

Office of the Auditor General
Performance Audit Report

Motor Fuel Tax Systems
Department of Treasury and
Department of Technology, Management, and Budget

June 2017

State of Michigan Auditor General
Doug A. Ringler, CPA, CIA

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Article IV, Section 53 of the Michigan Constitution



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Report Summary

Performance Audit

Motor Fuel Tax Systems

Department of Treasury (Treasury) and Department of Technology, Management, and Budget (DTMB)

Report Number:
271-0525-16

Released:
June 2017

The Motor Fuel Tax (MFT) Section of Treasury administers motor fuel tax returns, processes refund claims, and licenses persons involved in the sale, use, or transportation of motor fuel. Treasury and DTMB contracted with a third party vendor to host, maintain, and support the Fuel Tax Tracking and Compliance System (VISTA). DTMB also hosts and maintains systems for the processing of motor fuel tax returns and refunds. In fiscal years 2014, 2015, and 2016, the MFT Section received \$964 million, \$1.01 billion, and \$1.02 billion, respectively, in motor fuel tax revenue.

Audit Objective			Conclusion
Objective #1: To assess the sufficiency of Treasury and DTMB's oversight of the VISTA contract.			Not sufficient
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
Treasury and DTMB did not effectively manage the VISTA contract, resulting in outdated software and unsupported servers. Also, Treasury did not assign contract management roles to persons with the knowledge and authority to make contract decisions (Finding #1).	X		Agrees
Treasury and DTMB did not require the VISTA contractor to conduct and provide Service Organization Controls (SOC) reports. Also, Treasury and DTMB should implement a process for reviewing the SOC reports upon receipt. Doing so would have alerted DTMB that the contractor sold its hosting center and enabled Treasury to determine the potential impact on the operations and security of motor fuel tax data (Finding #2).	X		Agrees

Audit Objective			Conclusion
Objective #2: To assess whether Treasury and DTMB sufficiently secured motor fuel tax and refund data.			Not sufficient
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
DTMB did not require the VISTA contractor to encrypt motor fuel tax data in-transit and at-rest to minimize the risk of compromised confidential tax information (<u>Finding #3</u>).	X		Agrees
The Special Taxes Division did not securely store confidential information in accordance with Treasury security policies. Confidential information may be vulnerable to unauthorized access and misuse (<u>Finding #4</u>).		X	Agrees

Audit Objective			Conclusion
Objective #3: To assess the effectiveness of Treasury's efforts to administer the Motor Fuel Tax Act.			Effective
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
Treasury should work with the Legislature to assess the cost/benefit of establishing funding for motor fuel tax enforcement services (<u>Finding #5</u>).		X	Agrees

Audit Objective			Conclusion
Objective #4: To assess the sufficiency of Treasury's motor fuel tax refund processes.			Sufficient
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
None reported.			Not applicable

Audit Objective			Conclusion
Objective #5: To assess the effectiveness of Treasury and DTMB's general and application controls over the motor fuel tax systems.			Moderately effective
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
The Special Taxes Division did not establish effective security administration over the motor fuel tax systems to ensure that tax data is protected from unauthorized access, modification, or disclosure (<u>Finding #6</u>).		X	Agrees

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June 20, 2017

Mr. Nick A. Khouri
State Treasurer
Richard H. Austin Building
Lansing, Michigan
and
Mr. Brom Stibitz
Interim Director, Department of Technology, Management, and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Khouri and Mr. Stibitz:

I am pleased to provide this performance audit report on Motor Fuel Tax Systems, Department of Treasury and Department of Technology, Management, and Budget.

We organize our findings and observations by audit objective. Your agencies provided preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Doug Ringler
Auditor General

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AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND OBSERVATIONS

OVERSIGHT OF THE VISTA CONTRACT

BACKGROUND

The Motor Fuel Tax Act, Public Act 403 of 2000, provides the authority for the Department of Treasury (Treasury) to administer, collect, and levy an assessment for motor fuel* taxes. In 2010, Treasury and the Department of Technology, Management, and Budget (DTMB) contracted with a third party for the hosting, maintenance, support, and enhancement of the Fuel Tax Tracking and Compliance System (VISTA). The contract provided for three two-year renewal options beginning in 2015 based on acceptable contractor performance. Treasury and DTMB renewed a two-year option in September 2015 for \$1.5 million.

Treasury implemented VISTA for motor fuel taxes in April 2003. VISTA was designed to reduce tax-filing errors, increase customer service, and reduce tax avoidance through streamlined electronic filing. Since 2010, Treasury has expended over \$4.4 million for hosting, maintenance, and support of VISTA. In fiscal years 2014 through 2016, VISTA annually processed an average of \$1 billion in motor fuel tax revenue.

AUDIT OBJECTIVE

To assess the sufficiency of Treasury and DTMB's oversight of the VISTA contract.

CONCLUSION

Not sufficient.

FACTORS IMPACTING CONCLUSION

- Two material conditions* related to improved contract management and enhanced review of Service Organization Controls (SOC) reports* (Findings #1 and #2).

