



State of Rhode Island and Providence Plantations

Department of Administration
BUREAU OF AUDITS
One Capitol Hill
Providence, RI 02908-5889
TEL #: (401) 574-8170

July 9, 2015

Mr. David Sullivan
Tax Administrator
Division of Taxation
One Capitol Hill
Providence, RI, 02908

Dear Mr. Sullivan:

The Bureau of Audits has completed its audit of Division of Taxation cash controls over revenues collected from the tax types included in the Release 1 implementation phase of the State Tax Administration and Revenue System (STAARS). The audit was conducted in accordance with Rhode Island General Law (RIGL) §35-7-3. The recommendations included herein have been discussed with members of management, and we considered their comments in the preparation of this report.

RIGL §35-7-3(b), entitled *Audits performed by bureau of audits*, states that, "Within twenty (20) days following the date of issuance of the final audit report, the head of the department, agency or private entity audited shall respond in writing to each recommendation made in the final audit report." Accordingly, management submitted its response to the audit findings and recommendations on July 1, 2015, and such response is included in this report. Pursuant to this statute, the Bureau may follow up regarding recommendations included in this report within one year following the date of issuance.

We would like to express our sincere appreciation to the staff of the Division of Taxation for the cooperation and courtesy extended to the members of our team during the course of this audit.

Respectfully yours,

Michael Sprague, CIA
Deputy Chief

c—Michael DiBiase, Director, Department of Administration
Honorable Daniel DaPonte, Chairperson, Senate Committee on Finance
Honorable Raymond Gallison, Chairperson, House Finance Committee
Dennis Hoyle, CPA, Auditor General
Dorothy Pascale, Chief, Bureau of Audits



AUDIT Executive Summary

Why the Bureau Did This Review

The Division of Taxation's Tax Administrator requested the Bureau review internal controls related to the collection and recording of the revenue received from the 36 tax types included in the Release 1 phase of the new integrated tax system known internally as the State Tax Administration and Revenue System (STAARS).

Background Information

Rhode Island's Division of Taxation is the primary revenue collecting agency for the State. It administers 57 different tax types and collects over \$3 billion per year. The Division is established under the Rhode Island Department of Revenue by Rhode Island General Law (RIGL) §42-142.

Prior to July 2014, Taxation utilized an assortment of software systems to administer taxes. In order to better serve the taxpayers of Rhode Island and ensure the accuracy and efficiency of the State's primary revenue agency, legislation was passed in 2012 which authorized \$25 million in funding for the implementation of a new integrated tax system.

To Improve Controls the Bureau of Audits Recommends:

- Periodically reviewing STAARS and Fairfax audit logs and access levels
- Ensuring the timely deposit of checks in accordance with the RIGL requiring deposit within seven business days
- Restrictively endorsing checks immediately unless checks are remotely deposited the same day they are received
- Ensuring reconciliations are approved by management
- Developing and implementing policies and procedures governing control over tobacco tax stamp inventory
- Programming changes to the STAARS and State accounting system to ensure transaction data is recorded in the same accounts in both systems

Contents

Objective and Scope.....	4
Methodology.....	4
Introduction.....	4
Recommendations for Improved Controls and Management Responses	5
Align User Access Rights to STAARS and Fairfax with Best Practices.....	5
Improve Processing of Cash Receipts within the Primary Processing Unit.....	7
Safeguard Assets within the Cashier Room.....	8
Ensure data is recorded in STAARS & the State Accounting System timely and consistently	9
Ensure segregation of duties.....	10
Implement an effective Inventory System for Tobacco Tax stamps.....	11
Background.....	11
Issue.....	12

Objective and Scope

The Bureau of Audits (“Bureau”) conducted a limited scope audit of the Division of Taxation (Taxation). The purpose of this engagement was to determine if adequate cash controls are in place for specific tax types included as part of the Release 1¹ implementation phase of STAARS at Taxation to ensure safeguarding of assets, accurate reporting, and collection of revenues in accordance with applicable statutes.

