

An Audit Report on

The Comptroller's Tax Revenue Management Process



Office of the State Auditor
Lawrence F. Alwin, CPA

December 1994

Report No. 95-030

Key Points Of Report

An Audit Report on the Comptroller's Revenue Management Process

December 1994

Key Findings

- The Office of the Comptroller of Public Accounts (Comptroller) has an effective and efficient tax revenue management function, which collected and processed taxes of over \$17 billion in fiscal year 1994. The function educates taxpayers, processes tax payments and returns, audits returns, provides for formal hearings where there are disagreements, collects delinquent accounts, and identifies non-filers.
- Total revenues could be increased by increasing the number of auditors. We estimate that additional auditors would bring in over three times the related additional costs, or approximately \$13 million, if the total number of auditors were increased to 550. Funds were appropriated for this purpose in 1992. However, while total audit billings have exceeded projections, the net number of auditors has not increased.
- The non-filer identification function could be more effective by concentrating on only identifying non-filers. Currently, this section also brings identified non-filers into compliance.
- The formal hearings process, redeterminations, needs to be revised to address workload problems. The number of cases in redetermination has increased nearly 200 percent since 1991. The internal study of this issue should be completed. Additionally, the redeterminations data base needs to be revised to report reliable financial information. Our tests indicate that the May 1994 reported amount of \$742 million was over twice the actual figure of approximately \$350 million.
- Additional monitoring tools should be developed to help ensure the Audit Division's effectiveness. These tools include capturing and monitoring actual dollar collections resulting from audits and more formal comparisons of field office productivity and coverage. These will better quantify the audit function's performance and allow more informed staffing decisions.
- Interest earned by the State could be increased by applying payments to interest owed before the tax liability. Interest accrues on outstanding taxes, but not on interest due. The State lost \$381,000 when one taxpayer paid overdue taxes but not the related interest.

Contact:

Paul H. Hagen (479-4760)

This revenue audit was conducted in accordance with Government Code, Sections 321.014 (a) and (b) (1) and 321.015.

Table of Contents

Executive Summary 1

Section 1:

**The Tax Administration Division's Procedures
Reduce The Likelihood Of Taxpayers Not Filing
Or Paying Due To A Lack Of Available Information** 5

There Are Several Policies And Procedures In Place To
Help Ensure That Taxpayers Know How, When, And Where
To File Taxes Owed 5

The Taxpayer Education Process Could Be More Efficient
With More Formalized Procedures 7

Section 2:

**Revenue Processing Has Effective And Efficient
Procedures To Deposit Funds And Process Returns** 9

Tax Payments And Returns Are Processed To Ensure That
Dollars Are Deposited As Quickly As Practical 9

The Comptroller's Office Is Addressing The Need To
Integrate Taxpayer Data Bases And Speed Up Deposits
From Field Offices 10

There Are No Controls At The Comptroller Level To Ensure
That State Agencies And Universities Properly Collect And
Report Sales Tax 11

Section 3:

**The Revenue Audit Function Focuses On Maximum
Dollar And Risk Coverage, But Would Bring In More
Net Revenue By Adding Auditors; Additional
Monitoring Tools Could Help Ensure Effectiveness** 12

The Revenue Audit Function's Procedures And Policies
Concentrate On Maximum Dollar And Risk Coverage While
Ensuring Quality And Consistent Audits 12

Additional Revenue Auditors Would Produce A Net Increase Of
Revenues Over Costs 13

Table of Contents, continued

The Revenue Audit Function Is Actively Monitored, But Additional Monitoring Tools Would Help Ensure The Audit Function's Effectiveness	15
--	----

Section 4:

The Comptroller Is Studying Ways To Increase Efficiencies In The Hearing Process, Called Redeterminations, To Address The Dramatic Increase In Cases; However, A System Also Needs To Be Developed To Capture Reliable Financial Information	17
---	-----------

There Has Been A Dramatic Increase In The Number Of Cases In Tax Redetermination Hearings, And The Comptroller Is Studying The Issue	17
--	----

The Dollars Reported Are Unreliable Because The Data Base Was Not Designed For Accumulating Financial Data	18
--	----

Procedures For Updating The Data Base For Various Transactions Are Not Formally Documented	20
--	----

Applying Payments First To The Original Tax Liability Cost The State Revenue By Delaying Receipt Of Interest Payments	21
---	----

Section 5:

The Enforcement Division's Procedures Focus Its Efforts On Collecting The Most Dollars Practical	22
---	-----------

The Enforcement Division's Emphasis Is Collecting The Large Dollars First, While Still Processing Small Dollar Accounts Timely	22
--	----

The Enforcement Division Has Increased Collections by Contracting The Work In The Automated Collection Center	23
---	----

The Enforcement Division Is Continuously Monitoring Its Performance On A Statewide Basis And By Field Office Region	23
---	----

Section 6:

The Comptroller Has A Productive Non-Filer Identification Section Whose Effectiveness Could Be Enhanced By Concentrating On Only Identifying Non-Filers	24
--	-----------

The Program Has Developed Some Effective Techniques For Identifying Non-Filers	24
--	----

Table of Contents, concluded

The Program Could Be More Effective By Letting Other Divisions Bring New Taxpayers Into Compliance	24
--	----

Appendices

1 - Objective, Scope, and Methodology	27
2 - Background Information	31
2.1 Agency Profile and Financial Information	31
2.2 Organizational Chart	33
3 - Reference List	34

Executive Summary

The Comptroller has an effective and efficient tax revenue management function. The Comptroller collected and processed over \$17 billion in tax revenue in fiscal year 1994. Tax revenue management consists of the following functions:

- Taxpayers are provided access to information that enables them to voluntarily comply with tax laws.
- Tax payments and returns are processed so that dollars are deposited as quickly as practical.
- The audit function concentrates on high-dollar and high-risk audits.
- A formal hearings process, redeterminations, is available when taxpayers disagree with a tax liability.
- The enforcement of known, unpaid taxes is designed to emphasize collecting the large dollar accounts first, while still getting the small dollar accounts cleared timely.
- There is also a section that identifies taxpayers who do not file returns.

There are several changes that could enhance the current revenue management function. The Comptroller should consider the following recommendations:

- Bring in more tax revenue by increasing the number of auditors.
- The non-filer identification function should concentrate on identifying non-filers.
- Consider implementation of the hearings process study recommendations, when complete, and accumulate reliable financial information on redetermination cases.

- Develop additional monitoring tools to help ensure the Audit Division's effectiveness.
- Increase interest earned by applying taxpayer payments to interest owed before the tax liability.