* See glossary at end of report for definition.

FINDING #1

Improved contract management needed.

Treasury and DTMB did not effectively manage the VISTA contract. Also, Treasury did not assign contract management responsibilities to persons with the knowledge and authority to make contract decisions, which increases the risk that VISTA does not meet the State's IT requirements and the needs of the Special Taxes Division.

VISTA is used by motor fuel licensees, including suppliers* and terminal operators*, to electronically file motor fuel tax returns and reports. Treasury processes an average of \$1 billion annually in motor fuel tax revenue. VISTA calculates tax liabilities, processes and stores tax returns, and transmits tax data to Treasury from the taxpayers.

According to Control Objectives for Information and Related Technology* (COBIT), organizations should manage, maintain, and monitor contracts and service delivery. Also, organizations should clearly define roles and responsibilities for the management of third party contractors and identify the skills, decision-making authority, and time requirements of all involved individuals.

Treasury and DTMB did not:

- a. Monitor the VISTA contractor's compliance with contract terms. For example:

VISTA upgrade was not implemented in 2010, resulting in outdated software and unsupported servers.

- (1) The contractor is responsible for patching and upgrading outdated software. The contractor informed Treasury that it would upgrade VISTA by December 2010; however, the upgrade was not implemented and the new system is hosted on servers that are no longer vendor-supported.
- (2) The contractor must coordinate the implementation of enhancements with State staff. In July 2013, Treasury, DTMB, and the contractor verbally agreed to upgrade VISTA to a new system called eTRACS by late summer 2014. However, Treasury and DTMB did not require the contractor to submit an eTRACS project plan and design documentation, including major project phases, tasks, deliverables, and design milestones. This resulted in Treasury and DTMB not clearly understanding the software that the contractor was supposed to deliver. Without project documentation, the State could not effectively manage the project, the contractor delayed eTRACS implementation three times, and ultimately, VISTA was not upgraded.

* See glossary at end of report for definition.

- b. Manage the motor fuel tax refund project effectively.

Treasury received a \$250,000 grant from the Federal Highway Administration in September 2012 to oversee the development of a refund module to be shared with two other states.

In July 2013, the contractor informed Treasury that the refund module would not be developed as part of VISTA but as part of a new system. As of June 2016, Treasury expended \$17,040 and \$54,828 of the federal grant for work completed by the contractor and DTMB, respectively; however, the module was not fully developed and the statement of work was canceled in 2016 because the contractor could not meet Treasury's business requirements.

Treasury expended \$71,868 on a refund module that was not developed.

- c. Ensure that the VISTA contract and two-year contract extension contained required documents.

Items omitted from the contract and extension included:

- Disaster recovery strategy document.
- Hosting and security environment.
- Technical architecture description.
- Server specifications.
- Service level requirements.

Without this documentation, Treasury and DTMB cannot ensure that VISTA meets the State's IT standards.

- d. Require that the contractor remain in compliance with current Treasury security policies and DTMB IT standards.

Not including these requirements in the contract amendment could have contributed to the exceptions noted in Findings #2 and #3.

- e. Utilize DTMB's annual contractor compliance report tool to effectively manage contractor performance.

Treasury and DTMB documented the contractor's "timeliness of deliverables" as below standard in the annual compliance report for 2014 and 2015. The compliance report is a tool that allows DTMB Procurement staff to resolve the contractor's inability to meet IT standards by initiating the issue resolution process.

Treasury did not assign staff to contract management roles who understood their responsibility for monitoring project status, timely resolving project issues, and serving as the technical and business needs expert. Also, roles were assigned to Treasury and DTMB staff who did not have the authority to make contract decisions.

RECOMMENDATIONS

We recommend that Treasury and DTMB make needed improvements to more effectively manage the VISTA contract.

We also recommend that Treasury assign contract management responsibilities to persons with the knowledge and authority to make contract decisions.

AGENCY PRELIMINARY RESPONSE

Treasury and DTMB provided us with the following response:

DTMB and Treasury agree with the recommendations. DTMB Agency Services for Treasury will be working with DTMB Procurement to arrange for training for staff that oversee contracts including contract roles, responsibilities, and the Michigan Procurement Manual so that the correct staff are assigned to contract roles and the staff understand their responsibilities for those roles. DTMB and Treasury will also add the review of the annual contractor compliance reports to its partnership agreement to formalize the review of these documents.

A request has been submitted to DTMB Procurement to:

- Change the Program Manager/CCI to the administrator of the Special Taxes Division,*
- Update the contract with active links to IT policies, standards, and procedures, and*
- Update the contract with required documents.*

Concerning management of the statutory refund system change and federal grant, Treasury believes that it handled that management as effectively as it could under the circumstances where the vendor's failure to provide the statutory system prevented implementation of a new system. Treasury has also been able to preserve the remaining balance of the federal grant for use in developing another vendor's refund system.

FINDING #2

Enhanced review of SOC reports needed.