Methodology

As part of our audit work, we gained an understanding of the existing controls over cash receipts and revenue recording for certain tax types at Taxation. To address our audit objective, we performed the following:

- Interviewed Taxation management and staff.
- Reviewed applicable state laws and regulations.
- Gained an understanding of the processes governing the collection and recording of receipts.
- Gained an understanding of the newly implemented State Tax Administration and Revenue System (STAARS) and the Fairfax Imaging software.
- Performed walk-throughs of revenue collection and recording processes and identified weaknesses and opportunities for control improvements.
- Performed walk-throughs of the tobacco tax stamp storage areas.

Introduction

Rhode Island’s Division of Taxation (Taxation) is the primary revenue collecting agency for the State. It administers 57 different tax/fee types and collects approximately \$3 billion per year. Taxation is responsible for administering and collecting all taxes required by Rhode Island law in the most efficient and cost-effective manner and assisting taxpayers in understanding and meeting their tax responsibilities. Taxation is established under the Rhode Island Department of Revenue by Rhode Island General Law (RIGL) §42-142.

Prior to July 2014, Taxation utilized an assortment of software systems to administer taxes and fees. These systems included various Microsoft Access databases and the Mainframe system. The Mainframe system is built on 40-year-old technology and has become increasingly difficult and expensive to use and maintain. In order to better serve the taxpayers of Rhode Island and ensure the accuracy and efficiency of the State’s primary revenue agency, legislation was passed in 2012 which authorized \$25 million in funding for the implementation of a new integrated tax system.

¹ The Division of Taxation purchased and recently began to implement a new tax administration system, STAARS. See the “Introduction” section at the bottom of page 4 for more detail. The Bureau reviewed taxes which were converted to STAARS during the Release 1 phase of the project.

The new integrated tax system is known internally as STAARS, State Tax Administration and Revenue System. This system is planned to be released in three phases:

- Release 1- This release went “live” in July 2014 and included 36 types of low-volume/low-risk miscellaneous tax types and fees that were previously recorded in Access databases.
- Release 2- This phase is planned to be implemented September 2015, and includes the conversion of Personal Income Taxes, Fiduciary taxes, and Property tax relief from the Mainframe system to STAARS.
- Release 3- Implementation is anticipated during September 2016. This phase will convert the remaining taxes to the new system. (See Appendix A for a complete listing of the tax types included within each release.)

The vendor for this project is Revenue Solutions, Inc. (RSI). STAARS is based off of RSI’s Revenue Premier product, which is a commercial off-the-shelf solution that supports the processing, tax accounting, and compliance functions for revenue agencies. STAARS also includes front-end imaging and data-capture capabilities through Fairfax Imaging software and scanners, with whom RSI has a partnership.

Recommendations for Improved Controls and Management Responses

The Bureau performed a cash controls audit for those tax types which were part of the Release 1 phase of the STAARS project. At the time of testing Taxation did not have set policies or procedures in place for many aspects of the Release 1 phase. The Bureau understands Taxation is in the process of implementing a new system and, therefore, has offered improvements to current controls and suggestions for future controls as the implementation of STAARS progresses.

Align User Access Rights to STAARS and Fairfax with Best Practices

The Bureau reviewed user access rights for both the STAARS and Fairfax softwares. Access rights are the permissions or privileges granted to users to create, change, delete, or view data and files within a system as defined by rules established by data owners and the information security policy. The following issues were noted during the review of the STAARS access levels:

- Out of 226 active users, 2 individuals do not have defined roles within STAARS.
- Five active STAARS user accounts belong to individuals that are no longer employed by the State.
- Seven individuals with active user accounts have not accessed STAARS during FY 2015, including four individuals who have not logged in since at least 2013 (two of these individuals have left State service and are included in the total under the second bullet).
- Eighteen individuals have never accessed the system.
- Lack of monitoring of system-audit reports detailing system access and changes.