Bring In More Tax Revenue By Increasing The Number Of Auditors

The Comptroller should increase the total number of auditors to approximately 550 to increase net revenues to the State. We estimate an increase in revenue over three times the cost of the additional auditors. This would result in approximately \$13 million of revenue over costs if the total number of auditors were increased to 550. Based on a Texas Performance Review recommendation in 1991, funds were appropriated for this purpose. However, while total audit billings have exceeded projections, the number of auditors has not increased.

The Non-Filer Identification Function Should Concentrate On Identifying Non-filers

The Revenue Opportunity Program should concentrate on just identifying non-filers. More resources applied to this important function would identify more non-filers, which would increase revenues. Additional efficiencies would be achieved in having other divisions bring the identified non-filers into compliance.

Executive Summary

Consider Implementation Of The Hearings Process Study Recommendations, When Complete, And Accumulate Reliable Financial Information On Redetermination Cases

The Comptroller's study on improving the effectiveness and efficiency of the formal hearings process, redeterminations, should be completed and the recommendations implemented. The number of redetermination cases has increased nearly 200 percent since 1991.

The redeterminations data base should also be revised to report reliable amounts for uncollected dollars in dispute. Our tests indicate that the current reported amount of \$742 million was over twice the actual \$350 million figure. Additionally, large dollar cases closed in 1994 reported a potential \$124 million of uncollected taxes although these cases actually resulted in a net refund of \$15 million.

Develop Additional Monitoring Tools to Help Ensure Audit's Effectiveness

Additional monitoring tools should be developed to help ensure the Audit Division's effectiveness. These tools should include actual collections resulting from audits and more formal evaluations of field office staffing.

- Actual dollars collected should be captured and monitored. Currently, only the total dollars assessed are accumulated. The length of time between audits and actual collections make capturing this information difficult. However, some decisions need to be based on this "bottom

line" information. For example, the marginal benefit of adding auditors depends on the collections per audit dollar spent. As the optimal number of auditors is approached, assessments per audit cost get lower; therefore, collected dollars become increasingly important in calculating the benefit.

- Additionally, more formal comparisons should be made to ensure that field office staffing decisions provide the highest return on the dollar spent while maintaining an acceptable coverage per taxpayer. Comparisons should be made based on productivity and coverage of field offices, excluding required audits and out-of-state audits.

Increase Interest Earned By Applying Taxpayer Payments To Interest Owed Before The Tax Liability

Additional interest could be earned if taxpayer payments were applied to interest owed first. Current procedures apply payments to the original sales tax liability first. Interest accrues on taxes owed but, by law, interest does not accrue on interest due. This process cost the State approximately \$381,000 in interest for one case in redetermination. This taxpayer paid the taxes due but not the interest owed, even though the interest was not in dispute.

Summary Of Management's Responses

Management generally concurs with the findings and recommendations contained in this report. They have included corrective action plans for implementing many of the recommendations.

Executive Summary

Summary Of Audit Objective And Scope

The objective of this audit was to evaluate the effectiveness of control systems essential to the tax revenue management function at the Office of the Comptroller of Public Accounts and to identify opportunities to enhance the effectiveness and efficiency of the revenue process.

The scope of the audit included consideration of the Comptroller's:

- controls over the revenue process
- potential related issues
- performance measures
- organizational structure in the revenue process

Recommendations from the previous revenue report, *A Review of the Comptroller's Revenue Management Process* (SAO Report No. 3-015), issued in November 1992, have been addressed, are in the process of being addressed or studied, or are incorporated into this report.

This page is intentionally blank.

Section 1:

The Tax Administration Division's Procedures Reduce The Likelihood Of Taxpayers Not Filing Or Paying Due To A Lack Of Available Information

The Tax Administration Division provides taxpayers access to information which enables taxpayers to voluntarily comply with tax laws. Taxpayers need to know which taxes apply to them. They also need to know which forms to file and how to fill the forms out, as well as where and when to file and pay. Information is made available to taxpayers through the phone bank, mailouts, and seminars. Committees, which include representatives from various divisions, and practitioners bring various perspectives to help ensure that tax information will be complete and understandable.

Section 1-A:

There Are Several Policies And Procedures In Place To Help Ensure That Taxpayers Know How, When, And Where To File Taxes Owed

Tax Administration emphasizes fairness and clarity in tax policy and tax information. The Division's methods address taxpayer problems with current laws, as well as making taxpayers aware of new laws or changes in existing laws that may affect them. The Division also gets input from taxpayers and other divisions within the Comptroller's Office relating to tax policy and information. A detailed operations manual provides staff with specific instructions and guidance for most aspects of the taxpayer education function. The various input and established procedures help ensure fairness and clarity.

Tax Administration operates a phone bank to answer taxpayer questions. The telephone bank is organized into "gates" which direct the call to the appropriate Comptroller personnel. There are five tax teams made up of tax specialists. Each team has a primary tax area (gate) and acts as backup for two other gates. Calls are accumulated using a "stroke count," by type of tax or problem, to help ensure that sufficient personnel are available to handle the calls. The gates can be changed to allow for special issues or to put more personnel on a particular gate. When there is a question the specialist cannot answer, the question is referred to a Resource Group, comprised of subject matter experts. Calls are monitored by each tax team's supervisor and the Customer Service section to help ensure accuracy and consistency of information.

The Comptroller has taken steps to address the need to increase the staff in order to handle the number of phone calls. Statistics maintained for the phone bank indicate that it did not meet many of its goals during our test period of January 1994 through March 1994. The primary problems related to time taken to answer calls and the number of callers who hung up before a specialist got to their call. This was the result of the phone bank being understaffed during that period. However, during May 1994, staff was transferred from the Enforcement Division. These staff, once trained, should enable the phone bank to reduce call waiting and the number of calls not completed.

Recurring or unusual questions or issues are passed on so that needed tax information can be communicated to all applicable taxpayers or needed tax policy can be made. The stroke totals may indicate problems with a particular tax or issue. Routine meetings of specialists may also identify problems with specific tax requirements or issues. These issues are communicated to taxpayers through mailouts or are referred to committees to be addressed.

There are three committees made up of representatives from several divisions, which help ensure that all aspects of a tax issue are considered.