Treasury and DTMB did not require the VISTA contractor to conduct and provide SOC reports. Also, Treasury and DTMB should implement a process for reviewing the SOC reports upon receipt.

Certain SOC reports provide assurance of the design and effectiveness of system controls and the security, availability, processing integrity, confidentiality, and privacy of the system.

The State of Michigan Financial Management Guide (Part VII, Chapter 1, Section 1000) requires oversight of a third party service organization's (TPSO's) internal control system when those services have a material effect on the department's operation and reporting. Contracts with TPSOs must include provisions allowing the State to evaluate relevant aspects of the TPSO's internal control system, how the assessment will be conducted, and the parties responsible for the associated costs.

SOC reports are internal control reports on the services provided by a service organization and provide valuable information that users need to assess and address the risks associated with an outsourced service. A SOC 1, type 2 engagement is conducted by an independent auditor to report on management's description of a service organization's system and the suitability of the design and operating effectiveness of those controls over financial reporting. A SOC 2, type 2 engagement provides an assessment of the operational controls over areas that may include security, availability, processing integrity, confidentiality, and privacy of the system.

Although DTMB received a SOC 1, type 2 report for 2014, the contractor did not provide a SOC 2 report. The contractor annually processes \$1 billion of State revenue on Treasury's behalf. Therefore, Treasury and DTMB should amend the VISTA contract to require the contractor to annually conduct both a SOC 1, type 2 and a SOC 2, type 2 engagement.

Also, DTMB should review and share the reports with the departments upon receipt. Doing so would have alerted Treasury and DTMB that the contractor sold its hosting center containing the VISTA server to an international company in June 2015. Neither Treasury nor DTMB were aware of the sale and the potential impact on the operations and security of motor fuel tax data.

RECOMMENDATIONS

We recommend that Treasury and DTMB require the VISTA contractor to conduct and provide SOC reports.

We also recommend that Treasury and DTMB implement a process for reviewing the SOC reports upon receipt.

**AGENCY
PRELIMINARY
RESPONSE**

Treasury and DTMB provided us with the following response:

DTMB and Treasury support the recommendations. A policy did not exist at the time of contract execution requiring SOC 1 Type 2 and/or SOC 2 Type 2 reports be provided by vendors annually. However, DTMB and Treasury do support the recommendation that SOC 1 Type 2 and/or SOC 2 Type 2 reports be provided if the results of a risk assessment determines these reports are necessary. DTMB will be issuing a Statement of Work (SOW) for the vendor to provide pricing for annually providing a SOC 1 Type 2 and SOC 2 Type 2 report, requesting the vendor respond within 30 days. Upon receipt of the estimate, Treasury will make a risk/benefit assessment based on the cost of the SOW and secure funding for the work if the assessment is positive. The contract was created when the State of Michigan did not have language in the contracts requiring SOC reports. Since the contract does not contain language requiring SOC reports, the vendor can decide not to accept the additional SOW to complete the SOC reports without violating the contract or may elect to price the work so high as to make the risk/benefit assessment fiscally irresponsible for the agency to proceed with the work.

SECURITY OF MOTOR FUEL TAX AND REFUND DATA

BACKGROUND

Motor fuel tax and refund returns contain confidential business and personally identifiable information. DTMB, in partnership with other State agencies, adopted information security policies and standards to ensure protection of sensitive information and reduce threats to the State's IT services. Contractors must adhere to State laws, policies, and standards in the collection, management, and security of such information.

Also, Treasury established data security standards and policy for the protection of sensitive and confidential data in the custody and care of Treasury.

AUDIT OBJECTIVE

To assess whether Treasury and DTMB sufficiently secured motor fuel tax and refund data.

CONCLUSION

Not sufficient.

FACTORS IMPACTING CONCLUSION

- One material condition related to encryption* of motor fuel tax data in-transit and at-rest (Finding #3).
- One reportable condition* related to securely storing confidential information (Finding #4).

* See glossary at end of report for definition.

FINDING #3

Motor fuel tax data should be encrypted.

DTMB did not require the VISTA contractor to encrypt motor fuel tax data in-transit and at-rest, in accordance with DTMB's data encryption standard, to minimize the risk of compromised tax information.

Motor fuel tax returns contain confidential business information, such as employer identification number and related tax information. Treasury and DTMB are responsible for protecting sensitive and confidential data through encryption of data in-transit and at-rest.

DTMB's Electronic Data Encryption Standard states that encryption must be utilized when moving or storing confidential data. Encryption helps minimize the likelihood that sensitive or confidential information is inadvertently disclosed or accessed during transmission.

In May 2013, DTMB informed the contractor of its new encryption standard and requested the contractor to encrypt all motor fuel tax data while in-transit and at-rest. However, DTMB did not verify that the contractor complied with the encryption standard.

RECOMMENDATION

We recommend that DTMB require the VISTA contractor to encrypt motor fuel tax data in-transit and at-rest, in accordance with DTMB's data encryption standard, to minimize the risk of compromised tax information.