Access rights for all users must include defined roles and responsibilities within the system and should be based upon the doctrine of least privilege² to limit the damage that can result from accident, error, or unauthorized use. Individuals who are no longer employees of the State must have accounts inactivated timely to limit the risk of the user or an individual impersonating the user abusing the system infrastructure or compromising sensitive data. Best practices also recommend organizations proactively monitor and analyze system-audit records for indications of unusual access patterns and “indications of inappropriate or unusual activity, investigates suspicious activity or suspected violations, reports findings to appropriate officials, and takes necessary actions.”³

The Bureau also reviewed those individuals who have access to both STAARS and the Fairfax. There are seven users that have administrative access in the Fairfax software and also have administrative "Superuser" access within STAARS. "Superuser" access grants the user full system privileges. One of these individuals also has administrative access to the Deposit Monitor module. Therefore, there is the potential for these users to change transactional information within the Fairfax and STAARS systems. Simultaneous changes to both systems may not be identified during the matching procedures performed by STAARS and, therefore, unauthorized and fraudulent changes could go undetected.

The Bureau understands that these systems were recently implemented and ongoing changes will occur until Release 3. Additionally, physical access to Taxation is restricted to authorized individuals. However, policies and procedures should be put in place immediately to prevent unauthorized and potentially harmful access and changes to the system.

Recommendation:

1. Taxation should develop and institute an access control procedure that ensures compliance with the doctrine of least privilege. The procedure should address the following:
 - Periodic review and management oversight of access levels.
 - The timely termination or reduction of user access rights for individuals who have separated from State service or have changed responsibilities.
 - The immediate removal of access rights in the event of a separation from State service.
 - An Audit log report to detail access.

Management's Response:

The Division of Taxation's Production Oversight and Development Section (PODS) was created in March 2014. The PODS primary responsibility is to oversee the daily production of the new integrated tax system (STAARS). In this role, the PODS will handle security access levels for new and existing employees. The PODS will develop a form, either paper based or electronic, to handle requests to establish, modify or delete user access in STAARS. These requests will be reviewed and approved by the Chief of the PODS.

² According to the Department of Defense Trusted Computer System Evaluation Criteria, the doctrine of least privilege states that each user in a system should be granted the most restrictive set of privilege needed for the performance of their authorized tasks. [Department of Defense Trusted Computer System Evaluation Criteria, (DOD-5200.28-STD)].

³ *Assessing Security and Privacy Controls in Federal Information Systems and Organizations Building Effective Assessment Plans*, NIST Special Publication 800-53A. National Institute of Standards and Technology. December 2014.

PODS will also develop a monthly report of the audit logs report. This report will be reviewed by the Chief and forwarded to the Tax Administrator, Assistant Tax Administrator, Chief of Examination and the Chief of Compliance and Collections.

Responsible Party: Dan Clemence, Chief, Project Oversight and Development Section

Estimated Completion Date: November 30, 2015

Improve Processing of Cash Receipts within the Primary Processing Unit

Cash receipts are not adequately safeguarded within the Primary Processing Unit both prior to and subsequent to deposit through the Fairfax scanner. The Office of the General Treasurer recommends the immediate restrictive endorsement of checks unless they are remotely deposited the same day they are received. However, checks are not restrictively endorsed upon receipt and are not deposited immediately. Checks are often not deposited within 7 days, as required by RIGL §11-28-1. The Office of the General Treasurer also recommends destroying checks within 60-90 days after deposit. However, 36 percent of the checks tested by the Bureau were more than 90 days old and did not comply with this guidance.

A closet is used to maintain the checks after they have been deposited. This closet is unlocked during the business day and is only locked at night. Checks that are scanned and deposited in the Cashier Room are transferred to Primary Processing after one month and are also maintained in this closet. There are no dual access controls⁴ to gain access to the closet and there are no cameras within the closet.

Funds should be properly safeguarded to provide reasonable assurance regarding prevention or timely detection of fraudulent activity or misappropriated funds. Currently, there is no policy within Taxation dictating the means and frequency of check destruction to ensure compliance with Treasury guidance.