- Tax policy questions are routed to the Taxpayer Response Committee. This committee, which has members from the Tax Administration, General Law, and Audit Divisions, makes formal responses to taxpayers. Taxpayer satisfaction with written responses is measured through a survey. If sufficient law, policy, or precedent does not exist, questions go to the Tax Policy Committee.
- The Tax Policy Committee has members from Tax Administration, General Counsel, the Hearings process, General Law, Audit, Enforcement, and Revenue Estimation. Input from many sources, including industry groups and other states, is considered by this committee. There is a very formal approval process for tax policy decisions that includes at least the Deputy Comptroller.
- The Tax Forms Committee evaluates tax forms for clarity and conformity. This committee consists of staff from Tax Publications, Tax Administration, Enforcement, Audit, Revenue Processing, Revenue Accounting, Account Maintenance, Applications Systems, Computer Services, and Warehouse Operations.

A practitioners liaison group, which is made up of practitioners and industry representatives, is involved in almost all tax policy matters. This group meets quarterly with representatives from the Tax Administration, Property Tax, Audit, Enforcement, Legal, and Revenue Estimating Divisions. There are also subcommittees that meet more often. This group provides input from their perspective on tax legislation, rules, policies, processes, and forms.

Other types of communication to taxpayers include mailouts and seminars. A monthly newsletter deals with problems and changes that affect large numbers of

taxpayers. For new taxes or law changes that expand the coverage of current taxes, the Tax Administration Division will review existing tax data bases to identify potential affected taxpayers. A mailing is sent to these taxpayers so that they can determine if they are affected. Information packets for each type of tax are available upon request. All mail outs, except the monthly newsletter, are routed through phone bank personnel for input. This helps ensure that the information is clear and that the phone bank personnel will give up-to-date information. There is also a formal approval process for mailouts. Seminars are conducted by Tax Administration to educate taxpayers, practitioners, or Comptroller staff on problems or changes. An individual seminar's effectiveness is measured through a class survey.

Section 1-B:

The Taxpayer Education Process Could Be More Efficient With More Formalized Procedures

More formalized procedures could produce efficiencies in several areas of the taxpayer education function. Tax Administration should consider formalizing the following procedures:

- A standard procedure to quantify issues could achieve efficiencies by not processing issues with limited impact. Problems identified in the phone bank or other areas are discussed within the groups and with others as needed. Supervisors make the decisions to recommend providing tax information through mailouts. The review and approval process for publications would likely determine if there were issues being forwarded that did not merit that level of treatment. However, a standard procedure to quantify issues by dollar or number of taxpayers affected might prevent issues with limited impact from being sent to Information Services. This could create efficiencies by not spending Information Services' resources on limited or narrow issues.
- A more extensive checklist of required procedures could create efficiencies by not involving the Tax Policy Committee before the issue is fully developed. There is a limited checklist of required procedures before issues are passed on to the committee. The reviews before an issue goes to committee and the various perspectives included in the committee make it unlikely that a relevant source or procedure would be overlooked. However, a more extensive checklist could create efficiencies by ensuring that the issue is fully developed before involving the committee. The checklist would also ensure that different sections did not duplicate efforts in developing the issue.
- A formalized listing of criteria for tax form content and design would further ensure the quality and ease of use of tax forms. Each division on the Tax Forms Committee is assigned certain areas to review. This process helps ensure that no areas are overlooked. However, a formalized listing of criteria would further ensure that areas were not overlooked without being detected.

Criteria would also provide a training tool, in the form of a task list, whenever new staff are assigned to the committee.

Recommendation:

More formal procedures for quantifying issues, developing tax policy issues, and revising tax forms should be implemented.

Management's Response:

***Tax Administration:** Suggestions from Tax Assistance supervisors are not the major source of information for taxpayer/practitioner publications. Rather, the editor of our taxpayer and practitioner newsletters gathers information from Comptroller Hearings Decisions, taxpayer correspondence, Tax Policy Committee (TPC) decisions, court cases, proposed and adopted rule changes, legislative changes, Tax Assistance supervisors, and internal and external surveys. In most cases, the possibility of far reaching implications (on tax revenues or numbers of taxpayers) is known when Hearings Decisions, TPC decisions, judicial decisions, rule changes, or legislative changes are made. These are obvious candidates for disclosure in a newsletter.*

However, the link is not as well established with calls received through the phone bank. To that end, subject matter experts in the phone bank have begun tracking frequently-asked questions. Each month, the four or so most asked questions will be summarized for the benefit of employees. In addition, a copy of the summaries will be sent to the newsletter editor. This will ensure that topics affecting larger numbers of taxpayers are included in future newsletter editions.

In the past year, Tax Policy Committee procedures were revised to ensure that issues brought before the Committee were fully developed. This process has been very effective. However, in light of the comment regarding the need for a more extensive procedural checklist, the checklist has been revised to more fully detail the issue submission process.

Tax Administration is one of several divisions on the Tax Forms Committee. Each division independently scrutinizes each form for items that are peculiar to that division, although there may be some overlap. In response to the comment that a formalized list of criteria for tax form content be developed, Tax Administration has developed a forms review checklist.

We should also make the point that not all decisions are based on dollars to be collected. Some tax publications are prepared to help industries with specific tax problems, as a taxpayer service and to boost voluntary compliance.

Auditor's Follow-up Comment:

In order to determine the impact on taxpayers or tax dollars, a process to evaluate the most frequently asked questions would be more efficient than automatically forwarding a set number. Efficiencies could be achieved by not forwarding issues with limited impact.

Section 2:

Revenue Processing Has Effective And Efficient Procedures To Deposit Funds And Process Returns

Processing of tax payments and returns concentrates on getting the dollars deposited as quickly as practical. Approximately 66 percent of tax dollars are received through electronic funds transfers directly into the Treasury. Multiple mail pick ups and deposits are made each day. Extensive automation is used in processing. Mail receipts of \$4,000 or more are separated for priority processing. On average, priority checks are deposited within nine hours of receipt, and routine checks are deposited within 24 hours. Processing times are monitored to ensure that funds are deposited in a timely manner.

Section 2-A:

Tax Payments And Returns Are Processed To Ensure That Dollars Are Deposited As Quickly As Practical

Electronic funds transfer payments account for 66 percent of total revenue deposited. The other taxes and fees collected are received through the Revenue Processing Division. For fiscal year 1994, the monies deposited through electronic funds transfer and through Revenue Processing were \$14.3 billion and \$7.4 billion, respectively.

Processing of tax payments and returns received through the mail concentrates on getting dollars deposited as quickly as practical. Mail is picked up three times each morning during peak periods and twice during non-peak periods. There are at least four deposits each day. Receipts of \$4,000 or more are separated for priority processing. Priority checks are deposited within an average of nine hours. Routine checks are deposited within 24 hours on average.

