GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER

OFFICE OF INTEGRITY AND OVERSIGHT

AUGUST 2009

FINAL REPORT ON THE REVIEW OF ESTATE TAX RETURNS AND REFUNDS AT OTR

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GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer

Office of Integrity and Oversight

MEMORANDUM

TO: Stephen M. Cordi, Deputy Chief Financial Officer
Office of Tax and Revenue

FROM: Robert G. Andary, Executive Director
Office of Integrity and Oversight

DATE: September 2, 2009

SUBJECT: Final Report on the Review of Estate Tax Returns and Refunds at OTR **(Report No.: IA:OTR:2803C-04)**

This final report summarizes the results of the Office of Integrity and Oversight (OIO) Review of the Office of Tax and Revenue (OTR) Estate Tax Returns and Refunds for FYs 2004 through 2008. This audit was requested by OTR's supervisor for the Inheritance and Estate Tax Unit and was included as part of our *Internal Audit Division Annual Work Plan Fiscal Year 2008/2009*. The objectives of our review were to determine if the estate tax system operates in an effective and efficient manner; if the estate tax system operates in compliance with the applicable statutes and regulations; there were controls to safeguard assets and ensure reliable financial and programmatic reporting.

This report contains 5 findings detailing the conditions we found during our audit. Overall, we found major deficiencies in the administration of the estate tax program. Over the five-year period, we found the program lacked management oversight, systems of controls including reconciliation and policies and procedures, and automation leaving the estate tax program vulnerable to undetected errors, manipulation, and fraud.

We made appropriate recommendations to address the issues cited herein in order to strengthen the internal controls over the management of the estate tax program.

We reviewed and evaluated OTR's response to the draft report, in which OTR concurred for the most part with our findings and recommendations. However, OTR did not agree with OIO's finding number 1, which concluded that there is a potential net loss to the District Government of $2.29 million, OTR disagreed with this finding on the basis that there is no objective way to measure or accurately estimate the true amount of the "potential net loss" to the District. The complete OTR management response is attached to this report as Exhibit B. We expect OTR to

prepare a formal action plan to address the recommendations and our office will follow up on this report in FY 2010 as part of our continued monitoring and review of OTR operations.

We appreciate the assistance and cooperation that you and your staff provided us during the review. Should you have any questions on the draft report or need additional information, please contact Mohamad Yusuff at 442-8240 or Tisha Edwards at 478-9143.

Attachments

cc: Natwar M. Gandhi, Chief Financial Officer for the District of Columbia
Lucille Dickinson, Chief of Staff, OCFO
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Glen Groff, Director of Operations, OTR
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Acronyms and Abbreviations

Audit Division	Division
Code of Federal Regulations	CFR
Deputy Chief Financial Officer	DCFO
District of Columbia	DC or District
District of Columbia Code	DCST
DC Estate Tax Return	Form D-76
District of Columbia Municipal Regulations	DCMR
Economic Growth and Tax Relief Recovery Act	EGTRRA
Fiscal Year	FY
Government Accountability Office	GAO
Inheritance and Estate Tax Unit	Unit
Integrated Tax System	ITS
Internal Revenue Code	IRC or Code
Internal Revenue Service	IRS or Service
Office of the Chief Financial Officer	OCFO
Office of Integrity and Oversight	OIO
Office of Tax and Revenue	OTR
Revenue Accounting Administration	RAA
Returns Processing Administration	RPA
Standards for Internal Control in the Federal Government	*Standards*
System of Accounting and Financial Reporting	SOAR
United States Code, Annotated	U.S.C.A.
United States Estate (and Generation-Skipping Transfer) Tax Return	Form 706

OFFICE OF THE CHIEF FINANCIAL OFFICER
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FINAL REPORT ON THE REVIEW OF ESTATE TAX RETURNS AND REFUNDS AT OTR

Executive Summary

As part of its fiscal year 2008/2009 audit plan the Office of Integrity and Oversight (OIO) is conducting a series of audits within the Office of Tax and Revenue (OTR), as part of our oversight responsibilities. This audit, which was requested by OTR's supervisor for the Inheritance and Estate Tax Unit (Unit), was included as part of OIO's audits and reviews of the OTR operations. The general objective of the audit was to determine whether OTR and the Unit have an adequate system of internal controls that: (i) safeguards assets and resources, (ii) provides timely and accurate financial and programmatic data and reporting, and (iii) assures compliance with applicable statutes, regulations, policies and procedures.

The OTR is one of the operating offices within the District Government's Office of the Chief Financial Officer (OCFO). OTR is headed by a Deputy Chief Financial Officer (DCFO) who has responsibility to collect the proper amount of tax due to the District of Columbia and correctly account for all revenues, while minimizing the burden on taxpayers and the cost to the government. OTR's responsibilities are separated among eight offices and administrations. The Compliance Administration is responsible for the oversight of non-real property tax revenues, including the collection of various excise taxes, including estate taxes. The Compliance Administration's Audit Division (Division), in which the Unit is located, is responsible for the processing of excise tax returns and for conducting both desk and field audits of those returns. At the start of this audit the Unit was assigned three staff members: a full time tax auditor and two part-time staff members.

Estate tax returns are required of both District residents and non-residents, who meet certain statutory requirements, when the decedent's gross estate[1] exceeds $1 million, for an individual who dies on or after January 1, 2003. Estate tax revenues and returns are received by the OTR Returns Processing Administration (RPA) and supporting documentation is forwarded to the Compliance Administration Audit Division for disposition. In fiscal year 2008 (FY-08), the District Government collected approximately $68 million in estate tax revenues.

Summary of Results

Our audit found OTR's estate tax program lacked management oversight, systems of controls including reconciliation and policies and procedures, and adequate automation, thus leaving the estate tax program vulnerable to undetected errors, manipulation, and fraud. The Unit failed to properly validate the accuracy of the estate tax documents submitted, and failed to assess penalties and interest to taxpayers, who did not request extensions or file returns in a timely manner. As a result of these deficiencies, there is a potential net loss to the District Government of $2.29 million.

Further, the Unit did not refund overpayments to taxpayers within the 181 days provided by statute, resulting in OTR incurring $14,060 in interest costs. The Unit did not adequately review a request to pay a taxpayer for late refunds of overpayment. The request did not meet the statute's requirements and resulted in the inappropriate disbursement of the $19,740. In addition, OIO determined that:

- Estate tax revenues reported within the system of accounting and reporting (SOAR) may be unreliable.

[1] The gross estate is determined using the Internal Revenue Code's (IRC's or Code's) definition of gross estate. This definition is included in sections 2031 through 2044 of the Code, 26 U.S.C.A. §§2031 – 2044 (2000) and 26 CFR §§2031 – 2044 (2008)

- Passive collection and enforcement efforts of the Collection Division and the Unit do not ensure that the District Government collects all the revenues that are due.

This report contains a series of recommendations addressed to OTR's Deputy Chief Financial Officer; the Director, Compliance Administration; Chief, Audit Division; Supervisor, Inheritance and Estate Tax Unit; and the Director, Revenue Accounting Administration. We believe that with the implementation of these recommendations, appropriate system of internal controls, regular oversight and transparency of the Unit's operations will significantly improve operational effectiveness.

Summary of Findings

1. Failure to Enforce Estate Tax Statutes Leads to Lost Revenues

The Unit failed to properly assess estate taxes of $2.29 million. This amount consists of $1,496,340 in taxes, applicable penalties of $710,364 and interest of $86,708 to extensions and returns that were filed after the statutory due dates and for returns which contained errors resulting in underpayment of the total amount due. Additionally, the Unit did not refund overpayments of estate taxes timely incurring interest due to the taxpayer of $[redacted]. Furthermore, the Unit did not adequately review a taxpayer's request for a refund of $[redacted] for interest on a late refund of an overpayment, resulting in an inappropriate disbursement of the amount requested.

2. The Unit does not maintain an Effective System of Internal Controls within the Unit.

The system of internal controls within the Unit is ineffective. OIO determined that the Unit did not use a risk assessment process to identify high-risk practices and operations and develop adequate controls to address the most significant of those risks. The Unit does not have adequate policies, procedures, and mechanisms to enforce management's directives and to ensure compliance with applicable statutes and regulations. The Unit effectively operates as a single-person operation; and the tax auditor assigned to the Unit effectively has sole control over all the significant transactions and operations. The Unit lacked documented management oversight of the operations in general and the estate tax refund process in particular. Further, OIO identified an absence of documentation to give assurance that the estate tax returns were reviewed, accurately assessed for additional taxes, penalties, and interest, when applicable.

3. Estate Tax Revenues and Refunds Reported in SOAR May Be Unreliable

Data reported in SOAR may be unreliable due to the absence of a reconciliation process between the Unit's records and the data generated by the Returns Processing Administration (RPA) as reported to the Revenue Accounting Administration (RAA). OIO found that the revenues for FY-05 were understated, as estate tax refunds totaling $77,571 were charged directly to the estate tax revenue object instead of the estate tax refund object. We also identified a FY-07 tax refund of $[redacted] that was inappropriately charged to the estate tax refund account. As a result, the amount of refunds reported in SOAR during the five years: FY-04 to FY-08 (October 1, 2003 to September 30, 2008) was overstated by $385,506. This amount represents an 8.07 percent overstatement of the estate tax refunds issued during the period.

4 Manual Tax System is Subject to Potential Fraud and Manipulation

The combination of a manual tax processing system, absence of visibility of the review of the returns and the processing transactions, and weak internal controls result in a system where the risk of fraud and manipulation has not been reduced to a very low level. OIO concluded that the Unit and Division rely solely on the veracity of the assigned tax auditor to process transactions and conduct the Unit's operations.

5 The Unit Utilizes a Passive Collection Effort for Estate Taxes

The Unit employed a passive effort to collect estate taxes which did not appear to be effective in ensuring compliance with the statutes. The process described to OIO relies on the probate court and the Internal Revenue Service to identify taxpayers, who have not complied with the applicable statutes and were mandated to file an estate tax return. As a result, this process delays the District Government's receipt of revenues and does not ensure that all estates that are required to file a tax return do so.

Summary of Recommendations

The Deputy Chief Financial Officer should:

- Mandate that Director, Compliance Administration, take action to (i) determine whether the unpaid estate taxes, penalties and interest can be collected, and (ii) direct the Collection Division initiate collection action.
- Require that the Director Compliance Administration and the Chief Audit Division develop and implement a work plan to conduct audits of a sample of the returns received by the Unit during the audit period (October 1, 2003 to September 30, 2008) as promptly as practicable. These reviews should be performed by staff independent of the Unit's operations. Where possible, efforts should be made to collect unpaid estate taxes, penalties and interest.
- Require that an agency-wide risk assessment be developed based on the OTR, individual office and administrations' performance and strategic goals. The risk assessments should include all functional areas within OTR.

