**
- b. generate output reports of “no fee” transactions recorded in the automated system, and ensure that supervisory personnel independent of the cash receipts functions review these transactions for propriety (repeat).**

**We advised DAT on accomplishing the necessary separation of duties using existing personnel.**



## **Audit Scope, Objectives, and Methodology**

We have audited the State Department of Assessments and Taxation (DAT) for the period beginning August 21, 2009 and ending July 29, 2012. 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. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included corporate fees and taxes, tax credits, real property assessments, procurements and disbursements, information systems, cash receipts, and payroll. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observations of DAT's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

DAT provides certain support services (such as payroll, invoice processing, maintenance of accounting records and related fiscal functions) to the Property Tax Assessment Appeals Board. These support services are included within the scope of our audits of DAT.

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.

DAT's response 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**



State of Maryland

DEPARTMENT OF ASSESSMENTS AND TAXATION

Office of the Director

MARTIN O'MALLEY  
Governor

ROBERT E. YOUNG  
Director

December 12, 2013

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

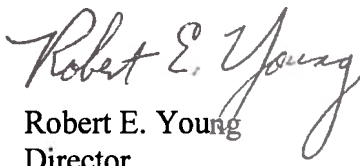
Dear Mr. Barnickel:

The State Department of Assessments and Taxation (SDAT) herewith submits its responses to the Audit Findings and Recommendations contained in your compliance audit of the agency for the period beginning August 21, 2009 and ending July 29, 2012.

The Department concurs with the Findings and each of the Recommendations contained in this audit performed by your office. SDAT's Responses provide specific information as to what steps we have already taken to implement the Recommendations and what actions will be taken by a date certain in the immediate future.

If you need any other information concerning the Department's Audit Responses, please let me know.

Sincerely,

  
Robert E. Young  
Director



## **RESPONSE OF THE STATE DEPARTMENT OF ASSESSMENTS AND TAXATION (SDAT) TO LEGISLATIVE AUDITOR'S REPORT OF NOVEMBER 2013**

### ***Finding 1*** by the Auditor:

Certain aspects of DAT's quality assurance process for real property assessments and related documentation requirements were not formalized.

SDAT Response: The Department concurs with the Auditor's Finding, and it has already taken steps to implement Recommendations 1 a, b, and c to provide greater transparency here. SDAT has developed a written, formalized policy for the reports and audits to be conducted by the Area Supervisors whose duty it is to oversee the performance of the County Supervisors of Assessment and the assessors assigned to that office. Specific reports will be reviewed by the Area Supervisors to ensure compliance of local assessment offices with assessment procedures. For the reassessment of Group 2 properties for the January 1, 2014 assessment notices, a memorandum dated August 12, 2013 was sent out to all local Supervisors of Assessment identifying specific reports and other items of information to be produced for review by the Area Supervisors. This detailed memorandum will be issued each year prior to that year's reassessment work for the next one-third Group of residential and commercial properties.

Regarding documentation to support assessment values as discussed in Recommendation 1b, the annual memorandum described above included a provision that an Area Supervisor must sign off whenever land values are adjusted across the board for a particular community. Similarly, each local Supervisor of Assessments will sign off and documents will be retained showing that they have independently checked and verified the individual Market Value Indexes (MVIs) being used in certain geographic areas. Incidentally, although the Supervisors did perform the proper sales analysis for the MVIs in all three subdivisions the Auditors visited, the retained documentation did exist in two of the three subdivisions. When the local Supervisors also perform the regular spot checks of the work performed each year, the central administration of Real Property will require that the particular checkoffs will be noted in the AAVS system.

Finally, the Auditor's Recommendation 1c suggests that the Department maintain documentation to support assessment value for commercial and residential properties under **EACH** assessment method. For commercial properties, there are three different assessment methods for valuing properties but standard appraisal law and Maryland court decisions specify that the assessor should use his or her professional judgment as to which assessment method produces the best indication of market value. Therefore, the Department will maintain specific documentation only for the assessment method used and only in those instances where the data exists for a particular commercial account.

***Finding 2*** by the Auditor:

Physical exterior inspections were not performed for all properties in accordance with State law.

SDAT Response: The Department agrees with the Auditor's Finding here and is already taking specific actions to address the Auditor's second and third Recommendations. The State Supervisor of Real Property Assessments is issuing a new procedure on the requirements for documenting in the agency's AAVS system all of the inspections actually conducted by local assessors each year. The AAVS system will produce a standardized report on that information for each local jurisdiction.