Automation is used extensively to speed up the process. Automation opens and pre-sorts the mail by reading magnetic codes on remittance documents and optic codes imprinted on return envelopes. Remittance processing devices combine the functions of microfilming, batching, and remittance entry into a single operation. This enables one person to perform the functions of several people. Optical scanning equipment reads the data on the returns. The accuracy of the scanners is very high, reading 94-95 percent of all characters. Those characters that cannot be read are automatically videoed for manual identification.

The processing time is a major concern and is monitored in several ways. There are meetings at the same time every day during peak periods for status reports from each section within Revenue Processing. Each section will report the number of returns and checks processed or being processed to monitor progress and help prepare the next section in the process. Revenue Processing samples receipts twice a month to determine the time it takes for a check to be deposited. The judgmental samples cover both peak times and non-peak times. Average time to deposit is calculated for both priority checks and routine checks. The deposit requirements for both audit and enforcement field offices are monitored for compliance through field office evaluations.

There are special planning meetings before peak periods each month to ensure efficiency. These meetings are used to determine if any procedural changes or adjustments are needed from the last peak period, the number of seasonal hours needed by each area, and if there are any other changes that affect the peak period.

Procedures are in place to protect receipts during processing. There is strong physical security over the revenue processing function. Card keys are required to gain entrance to the Revenue Processing area. Additionally, 28 video cameras are located throughout Revenue Processing. Revenue Accounting also reconciles recorded deposits to data in the system to ensure that all receipts are accounted for. The net activity is reconciled to the transactions in the tax system.

Section 2-B:

The Comptroller's Office Is Addressing The Need To Integrate Taxpayer Data Bases And Speed Up Deposits From Field Offices

The Integrated Tax System project will address the need for one integrated tax system. The scope of this project is to rewrite the nearly 30 different tax systems into one integrated tax system. This will help eliminate the need to learn so many different tax systems and will make it easier to access taxpayer information. Additionally, not keying the same information into the different systems will create efficiencies and reduce the potential for errors.

This project will also reevaluate possible cheaper and quicker processes of depositing dollars collected by the field offices. Currently, the enforcement and audit field offices are using a courier to deliver the monies collected to the Austin headquarters. Monies received after the pick-up time are secured in a safe and sent to Austin the next day. The prior revenue audit suggested depositing the money in local banks and wiring the money to Austin. This option and others will be investigated, with recommendations expected in the spring of 1995.

Section 2-C:

There Are No Controls At The Comptroller Level To Ensure That State Agencies And Universities Properly Collect And Report Sales Tax

Because state entities do not file sales tax returns, the Comptroller cannot ensure that state agencies and universities properly collect and report sales taxes. The tax return form provides some assurances by specifying the period covered, discounts, penalties, and local government allocations. This provides a way to identify errors in the calculation or allocation of taxes and to identify penalties due.

While these sources account for only about one-tenth of one percent of total sales taxes, there could be significant problems in deposited amounts. Our survey of universities noted several that were making "catch up" payments, but did not determine if applicable penalties were being paid. In many cases, the Comptroller's staff has to allocate sales tax deposits among local governments because the state agencies and universities do not indicate the allocation on their deposits. This is an inefficient use of the Comptroller's staff and does not ensure that the correct local government gets credit. An internal audit at one university indicated that penalties were not paid on sales taxes not previously collected and that some sales taxes were credited to the wrong local governments.

The current tax return system cannot process returns from state agencies and universities. State agencies and universities make multiple deposits every month in order to get monies into the Treasury as quickly as possible. The current automated processing system cannot handle multiple deposits for one return.

Recommendation:

The Comptroller should develop procedures for processing tax returns from state agencies and universities. Consideration could be given to requiring only the larger state entities to file returns. Twenty-three state agencies and universities account for 90 percent of all sales taxes collected by state entities.

Management's Response:

Current law requires state agencies to deposit sales tax collections within three business days. This is done under USAS and this activity report (Form 73.113) takes the place of a sales tax return. At the end of the month, the Comptroller's office accumulates the data from all agencies and prepares a combined monthly report. While there may be some late payments, the Constitution forbids payments to be made from the Treasury except pursuant to a specific appropriation. This would appear to make the penalty and interest issue moot. We will work through our USAS program and special tax seminars to better educate state agencies and universities on the proper reporting and allocation of local taxes.

We will also investigate how returns for State agencies and universities can be processed through the Integrated Tax System.

Section 3:

The Revenue Audit Function Focuses On Maximum Dollar And Risk Coverage, But Could Bring In More Net Revenue By Adding Auditors; Additional Monitoring Tools Would Help Ensure Effectiveness

The audit function concentrates on identifying high-dollar and high-risk audits while maintaining high-quality audits. This has resulted in increased audit billings, or assessments, well in excess of projections and performance measures. Audit selection procedures ensure that the highest dollar taxpayers and taxpayers with a history of poor compliance are audited. Additional audits are based on various indicators of potential productivity, or high-dollar return for the cost of the audit. Audits receive extensive reviews. The organization, audit programs, and training all contribute to effective and efficient audit services.

Significant additional revenue over costs could be generated by increasing the number of auditors. Our analysis indicates that additional auditors could assess seven times the related costs. If only 50 percent of these assessments are actually collected, these additional auditors would still return cash of three and one-half times their cost. This would result in approximately \$13 million if the total number of auditors were increased to 550. The Texas Performance Review came to a similar conclusion in 1991. Funds were appropriated for additional auditors beginning in 1992, but the number of auditors has not been increased.

The audit function is actively monitored. Field offices are effectively evaluated, and the overall Audit Division is evaluated on productivity, performance measures, and required management reports. Most performance measures are based on assessments per direct audit cost. However, capturing and monitoring actual collections from audits and the percentage of penalties waived would help identify when changes are needed or justify when changes have been beneficial. More formal comparisons of field office productivity and coverage could also help staffing decisions.

Section 3-A:

The Revenue Audit Function's Procedures And Policies Concentrate On Maximum Dollar And Risk Coverage While Ensuring Quality And Consistent Audits

The audit function has exceeded most projections and goals for tax billings, or assessments. Over 15,000 audits were performed in fiscal year 1993, resulting in tax deficiency assessments of \$491 million. This represents \$16.54 in assessments for each dollar of direct audit costs. Assessments are amended when additional records or information are provided. Historically, around 70 percent of assessments remain after amendments in the review and appeals process within the audit division. The

amount of actual collections related to these assessments is not captured by the current system.

Audit selection procedures put emphasis on large dollar and high-risk taxpayers. Audits are chosen at two levels, the headquarters level and the field office level. Priority I audits and prior productive taxpayer audits are selected by headquarters and performed by field offices. Priority I taxpayers pay 65 percent of the total sales and use taxes collected and are audited every four years. Prior productive audits are on taxpayers that have had deficiencies greater than \$10,000 in prior audits. Headquarters also generates rankings of taxpayers and other information for use by the field offices in selecting additional audits.

