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

Office of Integrity and Oversight

MEMORANDUM

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

FROM: William J. DiVello, Executive Director
Office of Integrity and Oversight

DATE: May 24, 2011

SUBJECT: Final Report on the Audit of Internal Controls over Federal Income Tax Adjustments **(Report No. 11-01-08 OTR)**

This report summarizes the results of the Office of Integrity and Oversight's (OIO) Audit of Internal Controls over Federal Income Tax Adjustments. This audit was requested by the Office of Tax and Revenue (OTR) Compliance Administration Director and is part of our continuing oversight of the OTR operations. The overall objectives of our audit were to determine whether OTR manages the federal tax adjustments in an efficient and effective manner, and whether any tax liability resulting from these adjustments were collected on a timely basis.

OIO provided 9 recommendations to address the findings cited in the report. OTR concurred with the recommendations and provided target completion dates. However, we consider OTR response to recommendation No. 3 to be non-responsive. Accordingly, we request OTR reconsider its position and provide a revised response to OIO by June 26, 2011.

We appreciate the assistance and cooperation that you and your staff provided to OIO during this audit. Should you have any questions or need additional information, please call me at (202) 442-6445 or your staff may contact Mohamad Yusuff, Director, Internal Audit at (202) 442-8240.

Attachment

cc: Natwar M. Gandhi, Chief Financial Officer, Government of the District of Columbia
Angell Jacobs, Chief of Staff, Office of the Chief Financial Officer
Kathy Crader, Chief Risk Officer, Office of the Chief Financial Officer
Glen Groff, Director of Operations, OTR
Bedell Terry, Director of Compliance, OTR

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

AUDIT OF INTERNAL CONTROLS OVER FEDERAL INCOME TAX ADJUSTMENTS

OFFICE OF INTEGRITY AND OVERSIGHT

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OIO No. 11-01-08 OTR

May 24, 2011

AUDIT OF INTERNAL CONTROLS OVER FEDERAL INCOME TAX ADJUSTMENTS

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AUDIT OF INTERNAL CONTROLS OVER FEDERAL INCOME TAX ADJUSTMENTS

ACRONYMS

CP2000	Computer Paragraph 2000
DCFO	Deputy Chief Financial Officer
EOAD	Examination Operation Automation Database
IRS	Internal Revenue Service
ITS	Integrated Tax System
OIO	Office of Integrity and Oversight
OTR	Office of Tax and Revenue
RAR	Revenue Agent Report
TSG	Tax Systems Group

EXECUTIVE DIGEST

OVERVIEW

The Office of Integrity and Oversight (OIO) has completed an audit of the internal controls over Federal Income Tax Adjustments at the Office of Tax and Revenue (OTR) at the request of OTR. Our overall audit objectives were to determine whether OTR managed federal tax adjustments in an efficient and effective manner, and whether any tax liability resulting from these adjustments were collected on a timely basis.

Our audit reviewed the process used by the Compliance Administration to administer the Federal Adjustment Program. The Internal Revenue Service (IRS) provides states and the District of Columbia with results of audits performed on taxpayers' federal income tax returns. When an audit results in an adjustment to the taxpayer's liability and the taxpayer has a District address, the District receives a federal tax adjustment report. The taxpayers are required to inform the District of any change made by the IRS; however, if they do not, the District has the ability to adjust the taxpayer's account based on this notice of federal adjustment received from the IRS and bill the taxpayer accordingly.

CONCLUSION

The audit disclosed that the Audit Division at OTR did not manage the federal income tax adjustments in an efficient and effective manner. Specifically, we noted significant deficiencies in the management of the program including ineffective inventory management and incomplete and inaccurate records. We reviewed 8,408 cases of federal tax adjustments received from the IRS for the 18-month period of the audit (April 2009 – September 2010) and found that there were 3,445 cases open at the end of the audit period. The estimated assessed uncollected revenue on these open cases is $17.1 million. Furthermore, we found that OTR did not collect estimated penalties of $1.2 million on 7,393 cases received through Computer Paragraph 2000 (CP2000) for the CY 2010.