AGENCY PRELIMINARY RESPONSE

DTMB provided us with the following response:

DTMB agrees with the recommendation. Data should be encrypted at-rest and in-transit to minimize the risk of compromised tax information. DTMB has upgraded the connection between the vendor and the State to the State's current standard for data transmission encryption. In addition, DTMB, working with Treasury, will issue a SOW for the vendor to provide pricing for encrypting the data at rest and request that the vendor respond within 30 days. Upon receipt of the estimate, DTMB, working with Treasury, will complete a risk/benefit assessment based on the cost of the SOW and work together to secure funding for the work if the assessment is positive. This contract was created when the State of Michigan did not have language in State contracts or a policy requiring data encryption at rest.

FINDING #4

More secure storage of confidential information needed.

The Special Taxes Division did not securely store confidential information in accordance with Treasury security policies. Confidential information may be vulnerable to unauthorized access and misuse.

Treasury policy ET-03203 requires that all documents containing social security numbers and other personal information, such as name, phone number, and address, be stored in a physically secure manner such as in locked drawers or cabinets. In addition, Treasury policy ET-03169 requires documents containing confidential or sensitive data be labeled as such.

The Division did not:

- a. Label refund forms as containing confidential personal and business information.

We selected 40 of 19,924 refund forms and noted that none of the 40 forms were appropriately labeled as confidential.

- b. Store all refund forms and supporting documentation in a secure location.

We observed confidential refund forms on employees' desks after work hours and in unsecured storage bins in public areas. In addition, the file cabinets designated for storing taxpayer submitted refund forms were not locked.

- c. Label boxes containing refund forms that were stored in the DTMB Records Center as confidential.

The Division did not integrate Treasury security policies into its statutory refund processing procedures. In addition, legacy systems used to process motor fuel tax returns were developed to use full social security numbers and other confidential information to identify taxpayers' accounts. As Treasury replaces its legacy systems, it should implement controls to ensure compliance with its personal information protection policy.

After bringing this to management's attention, Treasury's Office of Privacy and Security worked with the Division to ensure that confidential documents were properly labeled and securely stored.

RECOMMENDATION

We recommend that the Division securely store confidential information in accordance with Treasury security policies.

**AGENCY
PRELIMINARY
RESPONSE**

Treasury provided us with the following response:

Treasury agrees with the recommendation and has implemented changes to ensure the security of confidential information. Concerning the Division's failure to protect personally identifiable information (PII) and confidential business information, the Division agrees that there were opportunities to improve protection of certain confidential taxpayer information and it has addressed some of these (e.g., placing refund claim forms in a secure location after work hours and attaching a "confidential" label to boxes used to ship refund claim forms to storage). However, the Division believes that the vast majority of taxpayer information it handles is protected.

EFFORTS TO ADMINISTER THE MOTOR FUEL TAX ACT

BACKGROUND

The Special Taxes Division administers the motor fuel tax and is responsible for issuing and managing over 900 motor fuel tax licensees, processing approximately 5,800 annual motor fuel tax returns, reviewing and monitoring tax discrepancies, and responding to motor fuel tax inquiries. Treasury collected \$964 million, \$1.01 billion, and \$1.02 billion in fiscal years 2014, 2015, and 2016, respectively, in motor fuel tax revenue.

AUDIT OBJECTIVE

To assess the effectiveness* of Treasury's efforts to administer the Motor Fuel Tax Act.

CONCLUSION

Effective.

FACTORS IMPACTING CONCLUSION

- The Division established and implemented procedures for processing motor fuel tax licenses, taxes, and returns.
- The Division identified and monitored discrepancies between taxes reported by terminal operators and paid by suppliers. Between March and June 2016, the Division reduced its discrepancy backlog from 3,510 to 663 discrepancies.
- The Division reconciled motor fuel tax returns and tax receipts to ensure that all motor fuel tax was accounted for in the State's financial system.
- One reportable condition related to assessing the cost/benefit of establishing funding for motor fuel tax enforcement services (Finding #5).

* See glossary at end of report for definition.

FINDING #5

Funding needed for motor fuel tax enforcement services.

Treasury should work with the Legislature to assess the cost/benefit of establishing funding for motor fuel tax enforcement services.

Public Act 403 of 2000 created the motor fuel tax evasion prevention fund, but did not establish an associated funding source, preventing the Division from implementing an enforcement program to identify noncompliance or abuse.

According to the Act, the fund would provide:

- Oversight of public roads and highways to ensure that dyed diesel fuel and other untaxed fuel is not used in violation of Michigan law.
- Development of auditing techniques to expose tax evasion schemes and incidents.
- Inspection, testing, and sampling of persons involved in the sale, use, or transportation of motor fuel.
- Random on-road inspections.
- Funding for the additional administrative costs associated with the enforcement program's implementation.

The Division relies on VISTA-generated reports to identify discrepancies in the amount of fuel reported by suppliers and the amount reported by terminal operators. As of March 1, 2016, the Division had a backlog of 3,510 discrepancies dating back to December 2013. By June 30, 2016, the Division reduced the backlog to 663 discrepancies using 506 hours of overtime.