The Director, Compliance Administration should:

- Mandate the Chief, Audit Division periodically review the tax certificate issuance process in order to ensure compliance with the established standards and protocols.
- Mandate the Chief, Collections Division take the necessary action to collect any outstanding estate taxes, penalties, and interest from the impacted tax payers.
- Evaluate the feasibility of developing/purchasing an automated system to assist in the processing of estate taxes. This system should be able to interface with the current ITS system and its successors.
- Take action to require that at a minimum the Unit review the list prepared by the Register of Wills and determine whether the estates that equal or exceed the $1 million filing floor have met their legal obligation to file an estate tax return

OIO recommends that the Chief, Audit Division:

- Develop standardized operating policies and procedures for the Unit. These policies and procedures should be developed in concert with the Division's current policies and procedures and address the specific operations of the Unit.
- Establish a standardized system of documentation for all audit files. This system of documentation should include specific documentation that must be present in the file. Where appropriate, this standardized system should be supplemented by the requirements of the various operating units within the Division.
- Review the Unit's operations and determine whether it is cost effective to segregate the duties of the Unit's staff. If segregation of duties is not a feasible alternative, additional documented file review and oversight requirements are established. These additional review and oversight steps should be performed by the Unit's supervisor and other management level staff within the Division.
- Require the Unit's staff coordinate with RAA in performing monthly reconciliations of the revenues and refunds reported by RAA with the records available in the Unit. Differences should be documented and resolved. Copies of these reconciliations should be retained for audit purposes.
- Determine, to the extent possible, the amount of uncollected estate taxes, penalties, and interest based on the records maintained in the card files. These outstanding amounts should be referred to the Collections Division for potential collection actions.
- Establish with RAA an estate taxes receivable account for the amount of estate taxes, penalties, and interest for the uncollected amounts due to the District Government. This account should be used to record current and future receivable amounts. This account should be reconciled by the Unit to its records on a periodic basis.
- Develop a methodology to select estate tax returns for reviews and audits. The results of the reviews and audits should be used to determine adjustments to the selection methodology. The methodology should include both returns that may be audited by the Service and those that fall below the IRS reporting floor.
- Develop a system of reviews that require an individual independent of the Unit to periodically review, at least quarterly, the estate tax returns including review for mathematical accuracy. Evidence supporting this review should be included in the tax return file for each return reviewed.
- Notify the taxpayers identified, as the result of the desk audits, of any refunds and/or interest due. Payment of the refund and/or interest should be completed within 30 days of the taxpayer notification. This notification should be completed after recommendation of the audit of all estate tax returns received during the period.
- Require that: (i) all tax certificates issued by the Unit be reviewed and signed by the Unit's supervisor, at a minimum, and (ii) the Unit establish a database and system that in, conjunction with the supervisory reviews, document and control the issuance of tax certificates.

The Chief, Collections Division should:

- Assign staff, as necessary, to take the necessary collection action for the estate tax returns.

The Director, Revenue Accounting Administration should:

- Provide the Unit with a monthly report of the estate tax revenues received and the refunds processed, and follow-up with the Unit's staff on any outstanding reconciling items and adjustments with the Unit's staff.

The Supervisor, Inheritance and Estate Tax Unit should:

- Establish standard processing times for estate tax returns and refunds and require that the Unit's staff meet or exceed the times.
- Periodically review the times established in the standard with actual processing times. The standards should be adjusted as necessary based on the actual experience.

Agency Response:

OTR officials concurred with most of our findings and recommendations. Specifically, OTR took exception to Finding 1 in which OIO stated there is a potential net loss to the District Government of $2.20 million. While OTR agreed that there were deficiencies at the time of our audit, OTR does not believe there is an objective way to measure the true amount of potential loss to the District. OTR provided two responses to our draft report. Copies of OTR's responses in its entirety are provided as Appendix I of this report. OIO referred to both responses to evaluate OTR's response to our draft report.

OIO Auditor Evaluation:

We concur with the overall planned actions of OTR's management; however, there were some recommendations that were not specifically addressed in the management responses provided. We recommend OTR management develop a responsive corrective action plan to address all of the recommendations presented herein. Should OTR disagree with a finding, it should give valid reasons for the disagreement and why it should not be implemented. The development of a more comprehensive action plan, when fully implemented, should satisfy the intent of our recommendations.

Mohamad R. Yusuff, CPA
Director of Internal Audit
Office of Integrity and Oversight

INTRODUCTION AND PURPOSE

OTR is one of several operational offices under the control of the District Government's OCFO. OTR's operational responsibility includes the collection, recording, and reporting of all taxes and most District Government revenues received from the District of Columbia's (District's or DC's) taxpayers. In addition to its tax and revenue collection responsibilities, OTR is responsible for the enforcement of the various tax statutes and regulations used to assess and collect taxes. OTR's Compliance Administration enforces compliance with the District Government's taxation statutes and regulations through investigations and desk or field audits of individuals and other entities. The Unit is part of the Compliance Administration's Audit Division (Division). The Unit responsibilities include desk reviews, desk audits, and field audits of the estate tax returns filed with OTR. Additionally, the Unit assesses estates with additional taxes, penalties and interest for underpaid and late filed estate tax returns. At the commencement of this audit the Unit had three individuals assigned, a full-time tax auditor and two Division employees who are assigned to the Unit on a part-time basis, as the needs of the Unit arise.

The Unit receives approximately 300 estate tax returns each year and provides advice to personal representatives, attorneys, and accountants on the information required for filing a return in the District. The Unit is responsible for conducting both desk and field audits of the estate returns.

This audit is part of an ongoing assessment and review effort within OTR for FY-08 and FY-09, as outlined in our annual audit plan. Subsequent to the development of the FY-08/09 audit plan, OIO received a request from the Unit's supervisor to review the process used to generate estate tax refunds and to validate the refunds that were issued. OIO has expanded on this request to review the entire estate tax return process.

The audit's general objective is to determine whether OTR and the Unit have an adequate system of internal controls that: (i) safeguards assets and resources, (ii) provides timely and accurate financial and programmatic data and reporting, and (iii) assures compliance with applicable statutes, regulations, policies and procedures.

SUMMARY OF THE ESTATE TAX PROGRAM

The District authorizes the levying of estate taxes on both residents and non-residents who meet certain criteria, for example the ownership of real property or a business entity within the District. This authorization is contained in the District of Columbia Code, revised 2001[2] (DCST), specifically title 47 sections 47-3701 *et seq* (DCST §47-3701 *et seq*). Procedural regulations for the levying, reporting, and collection of the estate tax are provided in the DC Municipal Regulations (DCMR) title 9 section 3701 *et seq* (9 DCMR §3701 *et seq*). Generally, the estate's personal representative[3] is responsible for compliance with both the statutes and regulations.

Beginning with an individual's date of death, which occurs on or after January 1, 2002, and on or before December 31, 2002, an estate tax return would be required to be filed if the gross estate, defined by the Code, exceeded $675,000 (DCST §47-3701(4)(B)(iii)). Beginning with January 1, 2003, an estate tax

[2] Unless specifically stated, all citations referencing the District's Code refer to the 2001 version, as amended.
[3] The term "personal representative" and "executor of an estate" are synonymous. These individuals are generally named in the will or appointed by a judge in the jurisdiction's court. The personal representative/executor may be held personally responsible for the payment of any estate taxes using the assets of the estate.

return would be required should the decedent's estate exceed $1 million (DCST §47-3701(4) (C) (iii)). For both residents and non-residents, the taxes may be offset by certain non-refundable tax credits and exemptions provided by either District's statute or the IRC. Further, state death and estate taxes paid to other states may reduce the estate's District tax liability.

A decedent may avoid any tax on the estate's assets by the District though a complete transfer of the estate to a surviving spouse and/or to one or more charitable organizations, as defined by IRC §501(c) (3). This is done through the filing of a District Estate Tax Return (Form D-76-I:Z). Our sample of returns reviewed during the audit period did not include any of these returns.

The District enacted a statute, DC Law 16-191 in March, 2007, that limits the unified credit provided to an estate and fixes the filing requirement at $345,800 and $1 million respectively (DCST §47-3701(4)(B)(ii)). Increases in the Federal estate tax unified credit or in the filing requirement have no impact on the District's requirements unless specifically changed by the District's Council.

The District's estate tax statutes and computation of the amounts due do not fully comply with all of the Code's requirements. For example, the District requires that the estate's assets be valued as of the date of death; while the Code allows for an alternate valuation date, up to six months after the date of death, and certain alternative valuation procedures for specific assets. This District's decoupling from the Code's requirements was extended further with the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). This act decoupled the relationship between the estate tax filing requirements for the District and the Internal Revenue Service (IRS or Service). Also, EGTRRA eliminated the tax credit for the payment of state/District death or estate taxes and converted it to a deduction from the estate's gross value. The tax reporting floor for Federal estate tax returns increased from $1 million to $3.5 million, in a stair step process, to the elimination of the Federal estate tax for individuals with a date of death during calendar year 2010. EGTRRA imposes the Federal estate tax again in calendar year 2011, with a reporting floor of $1 million. Table 1 provides the Federal estate tax reporting floors for EGTRRA and the period covered by this audit.

Table 1 - EGTRRA - Estate Tax Reporting Floors

Decedent's Date of Death Falls Between	Federal Estate Tax Reporting Floor
January 1, 2002 and December 31, 2003	$1,000,000
January 1, 2004 and December 31, 2005	$1,500,000
January 1, 2006 and December 31, 2008	$2,000,000
January 1, 2009 and December 31, 2009	$3,500,000
January 1, 2010 and December 31, 2010	No Estate Tax is Levied by the Federal Government
January 1, 2011 and Undetermined	$1,000,000

Source: IRS website http://www.irs.gov/publications/p950/ar02.html#d0e40 last reviewed February 4, 2009

Collection of estate tax revenues have varied significantly throughout the audit period. This is due in part to an increase in the fair value of the some of the estates' assets (primarily real estate) and some stocks and other securities. Table 2 provides a summary of the revenues reported in the District's system of accounting and reporting (SOAR) for the audit period (FY-04 through FY-08).

Table 2 - Estate Tax Receipts FY-04 through FY-08

Fiscal Year	Estate Tax Receipts	Dollar Value Change from Prior Year	Percentage Change from Prior Year
2004	$27,539,824	Not Applicable (N/A)	N/A
2005	29,889,638	$2,349,814	8.53
2006	30,551,113	661,475	2.21
2007	56,065,213	25,514,100	83.51
2008	68,037,186	11,971,973	21.35
Total	$212,082,974	N/A	N/A

Source: SOAR – October 1, 2003 through September 30, 2008 – Object Class 8800

During the audit period the Unit generated refunds to taxpayers of approximately $5 million. These refunds are generated from two principal sources. First, are taxpayers overpaying the estate taxes and then filing a refund request. This is generally done on the DC Estate Tax Return (Form D-76). The second source of refunds results from the Service's audit of the taxpayer's Federal estate tax return which changes the taxpayer's District liabilities. This may result in a refund being requested several years following the initial filing of the return with the District. Table 3 provides a listing of refunds reported in SOAR during the audit period.