The field offices identify potential auditees through various means and select the most potentially productive audits. An experienced auditor is assigned to risk rank potential audits and select each field offices' Priority II audits. Potential audits come from spin offs from other audits and leads provided by auditors, enforcement officers, newspapers, and other publications.

The audits receive extensive reviews. Audit supervisors and/or field office managers are required to make field visits and review all audits. The audits are then sent to one of two regional processing centers for detailed reviews. This review helps ensure the quality of audits and consistency between field offices.

The Revenue Audit Division's organization, manuals, and training help provide effective and efficient audit services. The Audit Division has 21 field offices located throughout the State and in four major cities outside Texas. This helps provide timely audits, recognize potential productive audits, and maintain an audit presence to help encourage voluntary compliance. Audit procedures are well documented to help ensure the quality of the audits. Audit manuals contain detailed procedures for various tax types. The manuals are currently being put on disk for easier access and revision. The auditors are adequately trained to provide quality audit services. Applicants are required to have college degrees with 24 hours in accounting. New revenue auditors complete 668 hours of training in the first 30 months of employment. Over 400 hours of training are available above basic auditor training.

Section 3-B:

Additional Revenue Auditors Would Produce A Net Increase Of Revenues Over Costs

Our analysis indicates that increasing the number of tax auditors to 550 would generate \$13 million in additional revenue over costs yearly. We calculated that auditors assess approximately \$7.00 after amendments for each dollar spent, including indirect costs. Assuming only a 50 percent collection rate, additional auditors could be expected to produce \$3.50 for every dollar spent. Our analysis excluded assessments and costs related to Priority I and prior productive audits, since additional auditors could not increase the number of these types of audits.

The analysis was based on the current average auditor's effectiveness on in-state audits. It did not take into account the time needed for new auditors to become at least as effective as the average auditor or the training costs in the first year. However, we felt these factors would be offset by the placement of new auditors in the most productive field offices. The average auditor's effectiveness used in our analysis, was decreased by the less productive field offices. Additional auditors would not be assigned to these less productive field offices. Other factors also contributed to our analysis resulting in a conservative calculation of the return on cost.

Funds were appropriated beginning in fiscal year 1992 for additional revenue auditors, but the number of auditors has actually decreased slightly. The Texas Performance Review report, *Breaking the Mold*, recommended adding 50 auditors and enhancing the audit select function. To implement these recommendations, the Legislature appropriated \$2.559 million for each of the 1992 and 1993 fiscal years. However, while approximately 50 auditors were hired each year, it only covered the loss of auditors through attrition. The actual number of revenue auditors decreased from 518 at the end of fiscal year 1991 to 485 at the end of July 1994. The funds appropriated for additional auditors remain unexpended and have been moved forward to fiscal year 1995 as part of the Comptroller's unexpended balances.

This decrease in auditors combined with a significant increase in the number of taxpayers and tax dollars have decreased audit coverage. Therefore, fewer auditors must cover more taxpayers or tax dollars. From the beginning of fiscal year 1990 through fiscal year 1993, the number of audits per taxpayer declined 15.5 percent, and the number of auditors per tax dollar declined 26 percent. Additionally, the Comptroller was given the responsibility to audit several additional taxes during fiscal year 1994. A decrease in coverage could have a negative impact on voluntary compliance over time.

The training program may have to be increased to permit the processing of ample new hires to increase the net number of revenue auditors. There are training limitations on hiring auditors, but the training program was decreased in fiscal year 1994. Over 50 auditors attended basic auditor training classes during fiscal years 1992 and 1993. However, only 21 attended the one basic class held in fiscal year 1994. Attendees in fiscal year 1994 primarily represented the 20 auditors transferred from the Texas Alcoholic Beverage Commission when the Comptroller's Office took over the related audits.

Recommendation:

The net number of revenue auditors should be increased to at least 550 in order to generate additional tax revenue, comply with legislative intent, and enhance voluntary compliance. While tax assessments have increased over projected amounts, additional auditors would further increase tax revenue. Periodic analysis should be performed to determine if there would continue to be substantial benefit to increasing the audit staff further.

Management's Response:

The Audit Division did add 40 new auditors in September, 1994. We anticipate additional resources to meet or exceed the 550 auditor staffing recommendation as a result of our future development and implementation of the Integrated Tax System.

Section 3-C:

The Revenue Audit Function Is Actively Monitored, But Additional Monitoring Tools Would Help Ensure The Audit Function's Effectiveness

Customer satisfaction surveys are sent for each audit to get taxpayer perceptions of the audit experience. These surveys help ensure equity and quality of service by field auditors. Every survey response is reviewed and followed up on if needed.

Field office evaluations are conducted to help ensure that audits are properly supervised and that audits and personnel are properly managed. Specific criteria have been developed to use in the field office evaluations. The evaluation covers workload review, field visitations, audit inventory control, resource planning, audit quality, travel, audit selection, personnel development, salary administration, performance appraisals, and auditor time reports.

The overall Audit Division's performance is evaluated based on performance measures and management reports. These measures, which concentrate on deficiencies assessed, provide a sound foundation for evaluating the audit function. These measures are determined on a variety of bases, such as by field office, in-state and out-of-state audits, and by auditors.

There are some other monitoring tools that would be of help in ensuring the audit function's effectiveness. Formal analysis of actual dollars collected, field office staffing, and waiver rates could indicate problem areas. The actual dollars collected should be captured. While deficiencies assessed can be an effective measure of audit productivity, certain decisions can only be made based on the "bottom line" of the actual dollars collected. The return on cost of auditors cannot be adequately determined without the actual dollar benefit to the State for each dollar spent conducting the audits. Additionally, Audit Division performance data does not include all costs associated with performing tax audits and ultimately collecting the revenue. Comparing collections to all costs associated with establishing deficiencies and collecting the tax would provide a more accurate performance measure of actual return for dollars expended. A drop in the collection rate might be an indication that procedures need to be reviewed to determine why fewer dollars assessed are being collected. Increases in the collection rate might also provide support for changes made or new procedures implemented.