We contacted two states with motor fuel tax evasion prevention programs. The State of Utah generates \$267 of revenue for each hour invested in field and desk audits. The State of Texas audits large companies to ensure the accuracy of taxpayer reporting and investigates retail theft, which has resulted in 38 felony and 20 misdemeanor charges in a nine-month period.

RECOMMENDATION

We recommend that Treasury work with the Legislature to assess the cost/benefit of establishing funding for motor fuel tax enforcement and related services.

AGENCY PRELIMINARY RESPONSE

Treasury provided us with the following response:

Treasury agrees with the recommendation. Treasury agrees that it should work with the Legislature to pursue funding for motor fuel tax evasion enforcement purposes if the value of the enforcement effort justifies the funding. Treasury has communicated with departmental legislative and budget staff to pursue funding.

SUFFICIENCY OF MOTOR FUEL TAX REFUND PROCESSES

BACKGROUND

Treasury's Special Taxes Division processes refund claims for taxes collected on fuel used for tax-exempt purposes such as fuel used off-road in manufacturing, construction, and landscaping. Treasury grants refunds for claims that are filed within the Motor Fuel Tax Act guidelines outlined in Sections 207.1030 - 207.1048 of the *Michigan Compiled Laws*. The Statutory Refund System (TC35) is the system used by the Division to input, approve, and process motor fuel refunds.

The Division has two dedicated employees who process motor fuel tax refunds. Between October 2013 and February 2016, Treasury accurately processed 21,410 refunds totaling \$62 million:

<u>Fiscal Year</u>	<u>Claims Processed</u>	<u>Claimed Amount</u>	<u>Refunded Amount</u>
2014	9,002	\$ 23.7	\$ 23.2
2015	8,359	\$ 28.0	\$ 24.3
2016*	4,049	\$ 10.2	\$ 9.5

*Partial fiscal year: October 1, 2015 through February 29, 2016

AUDIT OBJECTIVE

To assess the sufficiency of Treasury's motor fuel tax refund processes.

CONCLUSION

Sufficient.

FACTORS IMPACTING CONCLUSION

- Division supervisors reviewed all refund claims to ensure appropriate approval prior to processing the refunds.

EFFECTIVENESS OF GENERAL AND APPLICATION CONTROLS

BACKGROUND

General controls include the structure, policies, and procedures that apply to the entity's overall computer operations. General controls include an entity-wide security program, access controls*, application development and change controls, segregation of duties*, system software controls, and service continuity controls.

Application controls related to individual applications help to ensure that transactions are valid, properly authorized, and completely and accurately processed and reported.

Security and access controls limit or detect inappropriate access, which is important to ensure the availability, confidentiality, and integrity of data.

AUDIT OBJECTIVE

To assess the effectiveness of Treasury and DTMB's general and application controls over the motor fuel tax systems.

CONCLUSION

Moderately effective.

FACTORS IMPACTING CONCLUSION

- Data edit controls within TC35, the Refund Request System (TC88), Customer Financial System (CustFin), Correspondence, and VISTA were in place and functioning.
- Interface controls were in place to ensure that records were accurately and completely processed.
- The Division performed reconciliations between CustFin and VISTA to ensure that records were transmitted completely.
- One reportable condition related to establishing effective security administration over the motor fuel tax systems (Finding #6).

* See glossary at end of report for definition.

FINDING #6

Effective security administration over motor fuel tax systems needed.

The Division did not establish effective security administration over the motor fuel tax systems to ensure that tax data is protected from unauthorized access, modification, or disclosure.

The Division did not:

a. Sufficiently define user roles for:

- (1) Any of the five TC35 user roles.
- (2) Two CustFin security manager roles which allow a user to grant and remove access.

Treasury monitors one of these security manager roles for inappropriate activity but not the other. By utilizing two roles, there is an increased risk that inappropriate activity is undetected. Also, the Division did not understand the capabilities of the manager role.

(3) Two of the VISTA user roles.

The security access framework identifies two roles with full query and update capabilities. The Division was unaware of the differences between the roles and agreed that the roles should be reviewed.

Treasury policy ET-03179 requires the implementation of a security access rights framework for each system to define the system roles and determine who should have access to those roles based on their job responsibilities. Implementing an effective framework helps ensure that appropriate access rights are granted based on the principle of least privilege*.

b. Segregate incompatible duties including:

- (1) The ability to grant user access and process system transactions.

Treasury policy ET-03173 states that the ability to grant user access and process system transactions are incompatible and must be separated.

The three individuals responsible for security administration over the motor fuel tax systems also had incompatible duties such as:

- (a) Approving refunds in TC35.
- (b) Approving taxpayer bill of rights letters in Correspondence.
- (c) Creating and deleting tax returns in VISTA.

* See glossary at end of report for definition.

- (2) The ability to approve transactions and administer the Correspondence database*.

Treasury policy ET-03173 prohibits DTMB technical staff from initiating changes to application files.

One DTMB employee had the ability to approve taxpayer bill of rights letters in Correspondence, which is a responsibility that should be performed by the Division.