The first Recommendation of the Auditor here is to take appropriate actions (such as requesting a law change, using technology) to help ensure compliance with State law regarding the physical inspection of properties. Under Maryland's triennial assessment law, the physical inspection requirement would entail that the Department physically inspect one-third of the 2,171,132 total residential and commercial accounts or approximately 723,000 properties each year. The Auditor also notes that the Department has 78 fewer assessors in fiscal year 2012 than in fiscal year 2002. In this same 10 year period, there was an addition of 177,348 new properties to be assessed. Although the Department has received 22 additional assessor positions in fiscal years 2013 and 2014, those positions are not sufficient to comply with the physical inspection law. Based on these facts, the Department is actively exploring the cost of a pilot project in one major subdivision to obtain satellite imagery of real properties at a sufficient resolution to replace physical inspection of properties. Once the Department determines the feasibility of this project and once it collects a year's worth of data in 2014 on the number of physical inspections actually conducted with the additional assessor positions noted above, the agency expects to propose departmental legislation on the physical inspection law to the 2015 session of the General Assembly.

***Finding 3*** by the Auditor:

AAVS has access vulnerabilities that placed critical assessment data at risk of unauthorized modification and certain historical data was not archived.

SDAT Response: The Department concurs in the Auditor's Finding and will comply with the four Recommendations but needs to supply "context" to the Auditor's comments. While the Department's IT managers want to acknowledge major credit to the Auditor's IT Unit for finding this particular vulnerability where all users could modify critical server data, the Department submits there is an extremely remote possibility that someone else would discover this vulnerability. As the Auditor notes, the Department promptly notified the AAVS vendor to prepare a permanent system fix to correct the problem. On December 10, 2013, the vendor provided an update that the problem will be remedied by January 15, 2014.

Regarding the Auditor's comment that as of February 27, 2013 that the Department was running a much earlier version of AAVS, the agency advised the Auditor that SDAT was awaiting funding on July 1, 2013 for the installation of new servers before installing the latest version of AAVS. Those servers have now been installed and so has the next version of AAVS.

Regarding the retention of the **complete** records for the data conversion from the old Real Property CAMA system to the new AAVS system, it needs to be noted that the Department did keep this information for five years prior to the time it was discarded (six months before the Auditor began this audit of the Department). If there are ever future conversions, the Department will keep such records in perpetuity or until at least the next audit of the agency by the Legislative Auditor.

***Finding 4*** by the Auditor:

DAT procedures did not ensure that certain data recorded in AAVS were complete and accurate.

SDAT Response: The Department concurs in the Auditor's three Recommendations here. The August 2013 Memorandum from the State Supervisor for Real Property discussed in the SDAT Response to Finding 1 also required checking on AAVS inputs of the applicable data by the Supervisor of Assessments or Commercial/Residential manager in the larger jurisdictions. The report generated by one of the three subdivisions is being critically reviewed by headquarters administration to rewrite its parameters; hopefully, with the cooperation of the local jurisdiction for the automated input of its information. The Auditor's comments referring to permit information and sales reflects the fact that the Department is implementing a new system for this information in AAVS.

Steps to track permit and sales are evolving and being implemented. During calendar year 2013, more Assessment offices have been able to import building permits which allows for better tracking. The import of this information also required SDAT to contact local governments to revise the manner in which they electronically presented the building permit data. After a property is physically inspected for a building permit greater than \$100,000 resulting in an out of cycle reassessment, then specific fields in the AAVS system are utilized to input and collect the information for supervisory review.

***Finding 5*** by the Auditor:

DAT had not performed timely and comprehensive verification procedures to help ensure the accuracy of information on certain returns and tax credit applications.

SDAT's Response: The Department concurs in the Auditor's Finding and will undertake different steps to implement the four Recommendations that affect Personal Property Assessments, Homeowners'/Renters' Tax Credits, and Franchise Taxes collected from telephone, electric and natural gas providers.

The Auditor's first comment in this Finding deals with a particular audit not being performed by SDAT on certain personal property returns due to staffing issues and the significant amount of time required to manually enter personal property data into the assessment system. The Auditor recommends the Department to determine the feasibility of instituting electronic filing of the returns to improve overall efficiency and the accuracy of the information entered. The Department has begun the process to obtain a system for the electronic filing of personal property returns, and we project its implementation on January 1, 2015 with the start of the filing of returns that year. This electronic filing system also should free up some resources to conduct a specialized audit noted by the Auditor to determine which business entities should be required to continue filing a personal property return in subsequent years. In the meantime, the Department will again conduct the two audits each year for all seven counties noted in the Auditor's description of this Finding.