Table 3 - Estate Tax Refunds FY-04 through FY-08

Fiscal Year	Estate Tax Refunds	Dollar Value Change from Prior Year	Percentage Change from Prior Year
2004	$1,074,169	Not Applicable (N/A)	N/A
2005	633,047	(441,122)	(41.02)
2006	426,481	(206,566)	(32.63)
2007	1,891,392	1,464,911	343.49
2008	1,137,710	(753,682)	(39.85)
Total	$5,162,799	N/A	N/A

Source: SOAR – October 1, 2003 through September 30, 2008 – Object Class 8801

Estate taxes are due, in full, ten months after the decedent's date of death. While the estate may request and receive an extension of time to file the return, this extension does not apply to the payment of the taxes. Exceptions to the payment requirement may be granted by the DCFO according to 9 DCMR §3705.4, by the taxpayer providing the DCFO with "good cause" for the extension of the payment period. However, the statute (DCST §47-4201(a) (1) (A)) and the regulation (9 DCMR §3705.7) require that interest be assessed to the taxpayer starting ten months from the decedent's date of death.

In addition to processing the estate tax requests for time extensions and the estate tax returns, the Unit is authorized to issue, on behalf of the DCFO, a certificate of payment. This certificate is authorized by DCST §47-3710 and 9 DCMR §3707.3 *et seq.* The certificate, in addition to delineating the amounts paid by the estate for taxes, penalties, and interest, indicates the amount of any refund due or that no refund is due to the estate. The certificate effectively discharges the personal representative from any additional estate tax liability and provides them with the support to release the balance of the estate to the beneficiaries. This certificate also supports the final accounting provided by the personal representative to the probate court that the estate tax, penalties and interest due to the District has been paid full. This certificate is required by statute, DCST §47-3716 to be filed with the court. These certificates, according to the Unit's staff, are generally issued after the taxpayer has provided a copy of the Service's estate closing letter or an audit report, if applicable, to the Unit.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit's general objective was to determine whether OTR and the Unit have an adequate system of internal controls that: (i) safeguards assets and resources, (ii) provides timely and accurate financial and programmatic data and reporting, and (iii) assures compliance with applicable statutes, regulations, policies and procedures. OIO's specific objectives are to:

- Verify that controls are in place to ensure that estate tax refunds are properly/adequately supported and issued in accordance with OTR policies and procedures;
- Determine whether the receipts for the estate taxes are received in the Collections unit and accounted for by both OTR and the Unit; and
- The audit covered FY-04 to FY-08.

This audit does not address the fiduciary income earned by an estate. This income is separately reported to OTR in a manner similar to a personal income tax return. Further, the audit will not determine whether the information reported on the estate tax returns reviewed by OIO is appropriate. OIO is not attempting to "audit the estate tax return," it is auditing the process used by the Unit once the tax return information is received by the Unit.

We conducted this performance audit from October 2008 through February 2009 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. We obtained evidence by performing the following tasks:

- Interviewed the full-time staff member assigned to the Unit and the Unit's supervisor to determine the procedures used to process estate tax returns and requests for extension of time.
- Reviewed the web sites of the District of Columbia Auditor, District of Columbia Inspector General, and the Office of the Treasury Inspector General for Tax Administration for prior audits related to our current review.
- Requested from the Unit copies of the policies and procedures related to the processing of estate tax returns and refunds.
- Reviewed the web sites for the District of Columbia Code and the District of Columbia Municipal Regulations to determine the statutes and regulations that impact the processing of estate tax returns and related refunds.
- Requested from RAA data on the revenues processed through SOAR for estate tax revenues and refunds for the audit period.
- Developed a judgmental sample of 75 refunds based on the selection criteria outlined below:
    - All refunds in excess of $50,000,
    - All refunds where the taxpayer was listed two or more times,

- A selection of every fifth refund from the balance of the refunds listed in the SOAR report.
- Appendix A provides additional information on the sample sizes.

- Obtained from the Unit and RAA the estate tax files that provide the basis for the refund amount and the "refund packages" processed by RAA for each refund in our sample.
- Reviewed a judgmental sample of 25 returns located in the Unit's files that were not expected to have a refund based on the information provided in SOAR. These returns were from taxpayers where the date of death occurred primarily in 2006 and 2007.

Use of Computer Processed Data

To perform this audit, OIO extracted computer processed data from SOAR used to report the revenue collections and refunds for estate taxes. We reviewed the data included in SOAR for revenue objects 8800 (estate tax revenues) and 8801 (estate tax refunds). Our review found that the data did not provide the necessary assurances that the revenue object data was reliable. Our discussion of these reliability issues is included in the Findings and Recommendations section titled "Reliability of Estate Tax Revenues and Refunds in SOAR". These issues precluded us from concluding that the reported estate tax revenues and refunds were reliable.

Audit Results

OTR's estate tax program lacks effective systems, internal controls, and oversight of its operations. OIO determined that the Unit failed to assess and collect approximately $2.29 million in estate taxes, penalties, and interest during the five year audit period. This was coupled with the payment or incurring interest for late return of taxpayer refunds of approximately $33,530. Further, we found that:

- The existing internal controls do not provide assurances that the financial data in SOAR was supported with accurate and reliable information and that the Unit complied with the applicable statutes and regulations related to the collection of estate taxes and the assessment of penalties and interest when appropriate.
- The failure to review data entered into SOAR and to ensure the accuracy and completeness of such data entered by the Returns Processing Administration (RPA) resulted in the understatement of revenues during the audit period and the overstatement of the amounts refunded on estate taxes.

DETAILED FINDINGS AND RECOMMENDATIONS

1. Failure to Enforce Estate Tax Statutes Leads to Lost Revenue

OIO identified that the Unit did not verify the mathematical accuracy of the returns and failed to properly assess estate taxes that were due, together with penalties and interest for late filing of estate tax requests for extension and tax returns. This resulted in potentially lost revenue to the District of approximately $ 2.29 million in taxes, interest and penalties. The majority of this difference is due to the lack of supporting documentation provided to OIO by the Unit. Nine of the requested refund case files were not provided; therefore, OIO used documentation obtained from the refund package where available.

Additionally, delays in processing the estate tax returns resulted in the Unit incurring, on behalf of the District additional costs of $14,060 for interest resulting from the late return of refunds.

Table 4 Uncollected Estate Taxes, Penalties, and Interest by Fiscal Year

Fiscal Year	Uncollected Estate Taxes	Uncollected Penalties	Uncollected Interest	Total [a]
FY-04	$165,480	$284,841	$(36,372)	$413,949
FY-05	700,595	6,697	10,091	717,383
FY-06	157,175	12,120	5,449	174,744
FY-07	471,298	370,781	79,358	921,437
FY-08	1,793	35,925	28,182	65,900
Total [a]	$1,496,340	$710,364	$86,708	$2,293,413

[a] Totals may not agree due to rounding
Source: OIO's analysis of sampled estate tax returns

a. *Failure to verify the returns mathematical accuracy and enforce the existing estate tax statutes leads to a loss of revenue.*

OIO found that the Unit did not verify the mathematical accuracy of the returns. The Unit accepted the returns at face value. We noted that in several of the sampled files the taxes were not correctly computed when apportionment between the District and other jurisdictions was required. We identified other mathematical errors that resulted in the understatement of the taxes due. In our sample of 85 files, we identified 30 returns (35.29 percent) where the tax amount on the return did not agree with our verification of the return. The calculation errors resulted in the OTR not assessing the estates involved for $1,196,340 (3.47 percent of the taxes due calculated by OIO) in taxes. This calculation is based on best information available at the time of our audit. Due to missing files and schedules, OIO used other sources such as the refund package return to determine the estate taxes due, therefore this potential loss is an estimate. There was no documentation in the tax returns folder that caused us to believe that the Unit did anything with the returns but accept them at face value

b. The Unit failed to assess interest and penalties on extensions and returns that were filed late.

Our review of the tax returns found that the Unit failed to assess penalties and interest filed after the statutory deadlines. These penalties and interest amounted to $710,364 and $86,708, respectively. Interest is required to be assessed based on the date that the return is originally due, ten months after the date of death regardless of any extensions received by the taxpayer (DCST §47-4201(a)(1)(B)). This interest is to be assessed by the Unit, until the date of payment[1] (DCST §47-47-4201(b) (2) (B)). The regulations regarding the assessment of interest and penalties are more specific by stating in 9 DCMR §3706.2 and 9 DCMR §3706.3 respectively for penalties that:

9 DCMR §3706.2 "*If an extension of time to file the estate tax return has not been obtained or, in the case of an extension, if the return or an additional extension is not filed within the prescribed extended time period, the penalty for late filing shall be assessed.*"

[1] OIO determined that the date of payment for this tax return would be the date of the postmark on the envelopes containing the request for extension, when applicable, and the tax return. This eliminates attempting to determine when the forms and payments were actually received by OTR and accounting for the lag in processing the payments and sending the returns to the Unit. For returns where this information could not be reliably determined, OIO used the processing date-stamp placed on the form(s) by the Returns Processing Administration (RPA) or the Unit's date stamp.

9 DCMR §3706.3 "*If an extension of time to pay the estate tax has not been obtained or, in the case of an extension, if payment is not made or an additional extension is not filed within the extended time period, the penalty for late payment shall be assessed.*"

Similarly, interest for extensions, returns or late tax payments are assessed from the original due date of the return, per DCST 47-4201(a) (1) (B). The regulation (9 DCMR §3705.7) speaks to the assessment of interest based on an amended District estate tax return or audit adjustments based on an audit of the return by the Unit or the Service. They also address the assessment of interest and penalties for outstanding taxes due in 9 DCMR §3706.4. These respective sections state that,

9 DCMR §3705.7 "*If additional District estate tax is due as a result of the amendment or adjustments to the federal and District estate tax returns, the personal representative shall pay the additional tax and interest calculated in accordance with D.C. Code §47-453, for the period from ten (10) months after the decedent's death until the amended return is filed. The tax and interest shall be paid at the time of filing the amended District estate tax return.*"

9 DCMR §3706.4 "*Any outstanding tax remaining after the expiration of the due date for payment or of an extension of time to pay shall be deemed delinquent and shall be subject to penalty and interest under the provisions of D.C. Code §47-453.*"

In our interviews with the Unit's staff we were told that the postmark date was used to determine the cutoff date for the timely filing of the return, penalties, and interest. In the case of the hand delivered returns it would be the Unit's date stamp indicating the date the return was received by the Unit. The files did not contain any evidence that Unit contacted the taxpayer regarding the late extension or return and inform them that additional penalties and interest would be assessed and were due because of the late filing.

We found one return in our sample where the Unit assessed additional interest charges because the taxpayer underestimated the total amount of taxes that would be due on the estate. This assessment of interest was for $[redacted] and represented 15 days of interest for an outstanding balance due. However, the Unit did not assess the required penalty of $96,149.

c. *Delayed processing of the refunds by the Unit's staff resulted in OTR incurring an additional $33,800 in interest costs.*

The District's statutes (DCST §47-4202(b) (2) (B)) require that interest be provided to the taxpayer when a refund is processed more than 181 days after the receipt of the return/request for the refund. In OIO's sample of refunds we determined that the OTR incurred a liability for the late payment of refunds of $14,060. The average processing time for a refund in our sample was 172 days. The range of processing times in our sample, in total, was 28 days to 1,014 days[5].