- c. Modify or delete user access rights when employees change job duties.

Treasury policy ET-03179 requires each division to modify or delete user access when an employee changes job duties. We identified 18 users who no longer required access to the following systems:

System	Number of Users Whose Access Should Be Modified or Deleted
TC35	2 (17%) of 12
TC88	1 (8%) of 13
CustFin	4 (14%) of 28
Correspondence	7 (32%) of 22
VISTA	4 (15%) of 26

Treasury policy ET-03179 states that the Division is responsible for appointing a security administrator that possesses an understanding of how system access impacts Treasury operations, financial records, and internal control. The Division assigned a staff member who did not possess security experience or expertise as a security administrator for motor fuel tax systems.

RECOMMENDATION

We recommend that the Division establish effective security administration over the motor fuel tax systems to ensure that tax data is protected from unauthorized access, modification, or disclosure.

* See glossary at end of report for definition.

**AGENCY
PRELIMINARY
RESPONSE**

Treasury provided us with the following response:

Treasury agrees with the recommendation. The Special Taxes Division agrees that it did not exercise its assignment of user roles and deletion of users in motor fuel tax related systems as well as it should have.

The Division has experienced significant employee turnover in recent years due to retirements and new job opportunities. The 5 systems used in the Division have separate user access rights and roles based on the employees' responsibilities. These responsibilities can sometimes overlap or be broadened based on operational needs and insufficient staffing. The Division has since researched and reviewed all access rights and has improved documentation with a detailed description for each system.

The Division is also reviewing current procedures for granting and removing user access and will work with Office of Security to ensure the Department's policies are being met. The User Access Manager will perform an annual review of each system and verify that all changes are documented in the future.

DESCRIPTION

The Motor Fuel Tax Act, Public Act 403 of 2000 (Sections 207.001 - 207.170 of the *Michigan Compiled Laws*), provides for the collection of motor fuel taxes by Treasury on behalf of the Michigan Department of Transportation. Transportation taxes are levied to pay for roads, highways, bridges, and public transportation throughout the State. The Motor Fuel Tax (MFT) Section of the Special Taxes Division, Department of Treasury, is responsible for the administration of the Motor Fuel Tax Act. During our audit period, the MFT Section consisted of 7 employees, 2 department analysts, 1 supervisor, and 1 manager.

The MFT Section oversees the licensing of all persons involved in the sale or transportation of motor fuel; provides services to licensees through technical advice letters; processes tax returns and refunds; performs error correction, verification, and desk audits for all tax returns and refunds; and represents Treasury at informal conferences when assessments and refund denials are appealed. The MFT Section processes over 10,000 motor fuel tax returns and claims for refund annually. The motor fuel tax generates approximately \$1 billion annually:

Motor Fuel Tax Revenue
(In Millions)

Fuel Type	Tax Rate	Fiscal Year		
		2014	2015	2016
Diesel fuel	\$0.15/gallon*	\$ 112.9	\$ 116.0	\$ 118.7
Motor carrier fuel	\$0.15/gallon	24.9	20.7	18.9
Liquefied petroleum gas	\$0.15/gallon	0.4	0.5	0.4
Gasoline	\$0.19/gallon*	820.6	866.6	873.0
Aviation fuel	\$0.03/gallon	5.1	6.4	6.1
Total		<u>\$ 963.9</u>	<u>\$ 1,010.2</u>	<u>\$ 1,017.1</u>

*Effective January 1, 2017, diesel fuel and gasoline tax rates increased to \$0.263/gallon.

Approximately 900 licensees, consisting of suppliers, permissive suppliers*, importers*, terminal operators, blenders*, carriers*, exporters*, liquefied petroleum gas dealers*, retail marine diesel dealers*, and transporters*, are licensed to commercially transport motor fuel in Michigan. There are 97 suppliers that account for 95% of the tax revenue.

* See glossary at end of report for definition.

Motor Fuel Product Flow Process

The Motor Fuel Tax Act imposes a tax on the sale and use of certain types of fuel in motor vehicles on public roads or highways within the State. Although the retail price of fuel purchased at the pump includes the motor fuel taxes, those taxes are not actually collected from the retailer. In most instances, the point of taxation for motor fuel is the point at which fuel is transferred across a terminal loading rack to a fuel wholesaler. Treasury collects the tax from fuel suppliers, as defined in the Act, and the revenue is transferred to the Michigan Department of Transportation. The supplemental information illustrates the motor fuel product flow.

System Descriptions

TC35 and TC88 are DTMB-managed mainframe systems for the input, approval, and processing of motor fuel refunds for taxpayers that use fuel for tax-exempt purposes.

CustFin and Correspondence are DTMB-managed applications that track tax payments, refunds, and liabilities and send letters to taxpayers who have not filed or owe additional tax liability.

VISTA is a contractor-managed system for the filing of motor fuel tax returns by suppliers and terminal operators*. VISTA calculates tax liability and processes and transmits tax returns and reports to Treasury. Information entered by the tax filers is stored on the contractor-managed database server.