Comparisons of audit field offices' performance and coverage in relation to optimum staffing should be formally analyzed. There is a need to balance field office staffing

levels based on productivity and coverage. A certain level of coverage is believed necessary to maintain high levels of voluntary compliance with tax laws. However, there are no formal comparisons of field offices' productivity and coverage ratios, such as the number of taxpayers to the number of auditors and to the number of audits. The best comparisons would be net of Priority I and prior productive audits since these are required. Additionally, out-of-state audits conducted by in-state field offices should not be included since these audits could be done from any field office and do not increase coverage in the region. These types of comparisons could improve staffing decisions so that productivity is increased while coverage is maintained at a reasonable level. For example, our test work indicated that one field office that had low productivity and high coverage had four new auditors assigned during fiscal years 1992 and 1993. This field office would have still maintained at least average coverage without the additional auditors, which could have been assigned to more productive field offices.

The rate at which penalties and interest are waived should be captured. The prior revenue audit noted that 41 percent of penalties were waived, and an additional nine percent were partially waived. Accumulating and monitoring the waiver rate will provide information to management for decision making. For example, increases in the rate could indicate a need to review procedures to determine why more penalties are being waived. Decreases in the rate could also support changes or new procedures.

Recommendation:

The Comptroller should implement procedures to capture and monitor audit collections and waiver rates. Additionally, formal comparisons of field office productivity with field office coverage should be considered in staffing decisions. These comparisons should be net of Priority I, prior productive, and out-of-state audits.

Management's Response:

We agree that actual dollar collections would be beneficial information. The current data architecture and tax applications do not lend themselves to a possible, much less efficient manner to retrieve this information. This problem should be corrected with the completion of the Integrated Tax System (ITS). We will capture and monitor waiver rates.

The Audit Division did complete an analysis in August, 1992 to review staffing levels in each office as part of a territory realignment project. This same type analysis has been used previously, and will continue to be used in future staffing decisions. Formal documentation will be maintained in this area in the future. This type analysis will also be improved with the completion of the ITS project. Obtaining the data on numbers of taxpayers and reported amounts from all the various tax systems constitutes a large project for our programming staff. The rewrite of the tax systems

will alleviate this problem. We have also requested approval to use an intern to formulate a model to be used in staffing decisions.

Reference is made that one office had four new auditors assigned during fiscal years 1992 and 1993 that had low productivity and high coverage. It is our understanding the comparison used in this situation eliminated Priority I, Prior Productive, and out-of-state audits to determine the productivity and coverage rates. I see this as a useful comparison to make in determining core amounts, productivity, and availability.

Section 4:

The Comptroller Is Studying Ways To Increase Efficiencies In The Hearing Process, Called Redeterminations, To Address The Dramatic Increase In Cases; However, A System Also Needs To Be Developed To Capture Reliable Financial Information

The Comptroller is studying the caseload problems in the hearing process. Instances where the taxpayer has challenged audit results or other tax liabilities are processed through the Comptroller's formal tax resolution hearings process. The number of cases in the hearing process has increased from 764 in September 1991 to 2,125 in May 1994. The Comptroller is conducting a study to determine the causes and make recommendations to address the case load problem.

The reported dollar amount of redetermination cases is unreliable because the data base which tracks these cases was not designed to accumulate related financial information. The financial information is now used to report redeterminations in a footnote to the State's financial statements. The reported dollar amount related to these cases totaled \$742 million in May 1994. However, the methods used to record financial data do not necessarily identify dollars potentially subject to collection upon completion of the hearing process. Our tests of case data indicate that the dollar amount of potential collections could be less than half the reported amount. Additionally, that figure includes amounts related to drug cases where there is considerable doubt as to the State's ability to collect.

Section 4-A:

There Has Been A Dramatic Increase In The Number Of Cases In Tax Redetermination Hearings, And The Comptroller Is Studying The Issue

The number of cases in tax redetermination hearings has dramatically increased. These cases represent instances where the taxpayer has challenged audit results or other tax liabilities. The number of cases in the hearings process has increased from 764 in September 1991 to 2,125 in May 1994. The number of cases per judge has increased from 139 in 1991 to 337 in 1994. Our tests indicate the average case closed in 1994 was in the hearing process 20 percent longer than the average case closed in

1989. This increasing trend will probably continue since many current cases have been in the hearings process longer than the average of those cases closed in 1994.

The Comptroller has taken a proactive approach to this potential problem by conducting an extensive study. The study was conducted by the Renaissance Hearing Team. The resulting report should be published shortly. The study covered the sources and some possible solutions to the increased work load. The objective was to "recommend changes that would ensure an equitable and uniform application of the law in a cost-efficient and expedient manner." Much of the work was directed toward identifying ways to decrease the number of cases in the process and getting cases through the process faster.

Recommendation:

The study should be completed, and the recommendations should be seriously considered. The sooner cases are resolved, the sooner any funds due the State are collected.

Management Response:

We agree with this recommendation.

A new audit dispute resolution process may decrease the number of new hearings cases. The new Dispute Resolution Conference process is increasing the number of audit issues resolved before going to the formal redeterminations process. The Audit Division has implemented a new procedure where dispute resolution officers attempt to settle disputed audits prior to the formal hearings process. There has been a reported 13 percent decline in formal hearings in the field offices where this program has been piloted. This compares to a 39 percent increase in hearings overall. We understand that the program is currently being implemented in all field offices.

Section 4-B:

The Dollars Reported Are Unreliable Because The Data Base Was Not Designed For Accumulating Financial Data

The redeterminations data base does not accurately accumulate the dollar amount uncollected. The data base was designed as a tracking system and was never intended to provide the type of financial information currently being reported. Also, since the hearing process does not use the dollar figures, little effort is expended to ensure accuracy. While not necessary for the redetermination process, cumulative financial information is needed for financial reporting and state decision makers. It would appear to be more practical to revise the current data base than develop a new system to capture this information.

Our tests indicate that the actual amount of potential collections may be less than half the reported amount. The data base indicated that \$742 million in redeterminations existed in May 1994. We tested all cases greater than \$4 million and a sample of 22 other cases. The 32 large dollar cases were originally reported at \$369 million, and we determined that only \$210 million represented potential collections. The 22 small dollar cases were reported at \$8 million and actually represented only \$3 million of potential collections. The projected results of our sample would indicate that only \$350 million of potential collections are involved in the hearings process.