Additionally, we found that OTR did not fully comply with the IRS Publication No. 1075 which requires the safeguarding and protection of confidentiality of federal tax information received from the IRS. The OTR Audit Division did not establish internal control policies regarding retention of the federal tax adjustments (CDs or hardcopies) by the audit assistant and the tax auditors.

SUMMARY OF RECOMMENDATIONS AND MANAGEMENT ACTIONS

We directed 9 recommendations to OTR management for necessary action to correct the described deficiencies. The recommendations focus on:

- Establishing an application within the ITS to process the Revenue Agent Reports (RAR) received from the IRS electronically;

EXECUTIVE DIGEST

- Assigning a team of tax auditors to process and close the aged inventory of federal tax adjustments;

- Revising the policy on penalty calculation to impose penalty on all federal tax adjustments (whether RARs or CP2000) that result in D.C. tax liability;

- Providing training courses to the tax auditors and the tax audit managers on understanding the Examination Operation Automation Database (EOAD) received from the IRS and their effects on D.C. tax returns; and

- Establishing an internal control policy regarding returning the CDs to the Program Analyst within 30 days from receiving them.

A summary of the potential benefits resulting from this audit is shown at Exhibit A.

OIO received written response from OTR on May 18, 2011. OTR concurred with the recommendations and provided target completion dates. However, we consider OTR response to recommendation No. 3 to be non-responsive. Accordingly, we request OTR reconsider its position and provide a revised response to OIO by June 26, 2011. A copy of the complete response is included as Exhibit B.

INTRODUCTION

BACKGROUND

The Internal Revenue Service (IRS) provides states and the District of Columbia with results of audits performed on taxpayers' federal income tax returns. When an audit results in an adjustment to the taxpayer's liability and the taxpayer has a District address, the District receives a federal tax adjustment report. The taxpayers are required to inform the District of any change made by the IRS; however, if they do not, the District has the ability to adjust the taxpayer's account based on this notice of federal adjustment received from the IRS and bill the taxpayer accordingly.

The IRS provides federal tax adjustments to OTR in two ways:

Revenue Agent Reports

Revenue Agent Reports are received in the form of CDs downloaded from the IRS's website or received in the mail by OTR staff. RARs include corrections or modifications that were completed by the IRS tax auditors and already informed to the taxpayers. Normally, it takes the IRS 2 to 3 years to complete the adjustments and send the Examination Operation Automation Database reports to the District.

The CDs are received by the Federal/State Program Coordinator at OTR who gives them to the Compliance Administration Program Analyst. The Program Analyst gives the CDs to an audit assistant, who prints and distributes the hardcopies of the RARs to the tax audit managers, who in turn distributes them to the tax auditors to work on the cases. Recently, OTR developed a policy that each tax auditor should not have more than 20 cases at a time. When the case is closed the tax auditor returns the hardcopies to the audit assistant to destroy, and the CDs are given back to the Program Analyst who keeps them for one year in the Federal Room (a secured and certified room by the IRS). When the year expires, the CDs are given back to the Federal/State Program Coordinator for disposition.

CP2000

Computer Paragraph 2000 (CP2000) reports contain output of the IRS's computer software that compares income, payments, credits, and deductions reported by the taxpayers with information reported to the IRS by employers, banks, businesses, and other payers. OTR receives 6 electronic CP 2000 reports per calendar year. The Office of the Chief Information Officer Tax Systems Group staff receives the information and uploads the file to the Integrated Tax System (ITS) which posts directly to the taxpayers' accounts. The taxpayers' D.C. tax returns are systemically adjusted based on the information included in the CP2000 reports. The adjustment results in the recalculation of the taxpayers' tax liability (if any) and generates a tax bill

INTRODUCTION

OBJECTIVES, SCOPE AND METHODOLGY

The audit was designed to determine whether: (1) Effective internal controls are in place to ensure accuracy and completeness of federal income tax adjustments; and (2) Effective internal controls are in place to provide reasonable assurance that tax liabilities resulting from federal income tax adjustments are collected on timely basis.