Further, OIO found that the Unit approved one refund for interest on an overpayment, which resulted from an IRS audit, of $[redacted] based on the request of a taxpayer's attorney. The request included a calculation which supported the amount requested. However, the calculation did not meet the requirements of the statute (181 day waiting period). As a result, the District overpaid the taxpayer by $[redacted] There was no evidence available that suggested the Unit's staff verified the amount due prior to the refund, and the supervisory review of the refund did not appear to address the compliance with the statute.

[5] This time period was calculated from the date of the postmark for the return to the check date shown in the SOAR report for the release of the check.

The following table provides information on the distribution of the additional interest costs incurred by the Unit's delayed processing of refunds.

Table 5 - Returns Incurring Interest Charges for Delayed Refunds

Fiscal Year [a]	Taxpayer Identification	Days to Process [b]	Refund Amount	Interest Incurred
FY-04	1	767	50,348	4,839
FY-05	15	1,014	1,827	250
FY-05	2	279	6,709	108
FY-06	33	227	3,464	26
FY-07	44	253	709	8
FY-07	45	198	633	2
FY-07	47	204	2,607	10
FY-07	49	257	2,838	35
FY-07	53	188	64,400	74
FY-08	57	494	85,500	4,389
FY-08	58	189	477,855	627
FY-08	60	279	151,855	2,441
FY-08	62	264	5,009	68
FY-08	64	182	11,536	2
FY-08	66	950	5,933	748
FY-08	49	389	12,700	433
	Average Days to Process and Total Refunds and Interest Incurred [c]	383	883,923	14,060

[a] Fiscal Year determined by the refund check date
[b] Computed from the Unit's Date Stamp on the return to the check date recorded in SOAR
[c] May not agree due to rounding
Source: OIO analysis of the Unit's estate tax files

Recommendations:

The Deputy Chief Financial Officer should take the following corrective actions:

1-1 Mandate that the Director, Compliance Administration take action to (i) determine whether the outstanding and unpaid estate taxes, penalties, and interest can be collected, and (ii) mandate that the Chiefs, Audit and Collection Divisions initiate collection action.

1-2 Require that the Director, Compliance Administration and the Chief, Audit Division develop and implement a plan to conduct desk audits of a sample of the returns received by the Unit during the audit period: October 1, 2003 to September 30, 2008. These reviews should be performed by staff independent of the Unit's operations. Where possible, efforts should be made to collect unpaid estate taxes, penalties and interest.

OIO recommends that Director, Compliance Administration and the Chief, Audit Division take the following actions:

I-3 Develop a system of reviews that requires an individual independent of the Unit to periodically review, at least quarterly, the estate tax returns and review for mathematical accuracy. Evidence supporting this review should be included in the tax return file for each return reviewed.

I-4 Notify taxpayers who were identified as due refunds and/or interest for the late return of a refund that they will be receiving the amount due within 30 days of this notification. This notification should be done subsequent to the completion of the desk reviews discussed in recommendation 1-2.

OIO further recommends that the Director, Compliance Administration

I-5 Mandates the Chief, Collections Division take the necessary actions to collect any outstanding taxes, penalties and interest due from the impacted taxpayers.

Agency Response: Officials did not concur with this finding as it relates to the potential loss to the District Government of $2.29 million; as they do not believe there an objective way to measure or accurately estimate the true amount of the potential net loss to the District. However, they did concur with our recommendations.

OIO Auditor Evaluation: The OTR planned actions are partially responsive to the issues we identified. We recommend OTR establish timelines for conducting the reviews of a sample of returns as recommended in I-2 and I-3 and take the necessary actions to collect any outstanding taxes, penalties and interest as cited in recommendation I-5. The completed action plan, when fully implemented, should satisfy the intent of our recommendations.

2. OTR does not maintain an effective system of internal controls within the Unit

The Government Accountability Office (GAO) in its report *Standards of Internal Control in the Federal Government (Standards)*[6] defines internal control as:

> *"Internal control is a major part of managing an organization. It comprises the plans, methods, and procedures used to meet missions, goals, and objectives and, in doing so, supports performance-based management. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal control, which is synonymous with management control, helps government program managers achieve desired results through effective stewardship of public resources."* (Emphasis added)

Our audit revealed that OTR does not maintain a functional and effective system of internal control for estate taxes. OIO found the following deficiencies through its testing:

(a) absence of a risk assessment for the Unit's operations;

[6] U.S. Government Accountability Office (GAO), formerly the General Accounting Office; *Standards for Internal Control in the Federal Government*, Report Number Report Number: GAO/AFMD-00.21.3.1; November, 1999;

(b) absence of policies, procedures and mechanisms to enforce management's directives and the ensuring compliance with applicable statutes and regulations;
(c) no segregation of duties within the Unit since the Unit's single tax auditor has unfettered access to the entire estate tax system and refund process;
(d) ineffective management oversight of the Unit's operations and of the refunds generated by the Unit;
(e) absence of documentation to support the actions taken on the individual estate tax returns;
(f) ineffective controls over the process for issuing tax certificates by the Unit; and
(g) absence of documentation necessary to support refunds to taxpayers.

As a result, OTR cannot provide reasonable assurance that the District (i) collects the appropriate amount of estate taxes due and related penalties and interest when required; (ii) that the estate tax information is processed accurately, timely, and supported with relevant documentation and (iii) the Unit complies with the applicable statutes, regulations, policies and procedures. The absence of an effective system of internal controls is a material weakness in the operations of both the Unit and OTR. OIO found no basis of assurance that a significant error or defalcation would be detected by the Unit or OTR personnel when performing their job related duties.

a. Absence of Functional Risk Assessments for the Unit's Operations

The absence of a functional risk assessment hinders the Unit's operations and may subject the Unit to unreasonable risk in carrying out its assigned functions. The risk assessment acts as a baseline for the development of internal controls and assists in targeting the development of controls to the areas that management believes are the highest risk.

The base purpose of a risk assessment is to:

(i) review the Unit's operations and determine what can go wrong should the system or controls fail;
(ii) how likely it is for a flawed event to occur;
(iii) determine level of risk that managers within the organization are willing to take should a failure occur;
(iv) determine processes or controls are in place to mitigate the failure; and
(v) estimate what it will cost in terms of resources and assets to reduce the risks to a more acceptable level, if not zero.

The GAO in its guide *Internal Control and Management Evaluation Tool* discusses the development of a risk assessment based on the use of clear and concise objectives. GAO states in part that[7]:

"A precondition to risk assessment is the establishment of clear, consistent agency goals and objectives at both the entity level and at the activity (program or mission) level. Once the objectives have been set, the agency needs to identify the risks that could impede the efficient and effective achievement of those objectives at the entity level and the activity level. Internal control should provide for an assessment of the risks the agency faces from both internal and external sources."

[7] GAO; *Internal Control and Management Evaluation Guide*, Report Number: GAO-01-1008G, August, 2001; page 23

OIO found that OTR had developed a document titled *Strategic Plan - FY2006-FY-2007*[8]. The document contained OTR's immediate objectives for the two-year period in addition to longer range objectives. The information in the document did not appear to be used to develop a risk assessment or methodology to define and then address the high risk areas.

Without documenting the risks and then prioritizing those at the OTR level and the subordinate operations down to the Unit's level, a reasonable assurance cannot be made by OTR's management that they have controls in place to mitigate the most significant risks should they occur. As OTR and the Unit do not have sufficient resources to address all of its risks, mitigating the most significant ones in each area increases the chances that OTR and the Unit will be able to carry out their missions throughout its span of operations.

b. *Absence of Effective Policies and Procedures for the Unit's Operations.*

As part of this audit, OIO met with the management and staff of the Unit and inquired about the policies and procedures that controlled the Unit's daily operations. The estate taxes are not controlled in District Government's integrated tax system (ITS) and lacks the visibility that other income based taxes receive. They also require more manual review and processing than other income based taxes.

During the fieldwork, OIO received what the Unit purported to be their procedures. These procedures were limited to four documents, which were summarized reiterations of selected statutes and regulations contained in title 47 of the DCST and in title 9 of the DCMR, respectively. OIO concluded that policies and procedures governing the Unit's operations are not readily available or do not exist. While the current tax auditor assigned to the Unit appeared to be knowledgeable of the steps necessary to process an estate tax return, the learning curve to train other individuals is very steep. Further, any training provided is by word of mouth and is subject to significant levels of interpretation by the trainer and the trainee. As a result, the processing of returns may not meet the standards required by OTR or the applicable statutes.

In addition to providing the staff with guidance on the processing of estate tax returns, written policies and procedures provide the Unit's staff with written limitations to the scope of their authority and responsibility for returns. Further, written policies and procedures outline the scope of the supervisor's responsibilities and the scope of their authority. By meeting the responsibilities outlined in the policies and procedures, both the Unit's staff and supervisors provide evidence that they are meeting management's expectations for compliance with the applicable statutes and regulations that apply to estate taxes in the District.

c. *Documentation supporting the return was not consistently secured by the Unit's staff.*

The Unit's estate tax files generally did not contain documentation that would support that the Unit in the following areas:

(i) secured the documentation required to accompany the return;
(ii) evidenced that the return had been reviewed for mathematical accuracy;

[8] This document is available at www.cfo.in.dc.gov/cfo/lib/cfo/pdf/tax/OTR_Strategic_Plan_FY06-07.pdf last reviewed on February 4, 2009

(iii) assessed the penalties and interest required by statute for extensions and returns that were not filed timely, and
(iv) evidenced that death/estate taxes had been paid to other states for assets located in those states.

Ensuring documentation for significant events and transactions is a critical component in any system of internal control. Within the Unit's operations, documentation is critical to demonstrate that the taxpayer has met their statutory responsibilities for filing of an accurate and complete estate tax return. For the staff of the Unit, documentation supports their actions within the scope of their authority and responsibility for the verification and processing of the estate tax returns.

OTR in its *D-76 DC Estate Tax Forms and Instructions* (*Instructions*) requires that the following documents accompany all estate tax returns. These documents include: a) a death certificate for the decedent, b) the decedent's will, and c) at minimum, pages 1 through 3 of the United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706). Other documentation may be required but not explicitly stated in the *Instructions*.

In order to verify that the estate tax returns were properly supported, OIO during its fieldwork, reviewed two judgmental samples of returns. The first sample consisted of 75 refunds representing 70 decedent files. Of the 70 decedent files, the Unit provided 61 files that supported the refunds of a portion or all of an estate tax payment. The second sample of 25 files was judgmentally selected from the returns that were received during fiscal years 2006 through 2008 (FY-06 FY-08). Of the 25 files selected, one file only had the extension available.