The Auditor offers two sets of comments on the different audits performed by the Homeowners'/Renters' Tax Credit Programs. The first comments note that the Tax Credit Programs had not **"completed"** audits of selected applications for certain years. The Auditor also notes that this condition was commented upon in the Auditor's preceding audit report. The Department is performing all of the audits just not as "timely" as the Auditor would like. For the record, it should be noted that there is an automatic 18 month delay in performing an audit in a new year because of the time period by which the Department receives the electronic transmission of the income tax information from the IRS. The primary reason that these audits cannot be more timely is because the Tax Credit Programs had four positions abolished in the last Cost Containment. The Tax Credit Programs need additional positions if the Department is to complete the audits the agency designed in a more timely manner. As a result, the Department has requested additional positions for fiscal year 2015 for the Tax Credit Programs.

For the Tax Credit Programs, the Auditor also noted that some local jurisdictions had not submitted monthly electronic redemption reports for all months showing the amounts of recaptured tax credits upon a transfer of the property. The Tax Credit administration will send out a written directive to the affected County Finance Offices to ensure that they submit the electronic report on a monthly basis even if there are no accounts to report in later months, and it will follow up on any jurisdiction that does not respond with a monthly report.

The Auditor's final comment in this Finding states that SDAT did not substantiate the extent to which franchise tax returns had been reviewed. This condition was also commented upon in the preceding audit report. For the 2008 returns, the Department had timely reviewed the returns of the top thirty filers who pay the largest amounts of the franchise taxes. As of August 2013, the audit completion rates were as follows: 2008 – 90%; 2009 – 82%; 2010 – 82%; 2011 – 76%; and 2012 – 28%. All returns could not be audited because the Department's Franchise Tax Unit has had two of its three positions vacant for two

years because of retirements and recruitment problems for this highly specialized work unit. Now that all three positions have been filled, the Department committed to the Auditor during the Discussion Note period for this audit that the agency would perform a specified number of audits each year, by a certain date, and appropriate documentation of the audits would be permanently noted in the records. The new audit schedule requires that audits will be completed on 70% of the returns within one year of receipt, and 100% of the returns will be audited within 20 months of receipt. Accounts with more \$1 million in annual Franchise Tax payments will be completed within 8 months of receipt. During the Discussion Note period for this audit, the Department specified in the “exit” conference that the Auditor would have to raise at that time any objections it had to the specific audit parameters the Department proposed here. No objections were raised, and the Department has already implemented the specific audit schedule provided to the Auditor.

***Finding 6*** by the Auditor:

Access and monitoring controls over the AAVS database were not sufficient to protect critical data.

SDAT Response: SDAT concurs in the Finding and Recommendations. It must be emphasized that this Finding and Recommendation “b” to document reviews of logs of security events will result in a massive amount of work for the IT Unit that will require the agency to obtain a new full-time employee in the FY’15 Budget Request to function as a dedicated Security Officer employee performing these tasks exclusively. It also should be noted that the Agency’s total number of IT employees in this Unit has declined from 20 to 13 employees from 2008 to 2013. The necessary security reports have been written and produced but cannot be thoroughly audited until that new employee is hired in the FY’15 budget.

Finally, it should be noted regarding Recommendation “a” on critical database access that only three senior level managerial employees have system administrator access to the AAVS database.

***Finding 7*** by the Auditor:

The DAT network was not adequately secured.

SDAT Response: The Department concurs in the Auditor’s Finding/ Recommendations and has taken the following actions.

Recommendation “a” to configure its firewall and virtual private networks to a “least privilege” strategy.

1. The Internet. SDAT has disconnected the line for the Image 1 server, and it is no longer used. This action was taken while the Auditor was here.
2. AAVS Vendor. SDAT’s CIO has limited the access by this vendor to just a preview test server and not on the main database. The ports were limited to just this server.

3. Virtual Private Networks (VPN). SDAT's CIO has removed one VPN. The partner VPN is limited to use by the AAVS vendor to access the preview server.

Recommendation "b" to modify network-based IDPS and firewall to send critical network to office to review by the IDPS module. We are in the process of ordering new equipment to allow review of all network traffic. The new equipment will be installed in July/August 2014, and it will be configured to address any of the concerns raised here by the Auditor.