In order to achieve these objectives, we reviewed 8,408 cases of federal tax adjustments received from the IRS for an 18-month period (April 2009 – September 2010), and 7,393 cases received through CP 2000 for the CY 2010. Our review included performing analytical procedures for the RARs received during the period of the audit, inspecting documents and records, examining the effectiveness of internal control procedures, and observing security over federal tax information.

In addition, we interviewed and obtained information from the OTR audit assistant, tax auditors, tax audit managers, Chief of the Audit Division, Chief of the Collection Division, Program Analyst, Tax Systems Business Analyst, and Federal/State Program Coordinator.

We relied on computer-processed data from ITS regarding CP2000 federal tax adjustment reports. We did not perform a formal reliability assessment of the computer-processed data because the ITS system reliability tests were performed previously as part of the audit of the Comprehensive Annual Financial Report.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATIONS

FINDING 1: MANAGEMENT OF FEDERAL INCOME TAX ADJUSTMENTS

SYNOPSIS

The OTR Audit Division of the Compliance Administration did not efficiently manage the federal income tax adjustments received from the IRS. This condition occurred because the Audit Division did not utilize its resources in an economic and efficient manner. A Federal Tax Adjustment Unit was established at the beginning of the FY 2011 to manage and process a backlog of federal adjustment cases. However, this unit did not establish any priority for federal tax adjustments nor close the delayed cases. As a result, there were 3,445 open cases in ending inventory at the end of the 18-month audit period. We estimated potential assessed revenue of $17.1 million related to this inventory.

Furthermore, ITS did not calculate any penalty on the federal tax adjustments received through CP2000 reports due to the fact that the ITS does not include an application to classify CP2000 reports based on the original filing dates to calculate or waive the penalty. As a result, we estimated lost penalty of $1.2 million on $4.9 million tax due resulting from CP2000 reports for the CY 2010.

DISCUSSION

Federal Tax Adjustment Case Inventory

The OTR Audit Division has seven audit units to manage and process federal tax adjustments along with performing other audits. At the beginning of the FY 2011, Audit Division management established a Federal Tax Adjustments Unit to process the federal tax adjustment inventory. However, this unit did not classify the federal tax adjustments as a priority task and hence did not achieve its main objective of closing these delayed cases of federal tax adjustment.

For the period under review, the Audit Division had 8,408 cases of federal tax adjustments in its audit inventory. This inventory included 2,551 in beginning inventory and 5,857 cases received during the audit period. We noted the Audit Division closed 4,963 cases (59 percent of 8,408) with total assessed revenue of $24.7 million. There were 3,445 cases (41 percent of 8,408) in ending inventory open at the end of the audit period

FINDINGS AND RECOMMENDATIONS

Currently, adequate resources are not assigned to work the federal adjustment cases. We believe that effective management of the federal adjustment inventory is imperative. If the inventory is managed effectively and backlogs are worked, this could potentially increase assessed revenue for the District by $17.1 million. This amount was determined by taking the average assessed revenue per case closed of $4,973, and the average case closure rate per month of 276 cases.

Based on the current inventory levels, OTR management will need about 12 months to close these cases assuming there are no new cases received. Closing cases not only increases the potential revenue generation for the District, but also the improved closure rate reduces the interest charged to the taxpayer due to significant delays in working the federal adjustments provided by the IRS.

Ineffective Inventory Management. The auditors are assigned cases on a monthly basis by the manager. Auditors are not allowed to have more than 20 cases at a time. However, we found that the tax audit managers do not reconcile the inventory list of federal tax adjustment cases open at the end of each month with the monthly production reports that show the closed cases. Inventory reconciliation would ensure that the tax auditors are processing the RARs using the first-in-first-out method, and no cases have been delayed because the tax auditor selected to process a case that is relatively easier.

In our review of federal adjustments posted to ITS, we noted significant delays in the posting of adjustments to taxpayers accounts, which further demonstrates the lack of inventory management. We noted adjustments to taxpayer's accounts ranged from one month to over 18 months from receipt of the adjustment.