These files were judgmentally selected and the error rates shown below cannot be projected to the entire population of estate tax returns during the period. However, OIO believes that our sample is indicative of the documentation problems that would be found in the population as a whole.

Table 6 - Missing Required Documentation in Refund Files

Required Document	Documents Missing	Percent of Sample
Death Certificate for the decedent	6	9.84
Will [9]	11	18.03
Form 706	5	8.20

[9] Does not include one file where the individual was reported to have died intestate.
Source: 61 of 70 requested Estate Tax Files provided by the Unit.

Table 7 - Missing Required Documentation in Other Estate Tax Files

Required Document	Documents Missing	Percent of Sample
Death Certificate for the decedent	3	12.50
Will	1	4.17
Form 706	1	4.17

Source: 24 Estate Tax Files selected by OIO from the Unit's files

[9] The Internal Revenue Service requires that the will be certified. The certification is generally done by the court that has jurisdiction over the decedent's estate. The District does not require a certified copy of the will.

OIO found that the Unit appeared to accept the estate tax returns at face value without verifying the accuracy of the information. In the 85 files provided, we found 30 returns (35.29 percent) where mathematical errors were committed by the taxpayers that were not identified by the Unit.

The Unit lacks procedures to ensure that taxpayers fully report the amount of death/estate taxes due or paid. Taxpayers are required to provide to the Unit a receipt from other jurisdictions evidencing that the death/estate taxes were paid. 9 DCMR §3705.3 states that:

> *"Where the personal representative claims credit or a deduction for state death taxes for taxes paid to another state and allowed as a credit against the federal estate tax he or she shall file with the District estate tax return a computation of the tax and proof of payment. The Deputy Chief Financial Officer shall accept a receipt issued by the other state's tax authority as proof of payment, and in his or her discretion, may accept other proof."* (Emphasis added)

This verification is necessary to ensure that the District receives estate tax is based on a proportional share of the assets within the District.

The following table provides a summary of the 61 files that were made available for our review. None of the estate tax returns in this sample provided the required proof of payment or documentation from the Deputy Chief Financial Officer (DCFO) that an alternative source of proof was acceptable.

Table 8 - Support for Out of State Estate Taxes

Estate Tax Payments	Number	Percent of Total
All Estate Taxes Paid to the District	41	67.21
Payments to Other Jurisdictions Supported with Tax Return	2	3.28
Payments to Other Jurisdictions Not Supported with Tax Return	18	29.51
Total	61	100.00

Source: 61 of 70 requested Estate Tax Files provided by the Unit.

d. Absence of Effective Segregation of Duties

The risks of significant and undetected errors increased substantially within the Unit due to the absence of segregation of duties for the tax auditor. OIO found that with the exception of directly receiving the funds included with the tax returns and requests for extension; the tax auditor effectively controlled the process used to review and process estate tax returns, including the issuance of refunds. The absence of effective segregation is compounded as the estate taxes are not reported through ITS and minimal oversight of the process is provided by the Unit's supervisors and other supervisors/management personnel of the Division.

During OIO's fieldwork for the audit, we were told by the Unit's staff that due to the low volume of estate tax returns, estimated at 300 annually, the Unit did not warrant additional staff to effect an adequate segregation of duties. Should this, in fact, be the case the Division has not developed alternative procedures to ensure that the tax auditor is complying with OTR and the Division's policies and procedures.

In the *Standards* GAO discusses the need for effective segregation of duties by stating that:

"Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event." (Emphasis added)

Further, good business practices dictate that, should adequate segregation not be possible to achieve then management oversight should increase, either through additional reviews of significant transactions, or through conducting reconciliations of the data. Such best practices could provide the Unit and the Division with the necessary controls without prohibitive cost increases for the Unit's operations.

e. Absence of Effective Management Review and Oversight

Management at every level of an organization is critical to the functioning of effective systems of internal controls. Management's review and evaluation of systems is critical to ensuring that the systems meet the stated objectives and operate in an effective and efficient manner. In *Standards* GAO discusses the impact of management on internal controls. They state in part that:[10]

"People are what make internal control work. The responsibility for good internal control rests with all managers. Management sets the objectives, puts the control mechanisms and activities in place, and monitors and evaluates the control. However, all personnel in the organization play important roles in making it happen." (Emphasis added)

GAO, in *Standards*, then states in discussing monitoring of systems of internal control that:[11]

"Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties.

Separate evaluations of control can also be useful by focusing directly on the controls' effectiveness at a specific time. The scope and frequency of separate evaluations should depend primarily on the assessment of risks and the effectiveness of ongoing monitoring procedures. Separate evaluations may take the form of self-assessments as well as review of control design and direct testing of internal control."

OIO found no documentation in the estate tax files that supported that the work within the Unit or those specific tax returns had been reviewed. Without documentation there are few assurances that can be provided by the Unit and the Division that the work of the Unit was reviewed and complied with management's policies and procedures. It also calls into question whether the documents were signed in a rote manner, or were reviewed prior to the receiving the approving authority's signature(s).

We did find that supervisory personnel had "signed-off" on refunds. However the signoffs were not consistently done nor was there evidence that the documents supporting the refund transactions were reviewed. Table 9 provides a summary of our review of the refund documents. With-

[10] U.S. Government Accountability Office (GAO), formerly the General Accounting Office; *Standards for Internal Control in the Federal Government*, Report Number Report Number: GAO/AFMD-00.21.3.1; November, 1999; page 6
[11] Ibid, page 20

out effective supervisory review, the Unit's staff has the opportunity to fully control the system and issue refunds without an effective oversight. This significantly increases the risk of erroneous or fraudulent transactions occurring with little opportunity for detection prior to the processing of a transaction.

Table 9 – Refunds with Incomplete Authorization and Approval Documentation

Missing Approval or Authorization	Number	Percentage of Sample
Refund Vouchers Not Approved by Supervisor or Authorized Officials	4	5.88
Refund Authorization Form Not Signed by Preparer	1	1.47
Refund Authorization Form Not Approved by Supervisor/Authorized Officials	12	17.65
Audit Reports Not Signed by Preparer	1	1.47
Audit Reports Not Approved by Authorized Officials	12	17.65
Refund Not Adequately Supported by Documentation	4	5.88

Source: 68 Refund Authorization Packages Maintained by RAA.

f. Absence of Supervisory Review and Concurrence for Estate Tax Certificates Issued by the Unit.

A tax certificate issued by OTR provides the taxpayer with documentary evidence that they have fully satisfied their reporting and payment obligations for the specific tax involved. In the case of the tax certificate for estate taxes, the issuance of this certificate relieves the personal representative of their personal liability for the payment of estate taxes, penalties and interest (DCST §§47-3712). Specifically, 9 DCMR §3707.1 states that, *"Issuance of a certificate shall discharge the personal representative from the tax, penalty and interest imposed under the Act."* Issuing tax certificates without the necessary reviews and verifications places the Unit at significant risk. The OTR and the District government may be barred from collecting any taxes, penalties and interest due should the certificate be issued erroneously or fraudulently.

OIO noted in its review of the tax certificates that the Unit does not have a system which: documents the issuance of the certificate, ensures that the tax liabilities have been resolved, and assure that each certificate is subject to independent review and approval. Our testing found that the Unit does not appear to have a database of certificates issued. The certificates are generated using an Excel™ spreadsheet form that is maintained on the tax auditor's PC. The individual certificate would be included in the taxpayer's estate tax file. Additionally, we found that the Inheritance and Estate Tax Unit supervisor generally did not sign the certificates. The certificates that we reviewed were signed by the Unit's tax auditor for the supervisor. The estate tax file contained no evidence that the Unit's supervisor or other responsible individual reviewed the file and certificate prior to issuance. Two of the 12 certificates (16.67 percent) that was included in our sample of tax refunds, were for returns where no tax was owed to the District. The issuance of these certificates is prohibited by 9 DCMR §3707.5 which states that: *"The Deputy Chief Financial Officer shall not provide a certificate where no District estate tax return is required to be filed."*

g. Absence of documentation necessary to support refunds to taxpayers

The Unit and RAA were unable to provide us with the documentation necessary to support the tax refunds included in OIO's selected sample. Of the 70 estate tax files with refunds OIO requested, the Unit provided us with 61 files (87.14 percent). Table 10 provides a list of the files that the Unit was unable to locate. The refunds missing estate tax files represent 4.95 percent of the total dollar value sampled.

Table 10 - Missing Estate Tax Files

Decedent	Date of Death	Refund Amount
34	[redacted]	$8,897.35
31		992.00
16		95,513.22
16		19,740.01
39		1,208.00
30		1,349.00
26		72,680.87
9		7,085.00
28		867.00
12		3,704.00
Total Refunds Not Supported with Tax Files		$212,036.45

Source: Estate tax refund files provided by the Unit

Similarly, we requested copies of the refund documentation supporting the sample. We received 68 refund packages (91.89 percent of the sample). The missing refund documentation represents 14.93 percent of the total value of the refunds selected. Table 11 provides additional detail for the missing refund documentation.

Table 11- Missing Refund Documentation Files

Decedent	Date of Death	Refund Amount
3	[redacted]	$3,003.00
49		12,700.00
61	Unavailable	324,674.00
63	[redacted]	14,442.87
24		132,762.00
60		151,855.00
Missing Refund Documentation		$639,436.87

Source: Refund documentation provided by RAA.

The Unit cannot be assured without the relevant documentation that the proper estate tax return was filed timely and that it complied with the District's statutes and regulations. Additionally, documentation is critical in supporting that the Unit and RAA acted within the scope of their authority and that action taken to assess or refund taxes, penalties, and interest were appropriate and approved by the relevant Compliance Administration management.

Recommendations

2-1 The Deputy Chief Financial Officer should require that the development of an agency-wide risk assessment, inclusive of the small operating entities such as the Unit. This assessment should include the risks, assessment of individual risk, steps that OTR, as a whole, will take to mitigate the risks based on resources, and who is responsible for mitigation of the risks that have been identified.

OIO recommends that the Compliance Operations Administration take the following actions to strengthen the system of internal controls as follows:

The Chief, Audit Division should:

2-2 Require the Unit's supervisor and staff develop written policies and procedures for daily operations. These policies and procedures should: (i) be in agreement with the Division's policies and procedures; (ii) provide specific guidance on the review of individual returns, selection of returns for desk and field audits, and steps to take to assure compliance with the District's estate tax statutes and regulations; and (iii) provide specific timelines for processing returns and notifications to taxpayers to resolve issues regarding the calculation of the tax liabilities and payment of penalties and interest.

2-3 Establish a standardized system for the documentation of estate tax returns including the retention of the documentation that supports the refund of overpayments. This system should capture all of the required and supporting documentation for the validation and significant transactions involving the individual estate tax return.

2-4 Establish standard processing times for estate tax returns and refunds and require that the Unit's staff meet or exceed the times. Periodically the standard should be reviewed against actual data and adjusted where necessary.

2-5 The Chief, Audit Division should with the Unit's supervisor review the Unit's staffing and establish an effective system of segregation of duties, this may include increased oversight and review of individual transactions should the volume and complexity of the current estate tax transactions not warrant additional staffing for the Unit.