* See glossary at end of report for definition.

AUDIT SCOPE, METHODOLOGY, AND OTHER INFORMATION

AUDIT SCOPE

To examine the program and other records related to the MFT Section. We conducted this performance audit* 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.

PERIOD

Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered October 1, 2013 through April 30, 2016.

METHODOLOGY

We conducted a preliminary survey to gain an understanding of the motor fuel tax systems, the collection of motor fuel taxes, and the processing of refunds. During our preliminary survey, we:

- Interviewed Treasury and DTMB management and staff to obtain an understanding of motor fuel taxes and the motor fuel tax systems and interfaces.
- Reviewed the Motor Fuel Tax Act, Public Act 403 of 2000.
- Reviewed system documentation for TC35, TC88, CustFin, Correspondence, and VISTA.
- Interviewed Treasury and DTMB management and staff to obtain an understanding of contract management.
- Reviewed the VISTA contract.
- Obtained an understanding of Treasury's processes for:
 - Protecting confidential data.
 - Granting access to TC35, TC88, CustFin, Correspondence, and VISTA.
 - Collecting and processing motor fuel taxes.
 - Issuing refunds to claimants.
- Reviewed Treasury's policies related to application and general controls.

* See glossary at end of report for definition.

- Reviewed DTMB's enterprise IT standards and policies and contract management policies.

OBJECTIVE #1

To assess the sufficiency of Treasury and DTMB's oversight of the VISTA contract.

To accomplish this objective, we:

- Interviewed Treasury and DTMB staff to gain an understanding of contract management roles and responsibilities.
- Reviewed the motor fuel tax system request for proposal, VISTA contract, contract extension, and federally funded refund module statement of work.
- Obtained and reviewed meeting notes and e-mail correspondence among the VISTA contractor, Treasury, and DTMB.
- Reviewed the partnership agreement between Treasury and DTMB.

OBJECTIVE #2

To assess whether Treasury and DTMB sufficiently secured motor fuel tax and refund data.

To accomplish this objective, we:

- Tested a random selection of 40 refund application forms containing social security numbers and federal employer identification numbers to determine if the Division protected confidential personal and business information in accordance with Treasury security policies at its work site and at the DTMB Records Center.
- Reviewed DTMB's encryption standards for highly sensitive data.
- Tested the encryption of data stored on the State's network and the contractor's network to ensure that it met the State's encryption standards for highly sensitive data.

OBJECTIVE #3

To assess the effectiveness of Treasury's efforts to administer the Motor Fuel Tax Act.

To accomplish this objective, we:

- Tested motor fuel tax return data obtained from VISTA from October 1, 2014 through September 30, 2015.

- Tested CustFin data edit checks for the validity of motor fuel payments and liabilities.
- Tested the motor fuel Correspondence data edit checks for validity as designed.
- Tested a random selection of 40 of 511 taxpayer bill of rights letters generated from Correspondence to verify that Treasury accurately communicated tax liability information.
- Judgmentally selected the 3 highest tax returns to verify the accuracy of VISTA tax calculations.
- Judgmentally selected the 5 largest taxpayers and randomly selected one month of bills of lading* (BOLs) for each taxpayer for a total of 60 BOLs reviewed. We:
 - Verified that the taxpayer maintained the BOL and submitted the documentation to the Division upon request.
 - Reconciled the gross and net gallons of fuel recorded in VISTA with the number of gallons on the BOL.
 - Reconciled the name of the carrier listed in VISTA with the name on the BOL.
- Contacted 2 states to obtain an understanding of their motor fuel tax evasion prevention programs.

OBJECTIVE #4

To assess the sufficiency of Treasury's motor fuel tax refund processes.

To accomplish this objective, we:

- Reviewed system documentation and met with Treasury and DTMB staff to gain an understanding of the motor fuel tax refund system and process.
- Verified that TC35 and TC88 data edit checks were in place.
- Randomly selected 40 refund forms and tested for completeness, accuracy, and compliance with Treasury policies.

OBJECTIVE #5

To assess the effectiveness of Treasury and DTMB's general and application controls over the motor fuel tax systems.

* See glossary at end of report for definition.

To accomplish this objective, we:

- Reviewed the security rights access frameworks for each system to gain an understanding of user roles.
- Obtained a list of active system users and their access request forms to determine whether Treasury:
 - Granted access as requested on the access form.
 - Timely deactivated accounts of users no longer requiring access.
 - Appropriately granted user access based on the access frameworks.
 - Obtained proper approval for access.
- Reviewed interface design documentation for the various system interfaces.
- Ensured that proper system documentation was maintained.

CONCLUSIONS

We base our conclusions on our audit efforts and any resulting material conditions or reportable conditions.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve State government operations. Consequently, we prepare our performance audit reports on an exception basis.

AGENCY RESPONSES

Our audit report contains 6 findings and 8 corresponding recommendations. Treasury and DTMB's preliminary response indicates that they agree with the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agencies' written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

SUPPLEMENTAL INFORMATION

Our audit report includes supplemental information. Our audit was not directed toward expressing a conclusion on this information.