There are several reasons that the amount included in the data base does not always reflect the actual amount uncollected:

- The taxpayer's statement of grounds on which they are appealing the tax liability and the related auditor's response are not very specific. In several cases in our sample, the required statement of grounds from the taxpayer did not detail the reason the taxpayer disagrees with the tax assessment. Additionally, the required auditor response did not provide this detail. It is difficult to determine the correct amount to record in these cases.
- The amount set up in redeterminations is supposed to be the amount of tax assessment that has not been paid as of the petition for redeterminations. Collections after that time are not entered into the system.
- Redeterminations include refunds sought for taxes already paid. Our samples included several cases reported in redeterminations that were actually refunds. We reviewed eight large dollar redetermination cases closed in 1994. The reported redetermination amount was \$124 million, but the net result was \$15 million refunded. This is a \$139 million swing from the perceived amount of potential revenue to the actual loss of funds.
- We also noted duplications of cases in the redeterminations data base. When there is more than one individual or company involved, each may be assigned as a separate case. Each case would report the total amount. Additionally, the same company with more than one hearing case sometimes reports the total amount in each case.
- Cases relating to illegal drugs are reported with redeterminations without recognition of their unique status. The State has little control over the processing of these drug cases or the collection of these liabilities. One case reported at \$46 million has been on hold since 1990 because the defendant cannot be found.

Recommendation:

The Comptroller should develop a system to capture financial information on redetermination cases, or revise the current data base as follows:

- The amount included in the data base should reflect the actual amount uncollected as closely as practical. The procedure should be to enter the amount uncollected, and update the amount for subsequent collections.
- The taxpayer's statement of grounds and the related auditor's response should be more specific. If statements of grounds are not specific enough to identify the amount in dispute, the taxpayer should be required to redo them. Auditor's responses should be more specific regarding the effect of the grounds questioned by the taxpayer.
- Refunds of taxes already paid and cases relating to illegal drugs should be reported separately from uncollected tax liabilities. Tax refunds are accumulated separately and are reported separately in the State's financial statements. However, these cases are included in the redeterminations amounts also, especially if the same company has a redetermination case pending. The total redetermination amount related to illegal drug cases should be indicated so that decision makers are aware of the effect that these types of cases have on totals reported.

Management's Response:

As stated above, the tracking system was not designed to accurately report financial data, but rather to serve as a basis for tracking the status of inventory in the hearings process. However, we agree that it may be necessary to present more accurate financial information for reporting purposes. We will investigate the options available to us; whether it means revising the current data base or developing new systems to capture more accurate information.

Section 4-C:

Procedures For Updating The Data Base For Various Transactions Are Not Formally Documented

The redeterminations data base has no formal documented procedures. The documentation currently in use is information passed on by the previous employee. There are no controls built in to ensure that the correct financial information is entered and maintained. There is little understanding of the effect current procedures have on financial information. For example, when cases are closed, the original amounts are replaced with the end results. This prevents the data base from being used to determine historical information or to analyze information such as the percentage of potential dollars collected or lost. This has not been a priority since this information has little impact on the tracking objective, for which the system was originally designed.

Recommendation:

Procedures for updating the data base should be documented. Since the reported amounts are used outside the hearing process, there should be specific procedures required to help ensure that the information is as consistent and reliable as practical. There could be other uses identified for the financial information, including use as a monitoring tool, if the information is accumulated correctly and protected from loss or errors.

Management's Response:

Procedures for updating the data base will be documented.

Section 4-D:

Applying Payments First To The Original Tax Liability Cost The State Revenue By Delaying Receipt Of Interest Payments

The State loses money when taxpayers pay the tax liability but not the related interest on cases in redetermination. One case in our sample involved a company that paid an estimated \$17 million in taxes due after an audit, but protested the \$1.7 million penalty. The related \$8 million in interest was not protested, but still not paid. Under current administrative rule, payments apply to the tax first.

Since interest will not accumulate on interest owed, there is an incentive for the company to not pay the interest until the redetermination process is complete. If the State applied payments to interest first and the tax liability second, the company would have had to pay the full \$25 million tax and interest up front or owe the State additional interest on the \$8 million tax not paid. The State would have earned an additional \$381,000 in interest on this one case in 1994 had this proposed rule revision been in effect.

Recommendation:

The Comptroller should consider changing the administrative rule to apply payments to interest owed first.

Management's Response:

Consideration will be given to changing the administrative rule.

Section 5:

The Enforcement Division's Procedures Focus Its Efforts On Collecting The Most Dollars Practical

The Enforcement Division's primary focus is collecting as much delinquent tax dollars as practical. Generally, high-dollar accounts are processed by field offices while low-dollar accounts are handled centrally through phone contacts. A total of \$443.5 million in delinquent taxes was collected in fiscal year 1994.

Section 5-A:

The Enforcement Division's Emphasis Is On Collecting The Large Dollars First, While Still Processing Small Dollar Accounts Timely

The Enforcement Division's procedures help ensure dollars will be collected as quickly as practical. All taxpayers who do not pay their taxes when they file their returns and those who stop filing returns are downloaded to and are prioritized through the Automated Collection System. All accounts are processed in order of decreasing liability.

Large-dollar accounts are processed by field offices. Each field office can set up their own prioritization scheme. For fiscal year 1994, the 184 field enforcement officers that work on cases and collect delinquent taxes brought in a total of \$308 million. This amounted to \$1.7 million per enforcement officer.

The Enforcement Division monitors the aging of taxpayer accounts by cases and dollars. The aging reports are generated monthly for headquarters, but almost weekly for the field offices. However, the priority is still on the high-dollar accounts. Once the high-dollar accounts are covered, a field office would start accessing aged accounts. The first priority would be chronic delinquent taxpayers which need to be educated and brought to a current status.

The Automated Collection Center (Center) processes the low-dollar accounts. In most cases, the Center gets any account under \$5,000. Most low-dollar accounts, which make up a large portion of the older accounts, are handled through the Center and phone campaigns. The Center's total collections in fiscal year 1994 were \$135.5 million.

Accounts are never declared uncollectible. If balances remain uncollected when cases are closed on Enforcement's system, a balance due remains on the individual tax system. Accounts over \$500 that cannot be collected are turned over to the Attorney General's Office for further collection efforts.

Section 5-B:

The Enforcement Division Has Increased Collections By Contracting The Work In The Automated Collection Center

Collections have increased by contracting 40 to 45 individuals to process the low-dollar accounts. Previously, 32 account examiners fulfilled this function. Due to the contractor's inexperience, they are only collecting on sales tax and they are only notifying taxpayers that there is a tax liability. Account examiners were trained to answer questions and help with account problems. However, because the contracted individuals are spending limited time with the taxpayer, they are accessing three times as many taxpayers as before. Accessing more cases has brought in more dollars. There has been a 42 percent increase in the amount of delinquent monies collected.

The contractors are evaluated by the quality of their work as well as collection statistics. The manager and supervisors of the Center monitor phone conversations to ensure that the callers are following collection procedures and providing accurate and consistent information.