The Director, Compliance Administration

2-6 Should mandate that: (i) all tax certificates issued by the Unit be reviewed and signed by the Unit's supervisor, at a minimum, and (ii) the Unit establish a database and system that in conjunction with the supervisory reviews documents and controls the issuance of all tax certificates. The Chief, Audit Division should periodically review the process used by the Unit to issue the certificates in order to ensure compliance with the established standards and for process improvements.

2-7 Work with the Chief, Audit Division to develop a scoring/selection system for desk reviews and field audits of the estate tax returns. This scoring/selection system should be risk-based. The scoring/selection process, once the agency-wide risk assessment is complete, should be modified based on the risks and mitigation strategies identified in the assessment.

The Director, Revenue Accounting Administration and the Chief, Audit Division:

2-8 Should take actions to ensure that documentation is maintained to support all refund transactions and the filing of all tax returns.

Agency Response: OTR concurred with this finding and recommendations.

OIO Auditor Evaluation: The OTR planned actions are partially responsive to the issues we identified. OTR cited the Deloitte & Touche risk assessment as a response to recommendation 2-1. However, the consultant's assessment was at a fairly high level. Thus, we recommend OTR build on the work performed by Deloitte & Touche and take the necessary steps to identify the operating risks and prioritize the steps necessary to eliminate risks as part of its overall risk mitigation strategy. Additionally, we urge

OTR to establish a target date for the development and implementation of the methodology to select tax returns for audit, when fully implemented, should satisfy the intent of our recommendations.

3. Estate Tax Revenues and Refunds Reported in SOAR May Be Unreliable

Data reported in SOAR may be unreliable due to the absence of a reconciliation process between the estate tax unit (Unit) records and the data generated by the RPA and reported on by the RAA. OIO found that the revenues for FY-05 were understated as estate tax refunds totaling $77,571 were charged directly to the estate tax revenue object instead of the estate tax refund object. We also identified a FY-07 tax refund of $463,077 that was inappropriately charged to the estate tax refund account. As a result the amount of refunds reported in SOAR during the audit period was overstated by $385,506. This amount represents an 8.07 percent overstatement of the estate tax refunds issued during the period.

The absence of a reconciliation process does not provide the necessary assurances that the information reported in SOAR is accurate and is supported by appropriate documentation. Additionally, the absence of a reconciliation process may allow errors and potential defalcations to remain undetected for extended periods of time. GAO in its *Standards* report states that:[12]

> *"Program managers need both operational and financial data to determine whether they are meeting their agencies' strategic and annual performance plans and meeting their goals for accountability for effective and efficient use of resources. For example, operating information is required for development of financial reports. This covers a broad range of data from purchases, subsidies, and other transactions to data on fixed assets, inventories, and receivables. Operating information is also needed to determine whether the agency is achieving its compliance requirements under various laws and regulations. Financial information is needed for both external and internal uses. It is required to develop financial statements for periodic external reporting, and, on a day-to-day basis, to make operating decisions, monitor performance, and allocate resources. Pertinent information should be identified, captured, and distributed in a form and time frame that permits people to perform their duties efficiently."*

GAO further states, in *Standards*, that as part of the control activities in an effective system of internal controls that:[13]

> *"Activities need to be established to monitor performance measures and indicators. These controls could call for comparisons and assessments relating different sets of data to one another so that analyses of the relationships can be made and appropriate actions taken. Controls should also be aimed at validating the propriety and integrity of both organizational and individual performance measures and indicators."*

a. Absence of Reconciliations between the Unit, the RPA, and RAA.

At the time of our fieldwork, we found no process in place to ensure that the data entered by RPA and RAA was supported by relevant and estate tax files maintained in the Unit. Further, we found no evidence to support that information on revenues and refunds were routinely generated

[12] U.S. Government Accountability Office (GAO), formerly the General Accounting Office; *Standards for Internal Control in the Federal Government*, Report Number Report Number: GAO/AFMD-00.21.3.1; November, 1999; page 19
[13] Ibid, page 14

by either the RPA or RAA for review by the Unit and RPA to assess the validity and accuracy of the information.

RPA is responsible for the receipt and processing of all estate tax revenues. The RPA receives the tax payments, logs the information into the system, and prepares the documentation to support the revenue entries in SOAR. The RPA does not enter the estate tax returns into SOAR but sends the original return and copies of the revenue entries to the Unit. We found that the Unit and the RPA had not established a process to ensure that all estate tax revenues reported by RPA were supported with requests for extension of time to file or estate tax returns. The Unit appeared to accept what it was sent at face value by the RPA. Further, the absence of reporting of RPA transactions to the Unit made it difficult for the Unit to ensure that the information contained in its files was complete and accurate.

b. Absence of Reporting of Estate Tax Revenues and Refunds by RAA to the Unit

RAA does not provide reports of the activity within the estate tax revenue and refund objects to the Unit for review and verification. Without reports on both the revenue received and the refunds issued it is impossible for the Unit to determine if it has been appropriately credited for the estate tax revenues received by OTR and for the refunds that it has approved for issuance. Without the reports the Unit is forced to accept at face value that it has received all of the estate tax revenues and all the supporting documentation.

OIO identified the erroneous processing of refunds during the audit period. First, in FY-05 (March and May) SOAR indicated that 11 refunds totaling $77,571 were charged directly to the estate tax revenue object (8800). This type of charge was contradictory to past practice where refunds were charged to a separate object (8801). The Unit's staff was not aware of the erroneous charges as they did not receive any reports from RAA regarding the amount of revenue or refunds processed during a specific month. This resulted in understatements of the estate tax revenues and refunds for that year.

Second, in FY-07 our testing noted that a refund of $[redacted] had been charged to estate tax refunds erroneously. This refund was the result of a special tax incentive program operated by the District. The erroneous coding of this refund resulted in the overstatement of the refund account by 32.42 percent. OIO was told that when this issue was brought to the attention of RAA that the refund was reclassified to the proper account.

Recommendations

The Chief, Audit Division should take the following corrective actions:

3-1 Request that the Director, Revenue Accounting Administration (RAA) provide a monthly report to the Unit of all transactions posted to Revenue Objects 8800 and 8801.

3-2 Require that the Unit's supervisor and staff to reconcile the monthly transaction report with their estate tax records for completeness and to determine whether any erroneous charges have been made to either the estate tax revenue or refund object codes.

Agency Response: OTR concurred fully with this finding and recommendations.

OIO Auditor Evaluation: The OTR planned actions are responsive to the issues we identified, and when fully implemented should satisfy the intent of our recommendations.

4. Manual Tax System is Subject to Potential Fraud and Manipulation

We found the combination of a manual tax processing system, absence of transparency of the review of the returns and processing transactions, and weak internal controls reveal a system where the risk of fraud and manipulation has not been reduced to a very low level. OIO concluded that the Unit and Division rely solely on the veracity of a single assigned tax auditor to process transactions and conduct the Unit's operations.

Estate taxes are tracked through a spreadsheet by the Unit. This PC based spreadsheet is controlled by the Unit's tax auditor. Once the request for extension or the estate tax return is received at the Unit, information from the document is entered into a spreadsheet which assists in tracking the processing of the return. The spreadsheet, according to the tax auditor, can be mailed to the other members of the Unit for data entry or other updates. The tax auditor told OIO that once the other staff has completed the data entry or updates, the spreadsheet is returned by e-mail to him. Prior to FY-07, there did not appear to be a tracking device used for estate tax returns.

Revenues from the taxes are posted directly to SOAR by the RPA, and the requests for extension and returns are sent directly to the Unit for processing. The Unit has the sole responsibility for processing of the extension or estate return and any action that is taken on the return to assess additional taxes, penalties, or interest or to authorize a refund of an overpayment. As OIO previously reported above, a reconciliation process does not exist for estate tax revenues; this creates a condition where the Unit cannot provide an assurance that it has received all the estate tax revenues or the forms related to those revenues.

We found no evidence to indicate that the Unit reviewed ITS to ensure that all District individual and business income taxes claimed as estate deductions had been paid, or that the income tax refunds due the individual were accurately reported. Further, we did not find evidence that the real property tax databases had been reviewed to validate the accuracy of any deductions claimed.

a. Absence of an Automated System May Have Contributed to Errors Noted in Calculation of Estate Taxes, Penalties and Interest Due.

One advantage of ITS and similar automated systems is the presence of an "error checking routine" that automatically recalculates the tax due, any amounts owed, or potential refunds. This error checking system in ITS serves as a basis for the Division's staff to review the return to determine the reason for the error, make the necessary corrections, and notify the taxpayer of the any additional amounts owed or due to them. These routines can also be employed when the taxpayer files amended returns, giving the Unit the ability to verify the mathematical calculations and the amounts with an IRS audit of the return. Using this type of automated routine reduces the man-hours involved in the review of the return and allows the Unit's staff to focus on reviews of other areas of the return and not essentially on the mathematical calculations.

OIO found that only one estate tax file contained evidence that the return had been reviewed for mathematical accuracy by the Unit's tax auditor. This was for a return that resulted in a refund

and processed in FY-08 by the current tax auditor. No evidence was provided in the files to evidence that the prior Unit staff had reviewed the mathematical accuracy of the returns and any related refund requests. The current tax auditor explained that, because of the press of responsibilities of this position (review of returns, answering the public's questions regarding filings, providing technical assistance to filers, and following up on issues raised by the returns), mathematical reviews may not have been completed on each return.

b. Absence of Transparency of Transactions Impacting Estate Tax Returns

Part of the process to ensure the transparency of estate tax transactions is the monitoring of those transactions. GAO in its *Standards* report states in part that:[14]

> *"Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."*

This concept is further emphasized in their report *Internal Control and Management Evaluation Tool* which states in part:[15]

> *"The monitoring strategy includes methods to emphasize to program and operational mangers that they have responsibility for internal control and that they should monitor the effectiveness of control activities as a part of their regular duties.*
>
> *The monitoring strategy includes methods to emphasize to program mangers their responsibility for internal control and their duties to regularly monitor the effectiveness of control activities.*
>
> *The monitoring strategy includes identification of critical operational and mission support systems that need special review and evaluation.*
>
> *The strategy includes a plan for periodic evaluation of control activities for critical operational and mission support systems."*

Effective monitoring of the estate tax transactions relies on the visibility of those transactions and the ability of managers and evaluators to independently review the transactions and assess their accuracy and compliance with the applicable statutes policies and procedures without intervention by the Unit's staff, to provide the transactions or to provide evidence supporting the transactions.

The current process used by the Unit does not provide any visibility for processing individual transactions or estate tax returns, and requires that the staff provide extensive support to a manager or evaluator reviewing the actions taken by the Unit's staff. In order for a manager or evaluator to review the estate tax transactions from "cradle to grave", they would require access to the Unit's spreadsheet database, access to the paper-based estate tax files, and copies of refund documentation packages from RAA. The current process does not allow for an individual to independently determine whether the transaction is accurate, appropriate, and processed within the Unit's and individual staff member's scope of authority.