Inaccurate and Incomplete Records. The Audit Division keeps statistical records for the RARs received from the IRS to include receiving date, number of cases, type of cases, assigned date, and assigned auditors' names. We found that these records are incomplete and missing information for several months. In addition, we found that the audit assistant receives information from the tax audit managers regarding the ending inventory of open federal adjustment cases at the end of each month, and mistakenly reports this information as beginning inventory. As a result of this incomplete and inaccurate recordkeeping, we were unable to determine the status of all cases received from the IRS to ensure that cases were reviewed, closed and taxpayer accounts were accurately adjusted. Additionally, notes are not placed in ITS to document when an adjustment was not required. This incomplete recordkeeping hinders management's ability to determine the effectiveness of the program which would ultimately allow a better alignment of audit resources.

CP2000 Reports. We reviewed 7,393 cases of federal tax adjustments received through CP2000 during the CY 2010 with total tax due of $4.9 million. We found that OTR did not calculate any penalty on these adjustments. These penalties are estimated to be $1.2 million.

FINDING AND RECOMMENDATIONS

According to OTR's policy regarding the calculation of penalty, if a taxpayer files the tax return within 6 months of original return due date and later received a bill due to an audit or CP2000, the penalty will be waived from the first bill. Therefore, if a taxpayer files the tax return beyond the six month mark, and later received a bill due to an audit or CP2000, the first bill will include a penalty.

Based on a review of CP2000 cases, we noted that the ITS does not include an application to classify CP2000 reports based on the original filing dates and whether the tax returns were filed within the six-month period or not in order to calculate or waive the penalty. Furthermore, since federal tax adjustments are due to taxpayers' errors (unintentional mistakes) or fraud (intentional mistakes) and normally received by OTR 2 or 3 years after the original tax year, OTR should calculate and impose the penalty on all of these adjustments that result in D.C. tax liability.

Other Matters

During our audit, other issues came to our attention that warrant further management consideration. We noted the following:

- *Peer Review.* The Audit Division management has implemented a very effective tool for reviewing the auditors' work on the federal tax adjustments. The peer reviews are performed by the tax audit managers for 3 federal adjustments cases selected randomly every week. However, we found that the peer reviews are performed after the taxpayers have been notified of the assessment in a letter from the auditor, and may be after the first bill.

- *Individual Performance Plan.* We found that the individual performance plan for the tax auditors grade 12 and 13 include the same smart goal of closing federal tax adjustment case within 30 days from the assigned date. Grade-13 tax auditors should have more experience and knowledge to allow him/her to close a federal tax adjustment case, on average, in less time than grade-12 tax auditors.

- *EOAD Reports.* Both the tax auditors and the tax audit managers confirmed the difficulties they experience in understanding the Examination Operation Automation Database (EOAD) Reports received from the IRS. These reports include the IRS Reason Code for the line adjustment that is not well known to OTR tax auditors and tax audit managers.

FINDING AND RECOMMENDATIONS

RECOMMENDATIONS

We recommend the DCFO, OTR:

1. Request the Tax Systems Group establish an application within the ITS to process the RARs received from the IRS electronically similar to the application used for CP2000 reports.

2. Assign a team of tax auditors to process and close the aged inventory of federal tax adjustments.

3. Revise the policy on penalty calculation to impose penalty on all federal tax adjustments (whether RARs or CP2000) that result in D.C. tax liability.

4. Design monthly inventory report for each tax auditor to show beginning inventory of the month, cases received during the month, cases closed during the month, and ending inventory.

5. Instruct staff to complete federal tax adjustments on a FIFO basis. Supervisors should review the inventory report to ensure the inventory is worked on a FIFO basis.

6. Maintain a detailed inventory listing of all federal adjustments received and the disposition of the case to provide management with an effective tool to measure the program.

7. Consider revising SMART Goals for tax auditors based on grade and experience.

8. Provide training courses to the tax auditors and the tax audit managers on understanding the EOADs received from the IRS and their effects on D.C. tax returns.

MANAGEMENT RESPONSES AND OIO COMMENTS

Management Response (Recommendation 1)

OTR concurred with the recommendation and provided target completion date of September 30, 2011.

OIO Comment

OTR planned corrective action is responsive and meets the intent of the recommendation.