Recommendations:

2. Taxation should establish a policy and procedure for the prompt processing and deposit of all payments received through the primary processing unit. This procedure should include at a minimum:
 - Deposit of all checks within 7 days for all tax types
 - Retention of deposited checks for 60, but no more than 90, days. Checks older than 90 days should be destroyed.

Management's Response:

As part of the modernization project in the Division of Taxation, the entire processing section is being relocated to the ground floor of the Department of Administration Building. After the relocation and

⁴ Dual access controls is a control procedure whereby the active involvement of two people is required to complete a specified process. For a fraudulent act to be committed, both parties would need to be in collusion.

the full implementation of STAARS (October 2016), the Division intends to not allow any checks from leaving the processing area. In addition, the Division will establish a goal to deposit all checks within three (3) days of receipts.

In the interim the Division will issue a written policy that all check must be deposited within seven (7) days of receipt. In addition, the Division will require all check that are electronically deposited to be destroyed within 90 days of deposit.

Responsible Party: David Sullivan

Estimated Completion Date: September 1, 2015

Safeguard Assets within the Cashier Room

Taxation maintains a Cashier Room with a window cut out where the general public communicates and remits payments to a Cashier. It is the Division's informal policy that two cashiers work in the room each day. The cashiers accept cash, checks, or money orders as payments for various types of taxes. Payments are maintained in either the cash register drawer, a locked filing cabinet, or a simple one-key safe until the deposit is made. Additionally, tobacco tax stamps are maintained in a locked filing cabinet in the room.

The Bureau noted instances in which the door to the cash room was open during the day and also instances in which only one cashier was present in the room. As both the safe and the locked filing cabinet do not require dual access controls, the lack of another individual present in the room increases the risk of misappropriation. Additionally, there are no cameras in the room, which would serve as a deterrent to wrongdoing. Without adequate safeguards in place, the risk of lost or misappropriated funds or fraudulent activity increases.

Internal control best practices prohibit the person ringing up the transaction from approving the transactional voids. Best practices recommend the utilization of forms documenting the details of the voided transaction including the amount of the void, the customer involved, an explanation as to why the transaction was voided, the signature of the employee working the cash register, and the signature of the manager approving the void. Currently, it is Taxation's practice that cashiers collect and process cash receipt transactions and are allowed to void the same transactions within the Cashier System without approval.

Allowing the person ringing up the transaction to also have the ability to approve voids increases the risk of fraud. For example, an employee may account for stolen cash by voiding a previously recorded transaction.

Recommendation:

3. Install a camera in the cash room and purchase a safe which requires dual access controls.
4. Implement procedures to ensure adequate approval of voids and mitigate misappropriation of assets.

Management's Response:

The Division of Taxation will work with the Division of Facilities and Capitol Police to explore possible options to add an additional camera to the cash room.

As part of the daily deposit process the Division of Taxation will add a daily voids report detailing all transactions that were voided during the day. This report will be reviewed by the Principal Revenue Agent or Chief Revenue Agent in the Accounting Section.

Responsible Party: David Sullivan/Kristin Ross

Estimated Completion Date: October 1, 2015

Ensure data is recorded in STAARS & the State Accounting System timely and consistently

Taxation's Accounting Unit is responsible for ensuring the accurate and complete recording and reconciliation of tax revenues in the State accounting system (RIFANS) and STAARS. The Bureau reviewed a sample of the daily reconciliations of receipts received via the Fairfax scanner from July through November 2014. The following issues were identified:

- Lack of management approval of the reconciliations.
- Lack of documentation regarding the person performing the reconciliation.
- Inconsistent recording of revenues between RIFANS and STAARS: one sub-ledger account was used in STAARS to record activity that was allocated amongst five general ledger (GL) accounts in RIFANS.⁵
- Lack of policies and procedures to ensure systems and related ledger accounts are updated to reflect changes in RIGL: RIFANS was updated to reflect a change in law related to Rental Vehicle tax, however, STAARS was not.⁶
- Cashiers' office has one identification code for two types of taxes, the Real Estate Home tax and the Mobile Home Tax. The Accounting unit must make a manual month-end adjustment in RIFANS to allocate the funds to the correct general ledger accounts.