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[14] Ibid, page 20

[15] GAO; *Internal Control and Management Evaluation Tool*, Report Number: GAO-01-1008G, August, 2001; pages 59 - 60

c. Outstanding Estate Taxes Not Tracked Through Automation

The District Government requires that estate taxes be paid in full (DCST §47-3705(c) and DCST §47-4201(a)(1)). Most estates, included in our samples, complied with this requirement. However, the Unit's process to account for outstanding taxes, penalties, and interest receivable is subject to error and potential manipulation of the amounts owed, or any collections made, or deferred by the Unit's staff and managers.

The Unit's tax auditor explained that, when additional estate taxes, penalties, and interest were owed; these amounts were not recorded in an automated database. Instead, the amounts were recorded on cards that were maintained by the Unit. The Unit's staff would update the cards to reflect any amounts remitted by the taxpayer and any additional assessments and interest imposed on the taxpayer. The Unit did not have a process in place to trace entries on these cards to source documentation for either the payments or the assessments.

Additionally, the Unit would refer the taxpayers and the amounts due to the Collections Division should the taxpayer not pay the additional amount after the notice of the additional assessment was provided to the taxpayer. The Collections Division did not appear to enter these assessments into ITS for tracking. Thus, any action taken by either the Unit or the Collections Division on the account was not recorded, and the effectiveness of the collection effort could be hindered.

Prudent management and good business practices emphasize that revenues owed to an entity be tracked, analyzed for collectability and efforts to collect the revenue be documented. The Unit's current practices provide for none of these controls. Determining the amounts owed to the District Government for uncollected estate taxes is time-consuming and tedious process, and may be inaccurate.

Recommendations

The Director, Compliance Administration should take the following corrective actions:

4-1 Evaluate the feasibility of developing/purchasing an automated system to assist in the processing of estate taxes. This system should be able to interface with the current ITS system and its successors.

4-2 Direct the Acting Chief, Collections Division to require that all referrals for collection action from the Unit be entered into ITS for tracking and follow-up when appropriate.

The Chief, Audit Division and the Supervisor, Inheritance and Estate Tax Unit should:

4-3 Work with the Unit's staff to develop policies, procedures, and detailed internal controls to support the actions taken by the Unit's staff in absence of an automated system. These policies and procedures should include definitive timelines for referral to the Collections Division or for other actions.

4-4 Determine, to the extent possible, the amount of uncollected estate taxes, penalties, and interest based on the records maintained in the card files. These outstanding amounts should be referred to the Collections Division for potential collection actions.

4-5 Establish, with RAA's assistance, an estate taxes receivable account for the amount of estate taxes, penalties, and interest for the uncollected amounts due to the District Government. This account should be used to record current and future receivable amounts. This account should be reconciled by the Unit to its records on a periodic basis.

Agency Response: OTR concurred fully with this finding and recommendations.

OIO Auditor Evaluation: The OTR planned corrective actions did not address recommendations 4-2, or the timelines of referral to Collections cited in 4-3. OIO requests that OTR develop and implement a responsive plan to this recommendation within 30 days after the issuance of this final report.

5. The Unit Utilizes a Passive Collection Effort for Estate Taxes

The Unit employed a passive effort to collect estate taxes which did not appear to be effective in ensuring compliance with the statutes. The process described to OIO relies on the probate court and the Internal Revenue Service to identify taxpayers who have not complied with the applicable statutes and being mandated to file an estate tax return. As a result, this process delays the District Government's receipt of revenue and does not ensure that all estates that are required to file a tax return do so.

a. Filing of Estate Taxes

The Unit is provided with a required monthly report from the Register of Wills on all wills probated in the District during the prior month (DCST §47-3715) including the estimated value of the estate and the personal representative's contact information. This report provides a basis for the Unit to verify the estates that have gone through the probate process, have filed return, required by OTR.

The Unit's staff explained to OIO that they did not pursue personal representatives to file the required estate taxes. The process was to wait until the Probate Court ordered the taxpayer to obtain a tax certificate from the District evidencing the payment of the estate tax or when the estate tried to transfer/sell real property, within the District, to another individual and estate need an unencumbered title to the property. According to the staff, when the taxpayer files the estate tax return and the required documentation to obtain the tax certificate, the Unit will assess the taxpayer with penalties and interest costs for late filing of the return, resulting in additional income to the District. This process relies on the Probate Court to enforce the District's tax statutes and denies the District Government with the timely receipt of tax income.

Sound business practices and applicable regulations dictate that a governmental unit should collect taxes when due based on compliance requirements and not rely on external forces to enforce the filings and payments. This practice helps to ensure that the tax revenues are available for the government's use within a reasonable period of time.

b. Absence of a System to Indentify and Audit High Risk Returns

The identification of high risk returns is a sound business practice that would allow the Unit to focus on those returns for additional review and potential audit. A system of risk identification allows the Unit to focus its limited resources on specific returns that meet certain criteria rather than attempting to review either all or none of the returns. As the Unit develops more experience with risk-based reviews and audits, the criteria can be modified to take advantage of the prior findings and focus on specific elements of the return.

The Unit's tax auditor told us that one of his performance goals was to conduct desk and field audits of the estate tax returns. Prior to the current tax auditor assuming this position, any reviews that were performed did not appear to be documented in the estate tax files. The tax auditor further indicated that the Unit had not established a methodology to select the returns for review/audit. Selecting returns for review and audit through a subjective process may produce additional revenue for the District; however, it may impair the auditor's independence and compliance with *Government Auditing Standards*[16] which states:

> *"3.02 In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence.*
>
> *3.03 Auditors and audit organizations must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by objective third parties with knowledge of the relevant information. Auditors should avoid situations that could lead objective third parties with knowledge of the relevant information to conclude that the auditors are not able to maintain independence and thus are not capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work.* (Emphasis added)

c. Reliance on the IRS for Estate Tax Return Audits Is Problematic

The Unit currently places a significant amount of reliance on the Service to conduct reviews and audits of estate tax returns that impact the District's estate taxes. This practice does produce additional income for the District; however, it is based on returns that do not necessarily comply with the District's estate tax statutes.

The District's current estate tax statutes do not mirror the Federal estate tax statutes, and differ with the IRS in several significant areas; the most significant of those being the value of the estate assets, on which the return is required to be filed. The District's filing floor is $1 million (DCST §47-3701(4)(B)(ii))[17]. The Federal filing floor has increased from $1 million in 2001 to $3.5 million for individuals with dates of death occurring on or after January 1, 2009.[18] Table 1 above provides the Federal filing floors for each calendar year included in our audit period. As a result, fewer District estate tax returns would be eligible for audit selection as the Federal reporting floor is significantly higher. Further, the Service allows for the use of alternative valuation dates for the estate's assets, while the District's return is to be based on the assets valuation at the date of death. Using the alternative valuation date may significantly reduce the estate's value for tax purposes.

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[16] GAO; *Government Auditing Standards 2007 Revision* , Report Number Report Number: GAO 07-731G; July 2007; sections 3.02 and 3.03

[17] The $1 million filing floor is for individuals whose date of death occurred on or after January 1, 2003.

[18] This District's decoupling from the Code's requirements was extended further with the passage of EGTRRA, which has significantly increased the filing floor for Federal estate taxes.

Reliance on Service as the planning method to conduct reviews and audits limits the reach of the OTR's compliance efforts and reduces the potential for additional revenues that may result from these reviews and audits.

Recommendations

5-1 The Director, Compliance Administration should take action to mandate that at a minimum the Unit review the list prepared by the Register of Wills and determine whether the estates that equal or exceed the $1 million filing floor have met their legal obligation to file an estate tax return. The Unit should notify non-filers of their obligation to file an estate tax return. The non-filers should be referred to the Collection Division for revenue collection action.

5-2 The Chief, Collections Division should assign staff, as necessary, to take the necessary collection action for the estate tax returns.

5-3 The Chief, Audit Division with the Unit supervisor and staff develop a methodology to select estate tax returns for reviews and audits. The results of the reviews and audits should be used to determine adjustments to the selection methodology. This methodology should include both returns that may be audited by the Service and those that fall below the IRS reporting floor.

Agency Response: OTR concurred fully with this finding and recommendations.

OIO Auditor Evaluation: The OTR response is partially responsive to the recommendations. We urge OTR to develop and implement target dates for the full implementation of recommendations 5-1 and 5-3.

Exhibit A
Sampling Methodology

OIO, as described in our audit methodology, selected a judgmental sample of estate tax refunds for testing. Our sample included: (i) all refunds in excess of $50,000, (ii) all multiple refunds to a single taxpayer, and (iii) every fifth item from a list of refunds sorted in order of their dollar value. This produced a selection of 75 items that were requested from the Unit. Further, we selected a sample of 25 taxpayer files directly from the Unit's files to verify that certain practices and documentation was in place in each of those files. The balance of this appendix describes the calculations of sample sizes to support the various tables in place in our report.

Original Sample Request

Original request to the Unit		
Misclassified Payment as Estate Tax Refund	75	
Multiple refunds to an estate taxpayer	(1)	
Expected number of individual estate tax files from the Unit	(4)	
Files that could not be located by the Unit for testing		70
		(9)
Estate tax files available for testing		61

Second Sample Request

Sample of files selected by OIO from the Unit's files	25	
File that contained only a request for an extension (return had not been filed)	(1)	
Sample files available for testing		24
Total sample of tax files tested from the audit period		85

Appendix I

OTR Management Responses

[illegible]

[illegible] Financial Officer

[illegible] Tax and Revenue

[illegible]

[illegible]

MEMORANDUM

TO: Robert G. Audary, Executive Director
Office of Integrity and Oversight (OIO)

FROM: Stephen M. Cordi, Deputy CFO
Office of Tax and Revenue

DATE: June 29, 2009

SUBJECT: Evaluation of OTR [illegible] Response to OIO's Audit of Estate Tax Returns and Refunds

This is in response to your memorandum of June 11, 2009. In your memorandum, you requested additional information regarding our response to the OIO Audit of the Estate Tax Returns and Refunds.

The information you requested is attached hereto.

If you have any questions or require additional information, please call me or [illegible] member of your staff, contact Bedell [illegible], Director, Compliance Administration at (202) 442-6863.

Attachment

1) *Mandate that Director, Compliance Administration, take action to [illegible] whether the unpaid estate taxes, penalties, and interest can be collected, and [illegible] direct the Collection Division to initiate collection action.*

   a) We agree with this recommendation.

      - The Director, Compliance Administration, will determine the collectability of the unpaid estate liabilities by September 30, 2009. If the amounts are found to be collectable, the Director will direct the Collection Division to proceed with collection activity.

2) *Require that the Director, Compliance Administration and the Chief Audit Division develop and implement a work plan to conduct audits of a sample of the returns received by the Unit during the audit period (October 1, 2003 to September 30, 2008) as promptly as practicable. Where possible, efforts should be made to collect unpaid estate taxes, penalties and interest.*

   a) We agree with this recommendation.