Management Response (Recommendation 2)

OTR concurred with recommendation and provided that the audit group No. 7 will work on the delayed inventory of the federal tax adjustments and bring it to current by September 30, 2011.

FINDING AND RECOMMENDATIONS

OTR also stated that the audit did not provide evidence that the federal tax adjustments provide greater yield than the current inventory.

OIO Comment

OTR's response to bring federal tax adjustments to current by September 30, 2011 meets the intent of our recommendation. However, it should be noted that our audit focused specifically on the efficiency and effectiveness of the federal tax adjustment program, as such, we did not perform a comparative analysis between the yields on federal adjustment inventory versus other audit types. Considering the current economic condition and budget pressures in the District, OTR should use its resources effectively to collect every tax liability.

Management Response (Recommendation 3)

OTR concurred with the recommendation and stated that the system does not post penalty until after the 21-day period and the 30-day period. OTR also stated that it is a systemic issue and cannot be resolved at the administration level.

OIO Comment

Management's response does not meet the intent of the recommendation. OTR receives federal tax adjustments from the IRS (whether in form of RARs or CP2000) after 2 or 3 years from the original tax return filing date. Therefore, the penalty should be assessed on all federal tax adjustments without applying any waiting periods. OIO requests management review the recommendation again and provide a revised action plan.

Management Response (Recommendation 4)

OTR concurred with the recommendation and stated that the federal tax adjustment liaison will amend their report to more closely track receipts and closures. OTR provided a target completion date of FY 2012.

OIO Comment

OTR corrective actions are responsive and meet the intent of the recommendation.

Management Response (Recommendation 5)

OTR concurred with this recommendation and provided a target completion date of July 30, 2011.

OIO Comment

OTR corrective actions are responsive and meet the intent of the recommendation.

FINDING AND RECOMMENDATIONS

Management Response (Recommendation 6)

OTR concurred with the recommendation and stated that federal tax adjustments liaison is monitoring the process for report purposes.

OIO Comment

OTR corrective actions are responsive and meet the intent of the recommendation.

Management Response (Recommendation 7)

OTR concurred with the recommendation and stated that it will consider and make a final decision by September 30, 2011.

OIO Comment

OTR corrective actions are responsive and meet the intent of the recommendation.

Management Response (Recommendation 8)

OTR concurred with the recommendation and stated that a training course has been provided on March 29, 2011, and additional training classes are scheduled to be provided by September 30, 2011.

OIO Comment

OTR corrective actions are responsive and meet the intent of the recommendation.

FINDINGS AND RECOMMENDATIONS

FINDING 2: SECURITY OF FEDERAL TAX INFORMATION

SYNOPSIS

OTR did not fully comply with the IRS Publication No. 1075 regarding the security of federal tax information. This condition occurred because OTR did not establish adequate policies and procedures regarding retaining and safeguarding federal tax adjustment information whether in form of CDs or hardcopies. As a result, federal tax information might be misplaced or available to unauthorized personnel.

DISCUSSION

The IRS Publication No. 1075 "Tax Information Security Guidelines for Federal, State and Local Agencies" provides guidance on ensuring that policies, practices, controls, and safeguards employed by recipient agencies or agents and contractors adequately protect the confidentiality of the information received from the IRS.

The IRS Safeguard Review Report dated October 2010 showed that the minimum protection standards were not met for OTR office components. Our observations during the course of the audit confirmed the IRS findings. We observed the following:

- ***Safeguarding the CDs.*** The audit assistant receives the CDs of the federal tax adjustments from the program analyst to print and distribute them to the tax audit managers. The audit assistant prints the CDs using shared/common printer in an open area. He also confirms that there is no written policy regarding the time frame that the CDs must be given back to the program analyst. Therefore, we found that the audit assistant sometimes retains the CDs after one month from receiving them, and at other times after 6 months.

- ***Safeguarding the Hardcopies***. The tax audit managers receive the hardcopies of the federal tax adjustments from the audit assistant to distribute them to the tax auditors to work on the cases. When a case is closed, the tax auditor should return the hardcopies to the audit assistant to destroy them. We found that the Audit Division did not establish a clear policy regarding the time period for retaining these hardcopies by the tax auditor after the case is closed. Some tax auditors keep these hardcopies for 6 months and some others keep them for one year.