Recommendation "c" to review network security risks is addressed in finding 6 and involves the hiring of a dedicated Security Officer employee performing these tasks exclusively.

Recommendation "d" is to restrict remote access to the IDPS module only to those needing such access. Currently, the network based device only allow access by the CIO and Deputy Director. The new Security Officer will be granted access.

***Finding 8*** by the Auditor:

Malware protection on DAT workstations and servers need improvement.

SDAT Response: The Department concurs in the Finding and provides the following information regarding the agency's implementation of the Auditor's Recommendations.

Recommendation "a" to ensure all workstations/servers are configured with anti-malware software that is operating properly. SDAT's response is that it did not have a new computer to use as a server for this Malware. With the new 2015 budget, the Department will obtain a computer to use as a server for Malware, and then explore the capabilities and option for using the software to serve all of its computer workstations.

Recommendation "b" to regularly confirm that anti-malware software and related definition files are properly updated. The new server will have software installed to regularly confirm updates on workstations and servers.

Recommendation "c" to limit local administrative rights on user workstations to only necessary personnel. The Department is in the process of removing all administrator rights from all workstations. Currently, we have completed this project in five of the twenty-four Assessment offices.

***Finding 9*** by the Auditor:

An up-to-date and comprehensive disaster recovery plan did not exist.

SDAT Response: The Department concurs in the Auditor's Finding and Recommendation. Though we do have a disaster recovery plan in place, the agency's IT Unit is in the process of updating our documentation, which will be annually maintained.

***Finding 10*** by the Auditor:

DAT did not adequately monitor certain contract billings.

SDAT Response: The Department concurs in the Auditor's Finding and will implement the three Recommendations. However, the Department must provide a fuller explanation as to what occurred regarding the **two** contract billings that are the subject of this Finding.

The first contract billing involved a "lock box" service provided under a contract procured by the State Treasurer's Office (STO). The Auditor notes that this condition was commented upon in the preceding audit period. The Department presented documentation to the Auditor in the Discussion Note period of earlier instances where the efforts by the agency's accounting chief to get applicable rate information from the STO resulted in being ignored or being rebuffed by STO personnel administering the statewide lockbox contract. At the exit interview, the Department requested the Audit Manager to intercede on the Department's behalf by providing directly to the STO the specific rate information for the period in question indicating an overcharge occurred and a refund was due for the year in question. Once that information is provided, the Department will complete the review of this billing.

The second contract billing involves a contract for document imaging services. The Auditor is correct in noting that the Department did not maintain a monthly record of images scanned per month. The Department does perform a review of the annual reconciliation report on the total number of images scanned in the reporting period. The Auditor is incorrect in stating that the annual settlement had not occurred for the specific reporting period. The Department had instead directed the vendor to perform a new major imaging initiative to scan personal property tax returns and apply the end of year reconciliation amount as partial payment towards the cost of the new major imaging project. In the prior reporting period, the Department had received an \$80,000 check payment from the vendor for the fewer scanned images provided under the contract.

The Department has already required and the vendor has responded in revising the monthly invoice document so the agency can better monitor the number of documents imaged monthly for each of the separate departmental programs (Charter, Homestead, and Personal Property) using the imaging services.

***Finding 11*** by the Auditor:

Sufficient controls were not established over certain collections.



SDAT Response: The Department concurs in the Auditor's Finding and has already taken steps to implement the two Recommendations. The first Recommendation deals with a particular subset of cash/check collections. A major independent audit (including computer report verification) was performed by the Department on all collections in the cash receipts process for a period of time to verify the cash receipts entered into the MBES system with the daily deposit record. No discrepancies were found. Going forward, our lead accountant will perform a daily verification of all of the cash receipts entered into the MBES system and the daily deposit. Also, the cash register will be closed later so that all cash receipts will be entered into the system by Charter staff by the close of business for that day's receipts and so that an exact reconciliation amount can be certified since cash receipts are no longer being received or processed after the cash register was closed.

The Department is producing a new automated report on "no fee" transactions for copies of documents provided primarily to State and local government agencies. An independent supervisor will review on a test basis the appropriateness of the "no fee" status on the sampled transactions to determine if further review for more accounts is appropriate. That review will entail a matching of the "no fee" document and the request on the letterhead stationary of the office making the request. The review of the sampled accounts will be documented with the supervisor's initials, the date it occurred, and an attachment of the letter request.

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