      - The audit division will conduct audits of a sample of returns received during the audit period and will endeavor to collect unpaid estate taxes, penalties and interest where possible.

3) *Require that an agency-wide risk assessment be developed based on the OTR individual office and administrations' performance and strategic goals. The risk assessments should include all functional areas within OTR.*

   a) This recommendation is being implemented through the risk assessment being conducted by Deloitte and by the CTO's establishment of a Chief Risk Officer position.

4) *Mandate the Chief, Audit Division, periodically review the tax certificate issuance process in order to ensure compliance with established standards and [illegible].*

   a) We agree with this recommendation. The Chief, Audit Division, will conduct an annual review of the tax certificate issuance process.

5) *Mandate the Chief, Collection Division, to take the necessary action to collect any outstanding estate taxes, penalties, and interest from the [illegible].*

   a) We agree with the recommendation. The Director, Compliance Administration, will direct the Chief, Collection Division to [illegible] the necessary information from the Chief, Audit Division, [illegible] and proceed with collection efforts.

6) *Evaluate the feasibility of developing purchasing an automated system to assist in the processing of estate taxes. This system should be able to interface with the current ITS system and its successors.*

a) We agree with the recommendation. OTR is in the process of developing requirements for a replacement integrated tax system. Requirements for automated handling of estate taxes will be included in the procurement.

7) Take action to require that at a minimum the Unit review the list prepared by the Register of Wills and determine whether the estates that equal or exceed the $1 million filing floor have met their legal obligation to file an estate tax return.

a) We agree with this recommendation and will implement it.

8) *Review the Unit's operations and determine whether it is cost effective to segregate the duties of the Unit's staff. If segregation of duties is not feasible, alternative additional documented file review and oversight requirements be established. These additional review and oversight steps should be performed by the Unit's supervisor and other management level staff within the Division.*

a) We agree with the recommendation. While it is not cost effective to segregate the duties of the unit staff, all estate tax cases will be reviewed by the supervisor, with the Revenue and Conference area making the final review and approval.

9) *Determine, to the extent possible, the amount of uncollected estate taxes, [illegible] and interest based on the [illegible] maintained in the card files. These [illegible] should be referred to the Collections Division for potential collection actions.*

a) We agree with the recommendation. See our response to item [illegible] above.

10) *Develop a methodology to select estate tax returns for reviews and audits. The results of the reviews and audits should be used to determine adjustments to the selection methodology. The methodology should include [illegible] returns that may be [illegible] that fall below the IRS reporting floor.*

a) We agree with this recommendation. We will develop a methodology to select estate tax returns for reviews and audits.

11) *[illegible] should assign staff, as necessary, to [illegible] the estate tax returns.*

a) We agree with the recommendation. See our response to item [illegible]

12) *The Director, Revenue Accounting Administration, should provide the unit with a monthly report of the estate tax revenue received and the refunds processed and follow up with the Unit's staff on any outstanding reconciling items and adjustments with the Unit's staff.*

- We agree with the recommendation. The Director, Compliance Administration, will contact the Director, Revenue Accounting Administration, to secure the necessary reports by July 30, 2009.

13) *The Supervisor, Inheritance and Estate Tax Unit, should periodically review the times established in the standard with actual processing times. The standards should be adjusted as necessary based on actual experience.*

- We agree with the recommendation. Cases will be assigned and worked in a First In First Out methodology, with a goal of completion within 5 days of receipt, providing all supporting documentation is provided. The supervisor of the unit will monitor actual processing times and make adjustments as required.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer

Office of Integrity and Oversight

[redacted]

MEMORANDUM

TO: Stephen M. Cordi, Deputy CFO
Office of Tax and Revenue

FROM: Robert G. Andary, Executive Director
Office of Integrity and Oversight

DATE: June 11, 2009

SUBJECT: Evaluation of OTR's Audit Response to OIO's Audit of Estate Tax Returns and Refunds

On June 8, 2009, the Office of Integrity and Oversight (OIO) received the Office of Tax and Revenue's (OTR) response to the draft report entitled, "Audit of the Estate Tax Returns and Refund Processing" (IA:OTR:2810-C-14), dated June 4, 2009. OIO's draft report contained five (5) findings detailing the conditions we found during our audit. We provided twenty-two (22) recommendations to correct the deficiencies noted. However, the response we received from OTR does not adequately address the recommendations outlined in our report.

Specifically, our review and analysis of the response found that the Compliance Administration (CA) stated they agreed with *most* of the findings; however, we found no specifics as to which findings they did not agree with. In response to one of the recommendations related to policies and procedures for the Estate Tax Unit, Recommendation 2-2, they did provide a copy of their newly developed policies with limited high-level procedures. The policies and procedures provided in the response alluded to some of the recommendations provided by OIO to remediate the cited deficiencies; however, the response does not adequately address all of the recommendations provided in our report.

In prior responses to audits and reviews performed by OIO, we have generally received responses from OTR that: (i) indicate concurrence or non-concurrence with the audit's recommendations; (ii) provide a corrective action plan that addresses the implementation of the recommendation, with appropriate timelines, or presents an alternative action plan when the client/auditee (OTR) does not agree with the recommendation; and (iii) provides a projected date when the recommendation(s) will be fully implemented. This type of response is similar to that required for the responses to *Yellow Book* reports and for the responses to the District's Single Audit report.

In its response to the subject audit noted above, and dated June 4, 2009, OTR did not provide any of the elements listed in the preceding paragraph. Further, the response appeared to be solely from OTR's Compliance Administration (CA), and did not include responses to various recommendations from the Deputy Chief Financial Officer (DCFO), Chief, Collections Division and the Revenue Accounting Administration (RAA). Since OTR did not properly respond to the recommendations identified in the draft report, we are returning the attached response to the Deputy Chief Financial Officer to reformulate using the information provided in the above paragraph as guidance in preparing the response. **A revised response should be submitted to OIO within 14 calendar days.**

Below, we reproduced the draft report's recommendations, showing the related divisions to which they are addressed. In addition, we inserted a notation to each recommendation indicating whether OTR "addressed" the recommendation or "did not address" the recommendation. This recommendation summary is taken directly from the draft report provided to OTR.

Summary of Recommendations

The Deputy Chief Financial Officer should:

- Mandate that Director, Compliance Administration, take action to (i) determine whether the unpaid estate taxes, penalties and interest can be collected, and (ii) direct the Collection Division initiate collection action. **(Not addressed)**
- Require that the Director Compliance Administration and the Chief Audit Division develop and implement a work plan to conduct audits of a sample of the returns received by the Unit during the audit period (October 1, 2003 to September 30, 2008) as promptly as practicable. These reviews should be performed by staff independent of the Unit's operations. Where possible, efforts should be made to collect unpaid estate taxes, penalties and interest. **(Not addressed)**
- Require that an agency-wide risk assessment be developed based on the OTR, individual offices and administrations' performance and strategic goals. The risk assessments should include all functional areas within OTR. **(Not addressed)**

The Director, Compliance Administration should:

- Develop a system of reviews that require an individual independent of the Unit to periodically review, at least quarterly, the estate tax returns including review for mathematical accuracy. Evidence supporting this review should be included in the tax return file for each return reviewed. **(Addressed)**
- Notify the taxpayers identified, as the result of the desk audits, of any refunds and/or interest due. Payment of the refund and/or interest should be completed within 30 days of the taxpayer notification. This notification should be completed after recommendation of the audit of all estate tax returns received during the period.**(Addressed)**
- Require that: (i) all tax certificates issued by the Unit be reviewed and signed by the Unit's supervisor, at a minimum, and (ii) the Unit establish a database and system that in, conjunct-

tion with the supervisory reviews, document and control the issuance of tax certificates. **(Addressed)**

- Mandate the Chief, Audit Division periodically review the tax certificate issuance process in order to ensure compliance with the established standards and protocols. **(Not addressed)**
- Mandate the Chief, Collections Division take the necessary action to collect any outstanding estate taxes, penalties, and interest from the impacted tax payers. **(Not Addressed)**
- Evaluate the feasibility of developing/purchasing an automated system to assist in the processing of estate taxes. This system should be able to interface with the current ITS system and its successors.**(Not addressed)**
- Take action to require that at a minimum the Unit review the list prepared by the Register of Wills and determine whether the estates that equal or exceed the $1 million filing floor have met their legal obligation to file an estate tax return **(Not addressed)**

OIG recommends that the Chief, Audit Division:

- Develop standardized operating policies and procedures for the Unit. These policies and procedures should be developed in concert with the Division's current policies and procedures and address the specific operations of the Unit. **(Addressed)**
- Establish a standardized system of documentation for all audit files. This system of documentation should include specific documentation that must be present in the file. Where appropriate, this standardized system should be supplemented by the requirements of the various operating units within the Division. **(Addressed)**
- Review the Unit's operations and determine whether it is cost effective to segregate the duties of the Unit's staff. If segregation of duties is not a feasible alternative, additional documented file review and oversight requirements be established. These additional review and oversight steps should be performed by the Unit's supervisor and other management level staff within the Division. **(Not addressed)**
- Require the Unit's staff coordinate with RAA in performing monthly reconciliations of the revenues and refunds reported by RAA with the records available in the Unit. Differences should be documented and resolved. Copies of these reconciliations should be retained for audit purposes.
(Addressed)
- Determine, to the extent possible, the amount of uncollected estate taxes, penalties, and interest based on the records maintained in the card files. These outstanding amounts should be referred to the Collections Division for potential collection actions. **(Not addressed)**
- Establish with RAA an estate taxes receivable account for the amount of estate taxes, penalties, and interest for the uncollected amounts due to the District Government. This account should be used to record current and future receivable amounts. This account should be reconciled by the Unit to its records on a periodic basis. **(Addressed)**
- Develop a methodology to select estate tax returns for reviews and audits. The results of the reviews and audits should be used to determine adjustments to the selection methodology. The methodology should include both returns that may be audited by the Service and those that fall below the IRS reporting floor. **(Not addressed)**

The Chief, Collections Division should:

- Assign staff, as necessary, to take the necessary collection action for the estate tax returns, **(Not addressed)**

The Director, Revenue Accounting Administration should:

- Provide the Unit with a monthly report of the estate tax revenues received and the refunds processed, and follow-up with the Unit's staff on any outstanding reconciling items and adjustments with the Unit's staff. **(Not addressed)**

The Supervisor, Inheritance and Estate Tax Unit should:

- Establish standard processing times for estate tax returns and refunds and require that the Unit's staff meet or exceed the times. **(Addressed)**
- Periodically review the times established in the standard with actual processing times. The standards should be adjusted as necessary based on the actual experience. **(Not addressed)**

If you have any questions or require additional information, please contact Mohamad Yusuff at 442-8240 or Tisha Edwards at 478-9143.

Attachment: OTR's Response of June 4, 2009, to Review of Estate Tax Program

cc: Glen Groff, Director of Operations, OTR
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Mohamad Yusuff, Internal Audit Director, OIO
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