FINDINGS AND RECOMMENDATIONS

RECOMMENDATION

We recommend the DCFO, OTR:

9. Establish an internal control policy for the audit assistant to return the CDs to the Program Analyst within 30 days from receiving them, and for the tax auditors to return the hardcopies to the audit assistant within 30 days from closing the case.

MANAGEMENT RESPONSES AND OIO COMMENTS

Management Response (Recommendation 9)

OTR concurred with the recommendation and provided a target completion date of June 30, 2011.

OIO Comment

OTR corrective actions are responsive and meet the intent of the recommendation.

Exhibit A: Summary of Potential Benefits Resulting from Audit

No.	Recommendations	Type of Benefit	Agency Reported Estimated Completion Date	Status[1]
1	Request the Tax Systems Group establish an application within the ITS to process the RARs received from the IRS electronically.	Economy and Efficiency	September 30, 2011	Open
2	Assign a team of tax auditors to process and close the aged inventory of federal tax adjustments.	Economy and Efficiency $17.1 million	September 30, 2011	Open
3	Revise the policy on penalty calculation to impose penalty on all federal tax adjustments (whether RARs or CP2000) that result in D.C. tax liability.	Economy. $1.2 million	TBD	Open
4	Design monthly inventory report for each tax auditor to show beginning inventory of the month, cases received during the month, cases closed during the month, and ending inventory.	Internal Control	FY 2012	Open
5	Instruct staff to complete federal tax adjustments on a FIFO basis. Supervisors should review the inventory report to ensure the inventory is worked on a FIFO basis.	Internal Control	July 30, 2011	Open

[1] This column provides the status of a recommendation as of the report date. For final reports, "**open**" means management and the OIO are in agreement on the action to be taken, but is not complete. "**Closed**" means management has advised that action necessary to correct the deficiency is complete. If a completion date was not provided, the date of management's response is used. "**Unresolved**" means that management has neither agreed to take the recommended action nor proposed a satisfactory alternative action to correct the condition.

Exhibit A: Summary of Potential Benefits Resulting from Audit

No.	Recommendations	Type of Benefit	Agency Reported Estimated Completion Date	Status
6	Maintain a detailed inventory listing of all federal adjustments received and the disposition of the case to provide management with an effective tool to measure the program.	Internal Control	May 18, 2011	Closed
7	Consider revising SMART Goals for tax auditors based on grade and experience.	Program Efficiency	September 30, 2011	Open
8	Provide training courses to the tax auditors and the tax audit managers on understanding the EOADs received from the IRS and their effects on D.C. tax returns.	Program Efficiency	May 18, 2011	Closed
9	Establish an internal control policy for the audit assistant to return the CDs to the Program Analyst within 30 days from receiving them.	Internal Control	June 30, 2011	Open

EXHIBIT B: OFFICE OF TAX AND REVENUE'S RESPONSE

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER
OFFICE OF TAX AND REVENUE

Stephen M. Cordi
Deputy Chief Financial Officer

MEMORANDUM

TO: William J. DiVello, Executive Director
Office of Integrity and Oversight

FROM: Stephen M. Cordi

DATE: May 18, 2011

SUBJECT: Response to Draft Report: Audit of Internal Controls over Federal Income Tax Adjustments (Report No. 11-01-08 OTR)

Attached is the response to the draft report regarding the Office of Tax and Revenue, Audit of Internal Controls over Federal Income Tax Adjustments (Report No. 11-01-08 OTR).

Our written response includes suggested actions taken, planned target dates for completion, and proposed alternatives to correct noted deficiencies.

If you have any questions, please contact Bedell Terry, Director, Compliance Administration, at 202-442-6863.

Attachment

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www.taxpayerservicecenter.com

EXHIBIT B: OFFICE OF TAX AND REVENUE'S RESPONSE

DRAFT REPORT ON THE AUDIT OF INTERNAL CONTROLS OVER THE FEDERAL INCOME TAX ADJUSTMENTS (Report No. 11-01-08 OTR)

Finding: MANAGEMENT OF FEDERAL INCOME TAX ADJUSTMENTS

Finding 1.1

Request the Tax Systems Group establish an application within the ITS to process the RARs received from the IRS electronically similar to the application used for CP2000 reports.