The reconciliation process ensures the accuracy and validity of financial information and ensures that unauthorized transactional changes have not occurred. Failure to ensure reconciliations are performed and approved consistently may result in financial statements that do not reflect accurate and complete revenues received from taxpayers. Additionally, delaying programming changes could create the need to constantly review both systems for necessary adjustments and lead to inefficiencies.

⁵ The account allocation in RIFANS is accurate; however, inconsistent recording between systems can lead to reconciliation and transparency issues.

⁶ As of the date of this report, STAARS had been programmed correctly to record these funds in the right sub-ledger account.

Recommendations:

5. Determine the programming changes necessary to ensure that transactional data is recorded in the same accounts in STAARS and RIFANS.
6. Develop and implement policies and procedures to ensure that when changes in the Rhode Island General Law occur, the appropriate programming changes are made in STAARS and RIFANS in a timely manner.
7. Ensure the approval of reconciliations is documented and indicates the individual who performed the reconciliation.

Management's Response:

The current process relating to the deposit and recording of motor fuel receipts require that all funds are deposited into one general ledger account and when the transaction is posted to RIFANS they are posted into the different general ledger accounts required under RIGL §31-36-20. These receipts are reconciled on a monthly basis. After implementation of Release 3, the full revenue accounting system for STAARS will be operational and the distribution of motor fuel tax will be handled within STAARS and posted electronically to RIFANS.

The Division of Taxation established a Change Control Board (CCB) in September 2014 that reviews and prioritizes changes made to STAARS. During this legislative session all changes were identified and approved by the CCB. The programming changes are in process and will be completed within the month of July/August. Potential statutory amendments are discussed throughout the legislative session with an emphasis on impact on the Division's processes and protocols. Generally, the Division has a process for notice and implementation of legislative amendments through coordination with the management team and does include the process for ensuring that programming changes to STAARS and RIFANS are made in a timely manner. The Division will establish a written protocol which will incorporate the current process and require confirmation to all affected parties that the programming changes to STAARS and RIFANS has been made within the acceptable timeframe.

The Accounting Section within the Division of Taxation will modify the reconciliation procedures to require each individual reviewing and approving the reconciliation to sign off on the documentation. The tracking function in STAARS will be able to track the individual who performed the reviews and approvals within each reconciliation procedures. This procedure will be implemented for fiscal year 2016.

Responsible Party: David Sullivan

Estimated Completion Date: #5 – October 2016 and #6 & #7 – July 2015

Ensure segregation of duties

There is inadequate segregation of duties related to the Chief of Tax Processing (CTP) in the Primary Processing Unit. The CTP has access within the revenue collection systems to initiate transactions, alter taxpayer information, alter payment amount, and also the ability to approve journal entries recording the transactions in the State accounting system.

Segregation of duties is critical to effective internal control; it reduces the risk of both erroneous and inappropriate actions. In general, the approval function, the accounting/reconciling function, and the asset custody function should be separated among employees. No one person should:

- Initiate transaction
- Approve transaction
- Record transaction
- Reconcile balances
- Handle assets
- Review reports

Inadequate segregation of duties may result in undetected erroneous or inappropriate transactions. The State accounting system general ledger approval hierarchy should enforce adequate segregation of duties for the revenue collection and recording functions.

Recommendation:

8. Implement adequate segregation of duties within the State accounting system and all revenue collection systems.

Management's Response:

With the implementation of a new system some of the Division of Taxation employees have been granted special access to test and document process in STAARS. After full implementation a review of security access will be completed for all users and any special access will be removed at that time. The complexity of managing and running two system necessitate the practice of granting special access to specific key staff members.