GLOSSARY OF ABBREVIATIONS AND TERMS

access controls	Controls that protect data from unauthorized modification, loss, or disclosure by restricting access and detecting inappropriate access attempts.
bill of lading (BOL)	Document issued by a carrier to acknowledge receipt of goods that have been loaded into the tank. It lists the date, the tank size, gross gallons of fuel shipped, and net.
blender	Any person who produces blended motor fuel outside of the bulk transfer/terminal system.
carrier	An operator of a pipeline or marine vessel engaged in the business of transporting motor fuel above the terminal rack.
Control Objectives for Information and Related Technology (COBIT)	A framework, control objectives, and audit guidelines published by the IT Governance Institute as a generally applicable and accepted standard for good practices for controls over information technology.
CustFin	Customer Financial System.
database	A collection of information that is organized so that it can be made easily accessed, managed, and updated.
DTMB	Department of Technology, Management, and Budget.
effectiveness	Success in achieving mission and goals.
encryption	Provides a high level of security to electronic data by translating data into secret code. Process of taking a plaintext message, applying a mathematical function to the message (encryption algorithm), and producing an encrypted (ciphertext) message.
exporter	A person who exports motor fuel.
importer	A person who imports motor fuel into this State.
IT	information technology.
liquefied petroleum gas dealer	A person who is licensed under this chapter to use liquefied petroleum gas.

material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
MFT Section	Motor Fuel Tax Section.
motor fuel	Gasoline; diesel fuel; kerosene; a mixture of gasoline, diesel fuel, or kerosene; or a mixture of gasoline, diesel fuel, or kerosene and any other substance. Motor fuel does not include leaded racing fuel.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.
permissive supplier	A person who may not be subject to the taxing jurisdiction of this State but who is both a position holder in a federally registered terminal located outside of this State or who acquires from a position holder motor fuel in an out-of-state terminal transaction that otherwise qualifies as a 2-party exchange and is registered under Section 4101 of the Internal Revenue Code for transactions in motor fuel in the bulk transfer/terminal system.
principle of least privilege	The practice of limiting access to the minimal level that will allow normal functioning. Applied to employees, the principle of least privilege translates to giving people the lowest level of user access rights that they can have and still do their jobs. The principle is also applied to things other than people, including programs and processes.
reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.
retail marine diesel dealer	A person who sells or distributes diesel fuel to an end user in this State for use in boats or other marine vessels.

segregation of duties

Separation of the management or execution of certain duties or areas of responsibility to prevent or reduce opportunities for unauthorized modification or misuse of data or service.

Service Organization Controls (SOC) report

Designed to help organizations that provide services to user entities build trust and confidence in their delivery processes and controls through a report by an independent certified public accountant (CPA). Each type of SOC report is designed to help service organizations meet specific user needs:

- SOC 1 (Report on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting) - Intended for user entities and the CPAs auditing their financial statements in evaluating the effect of the service organization's controls on the user entities' financial statements.
- SOC 2 (Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy) - Intended for a broad range of users that need information and assurance about a service organization's controls relevant to any combination of the five predefined control principles.

There are two types of SOC 1 and SOC 2 reports:

- Type 1 - Reports on the fairness of the service organization's description of controls and the suitability of the design of the controls to achieve the related control objectives included in the description, as of a specified date.
- Type 2 - Includes the information in a type 1 report and also addresses the operating effectiveness of the controls to achieve the related control objectives included in the description, throughout a specified period.
- SOC 3 (Trust Services Report for a Service Organization) - Intended for those needing assurance about a service organization's controls that affect the security, availability, or processing integrity of the systems a service organization employs to process user entities' information, or the confidentiality or privacy of that information, but do not have the need for or the knowledge necessary to make effective use of a SOC 2 report.

SOW

Statement of Work.

supplier

A person who meets all of the following requirements:

- Is subject to the general taxing jurisdiction of this State.
- Is registered under Section 4101 of the Internal Revenue Code for transactions in motor fuel in the bulk transfer/terminal distribution system.
- Is any one of the following:
 - The position holder in a terminal or refinery in this State.
 - A person who imports fuel grade ethanol into this State.
 - A person who acquires motor fuel from a terminal or refinery in this State from a position holder pursuant to a 2-party exchange.
 - The position holder in a terminal or refinery outside this State with respect to motor fuel which that person imports into this State on its account.

A supplier produces alcohol or alcohol derivative substances in this State or for import into a terminal in this State or acquires alcohol or alcohol derivative substances.

TC35

Statutory Refund System.

TC88

Refund Request System.

terminal operator

A person who owns, operates, or otherwise controls a terminal.

TPSO

third party service organization.

transporter

An operator of a railroad or rail car, tank wagon, transport truck, or other fuel transportation vehicle engaged in the business of transporting motor fuel below the terminal rack.

UAT

user acceptance testing.

VISTA

Fuel Tax Tracking and Compliance System.



Report Fraud/Waste/Abuse

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