- Agree: Date to Complete Submission to TSG: 9/30/2011.

Finding 1.2

Assign a team of tax auditors to process and close the aged inventory of federal tax adjustments.

- Agree: The audit did not provide evidence that Federal Tax Adjustments provided a greater yield then current inventory. Federal Tax Adjustments are provided as additional inventory for 6 of the 7 audit groups. FTA's are already primary inventory for the 7th group. This group should help bring FTA work current by 9/30/11. Therefore, we do not see that adding additional resources will result in additional yield.

Finding 1.3

Revise the policy on penalty calculation to impose penalty on all federal tax adjustments (whether RARs or CP2000) that result in DC tax liability.

- Agree: The auditors assess penalties and interest on the accounts when the liability is determined. However, the system does not post the penalty until after the 21 day period and the 30 day period. This is a systemic issue and cannot be resolved at the Administration level.

  Code Section 47-4201(b)(1) Except as provided under paragraphs (1) and (2) of this subsection, interest shall be imposed at the underpayment rate set forth in subsection (d) of this section on an assessable penalty or addition to the tax only:

EXHIBIT B: OFFICE OF TAX AND REVENUE'S RESPONSE

(A) If the assessable penalty or addition to the tax is not paid within 21 calendar days after the date of notice and demand, and." Based on the Tax Clarity Act.

Code Section 47-4213.a.3 states "In the case of a failure to pay an amount in respect of the tax that is required to be shown on a return specified in paragraph (1) of this subsection which is which is not shown (including an assessment made under this title), within 30 calendar days from the date of notice and demand for payment, unless it is shown that failure is due to reasonable cause and not willful neglect there shall be added to the amount of tax stated in the notice and demand 5% of the amount of the tax if the failure is not more than one month, with an additional 5% for each additional month or fraction thereof during which the failure continues, not exceeding 25% in the aggregate."

Finding 1.4

Design monthly inventory report for each tax auditor to show beginning inventory of the month, cases received during the month, cases closed during the month, and ending inventory.

- Agree: Individual auditors maintain an inventory report for overall inventory. FTA inventory is tracked by the FTI Liaison. The FTI liaison will amend their report to more closely track receipts and closures. They will also track destruction of the cases. Estimated Completion: FY 2012.

Finding 1.5

Instruct staff to complete federal tax adjustments on a FIFO basis. Supervisors should review the inventory report to ensure the inventory is worked on a FIFO BASIS.

- Agree: The Chief, Audit Division will amend the Audit Manual to state that federal tax adjustments will be completed on a FIFO basis. Estimated Completion Date: 7/30/11.

Finding 1.6

Maintain a detailed inventory listing of all federal adjustments received and the disposition of the case to provide management with an effective tool to measure the program.

- Agree: A Federal Adjustment inventory spreadsheet is already being maintained by each manager. However, the process is being monitored by the FTI liaison for reporting purposes.

EXHIBIT B: OFFICE OF TAX AND REVENUE'S RESPONSE

Finding 1.7

Consider revising SMART Goals for tax auditors based on grade and experience.

- Agree: We will consider and make a final decision by 9/30/11.

Finding 1.8

Provide training course to the tax auditors and the tax audit managers on understanding the EOADs received from the IRS and their effects on DC tax returns.

- Agree: A Senior Tax Auditor conducted EOAD training for businesses on March 29 to the adjustment team. Additional classes are scheduled to be provided for the balance of the division by 9/30/11.

Finding 2: SECURITY OF FEDERAL TAX INFORMATION

Finding 2.9.

Establish an internal control an internal control policy for the audit assistant to return the CDs to the Program Analyst within 30 days from receiving them and for the tax auditors to return the hardcopies to the audit assistant with 30 days from closing the case.

- Agree: A new procedure will be developed and implemented to meet this recommendation. Estimated Completion Date: 6/30/11.