Responsible Party: David Sullivan

Estimated Completion Date: October 2016

Implement an effective Inventory System for Tobacco Tax stamps

Background

RIGL §44-20-12 requires a tax to be imposed on all cigarettes sold or held for sale in the State. Licensed distributors show evidence of this tax payment through the placement of a cigarette tax stamp on each box of cigarettes. Distributors can receive Rhode Island cigarette tax stamps in one of two ways:

- Purchasing the stamps at the cashier window
- Ordering online through the Division of Taxation website

Distributors can pay the cigarette tax by either check, EFT, or establishing a Cigarette Tax Credit Bond.

Taxation's Excise Unit purchases cigarette tax stamps from its manufacturer twice a year. Each shipment contains 30 boxes valued at \$3,027,187 per box, and each box contains 25 rolls of tobacco tax stamps valued at \$121,087.50 per roll. The total shipment is worth \$90,815,625.

Currently, Taxation is utilizing STAARS to record the revenue received from the cigarette tax; however, the inventory records are not planned to be integrated into the system until Release 3 in 2016.

Issue

Internal controls over inventory are designed to promote the safeguarding of assets and protect against loss and theft. These controls include the physical security and accessibility of the supply, controls over revenue collection and recording, regular reconciliations of sales, and periodic inventory counts.

The Bureau reviewed the Excise Unit's inventory control procedures over the tobacco tax stamps. Controls over inventory were insufficient or non-existent:

- There is no formal policy governing the amount of stamps on hand and re-order thresholds.
- There is no formal record of inventory purchased.⁷
- Stamps are maintained in a small locked storage closet (located near the exit to the building) that has no cameras and is secured by a simple locked doorknob.
- The storage closet is used for purposes other than the maintenance of tobacco tax stamp inventory. For example, kitchen supplies are kept alongside tobacco stamps.
- Older stamps which can no longer be sold are retained.
- Refunded stamps are also maintained in the storage closet.
 - There are no destruction procedures for refunded stamps, such as formal authorizations.
 - Refunded stamps that are in resalable condition will be sold but are never formally brought back into inventory.
- A number of miscellaneous items such as decals for cigarette vending machines and IFTA (International Fuel Tax Agreement) decals⁸ are also stored in the closet and appear to be unaccounted for.
- There is no reconciliation between the log of serial numbers maintained in the vault closet and the tobacco tax stamp sales log maintained in the Cashier Room.

Tobacco tax stamp revenue and inventory per the State Accounting system may not reflect amounts actually sold or on hand. The amount of assets on the State financial statements may be undervalued or overvalued by the amount of unaccounted tobacco tax stamp inventory. Cigarette stamps and other inventory located within the vault are subject to loss, theft, or fraud.

⁷ There is a hand-written log of tobacco tax stamp serial numbers located inside the storage closet which is updated each time boxes are removed from the storage closet and taken to the Cashier Room. However, this does not tie back to inventory purchased or sold.

⁸ Cigarette vending machine decals are worth \$25 each, and IFTA decals are valued at \$10 each.

Recommendations:

9. Implement an inventory control system for tobacco tax stamps. An interim solution will ease the transition of the implementation of inventory controls in STAARS. This system should include at a minimum:
 - The re-introduction into current circulation or the destruction of refunded stamps.
 - The purchase of inventory that aligns with sales demands and minimizing the amount of excess inventory on hand and regular counts of the inventory to ensure what is physically on hand matches inventory records.
 - A schedule for the destruction of any items which are out of date and no longer hold value and the receipt of proper authorization.

Management's Response:

The Cigarette Stamp inventory system is part of Release 3 for the STAARS implementation schedule (October 2016). The inventory system will allow the Division of Taxation the ability to track and maintain cigarette stamp inventory through STAARS. In the interim, the Division of Taxation will develop a manual inventory report that will be completed on a monthly basis and submitted to the Chief of Examination. The Chief of Examination will review the report and perform an inventory to verify the accuracy of the report.

Responsible Party: Michael Canole

Estimated Completion Date: September 30, 2015