The impact of the Center's new procedures on the other areas of the Enforcement Division is still unknown. Contracting this function started in May 1994. Since then, any questions or problems identified during a phone conversation between the caller and taxpayer have been forwarded to the field offices. In addition, the Center is accessing more accounts than they have in the past. While the impact on the workload of other areas has not been completely evaluated, there should be a positive impact on taxpayer education due to the transfer of account examiners to the phone bank function.

Section 5-C:

The Enforcement Division Is Continuously Monitoring Its Performance On A Statewide Basis And By Field Office Region

The Enforcement Division uses the automated collection system to identify dollars collected per dollar cost. This allows them to see how efficient their processes and procedures are.

On a statewide basis, System Administration monitors workload, inventory, and performance. Field office service areas are reviewed twice a year to make necessary territorial adjustments. This is done to help even workload and coverage among the field offices.

Management support does a management evaluation on the field managers and the field offices. They evaluate the field office and the field managers on performance (planning and organization, directing, controlling, and standards and ethics) and personnel management.

Section 6:

The Comptroller Has A Productive Non-Filer Identification Section Whose Effectiveness Could Be Enhanced By Concentrating On Only Identifying Non-Filers

The Revenue Opportunity Program (Program) could be more effective if identifying non-filers was its only objective. The Program's current objectives are to identify taxpayers who have not filed returns and bring them into compliance. The Program has been able to capture costs directly linked to the operation, which began in July 1991. For fiscal year 1994, the Program collected \$18.3 million. The Program could identify more non-filers by focusing on that objective and letting other divisions bring new taxpayers into compliance.

Section 6-A:

The Program Has Developed Some Effective Techniques For Identifying Non-Filers

The Program has worked with other organizations and purchased data bases to help identify non-filers. They have worked with the Federal Aviation Administration, Coast Guard, Texas Parks and Wildlife Department, State Bar of Texas, Texas Employment Commission, and the Texas Department of Insurance. For example, the Comptroller's Office bought the list of attorneys from the State Bar of Texas to identify taxpayers of the new attorney fee. They have also arranged for periodic updates from the State Bar. Industry sources or industry-specific magazines have also been used to identify possible non-filers in industries like satellite programmers.

The Program has conducted cost-benefit analyses on various techniques and has concentrated on the most cost beneficial techniques. The dollars collected per hour expended on the technique is used to quantify the benefit. Several techniques have been delayed while more profitable techniques are pursued.

Section 6-B:

The Program Could Be More Effective By Letting Other Divisions Bring New Taxpayers Into Compliance

The Program's current objectives are to identify new taxpayers and bring them into compliance. In order to bring taxpayers into compliance, the Program provides the enforcement, audit, and collection function for most of the new taxpayers identified through its efforts.

The Program could be more effective by focusing its efforts on only identifying additional taxpayers. Having more resources dedicated to the process of identifying new taxpayers would result in more techniques being fully developed and implemented. This would identify more non-filers and increase overall revenues. Additionally, transferring the audit, enforcement, and collection duties to the

personnel who perform these functions on a full-time basis would likely result in efficiencies in these areas.

Recommendation:

The audit, enforcement, and collection functions should be transferred from the Revenue Opportunity Program to the appropriate sections, and the Program should concentrate on identifying non-filers. A method to relate collections to this Program would be necessary for cost-benefit analysis.

Management's Response:

We understand the theory of increasing efficiency by separating the functions of this group. Our current approach gives the taxpayer one person to contact with their questions and problems while they are learning how to comply with their obligations as a new taxpayer. Once the taxpayer is permitted and in compliance their account is no longer handled by the Revenue Opportunity Group. If this group is unable to bring the taxpayer into compliance, the taxpayer is referred to a field audit group or enforcement group to bring the taxpayer into compliance.

We will also be allocating more staff to this program with the implementation of the Integrated Tax Information System. This will increase overall revenues by identifying more non-filers.

This page is intentionally blank.

Objective, Scope, And Methodology

Objective

Our audit objective was to evaluate the effectiveness of control systems essential to the tax revenue management function at the Office of the Comptroller of Public Accounts. The evaluation focused on identifying opportunities to enhance the effectiveness and efficiency of the Comptroller's revenue process, which accounts for over \$17 billion annually. This process includes educating taxpayers, processing deposits and returns, auditing returns, hearing tax liability disputes, enforcing delinquent accounts, and identifying non-filers.

This audit also satisfies the statutory requirement for a biennial audit of the effectiveness of the Comptroller's revenue audit function.

Scope

The scope of this audit included consideration of controls over the revenue process, potential related issues, performance measures, and organizational structure in the revenue process. In addition, a follow-up was performed on the recommendations from the prior revenue audit.

The consideration of controls focused on policies and procedures, including evaluation systems, that help ensure effective and efficient operations. This consideration included a review of controls over the revenue process, with specific emphasis on the audit function. The revenue process consists of the following functions:

- Taxpayer education
- Payments and returns processing
- Audit
- Hearings, including filing liens
- Enforcement
- Identification of non-filers

Additionally, controls over the following specific areas or issues were reviewed:

- Additional taxes the Comptroller became responsible for during the 1994 fiscal year
- Taxes collected and remitted by local governments, especially courts
- Sales taxes collected and remitted by state entities, especially meal plans at universities

We also analyzed the following potential issues:

- Are there adequate interfaces with other agencies which monitor and/or regulate taxpayers?
- What is the impact of increased caseload and dollars in the redeterminations hearings process?
- Would adding more revenue auditors create significant financial benefits for the State?

We considered performance measure information in evaluating the effectiveness of various divisions in the revenue process. We conducted limited tests of the accuracy of and controls over this information.

The consideration of the Comptroller's organization focused on the current structure's ability to produce expected services.

All recommendations from the prior revenue audit, *A Review of the Comptroller's Revenue Management Process* (SAO Report No. 3-015, November 1992), have been followed up on. All recommendations have been addressed, are in the process of being implemented or studied, or are integrated into recommendations in this report.

Methodology

The methodology used on this audit consisted of collecting information, performing audit tests and procedures, analyzing the information, and evaluating the results against pre-established criteria.

Information collected to accomplish our objectives included the following:

- Interviews with members of the management and staff of the agency
- Interviews with staff members of the House of Representatives and the Legislative Budget Office
- Documentary evidence such as:
 - Selected state statutes and regulations
 - Various management reports
 - Performance Measurement Reports - fiscal year 1993 and year-to-date fiscal year 1994
 - Office of the Comptroller of Public Accounts documents, memoranda, and publications (including the current strategic plan, Texas Performance Review reports and working papers, operating manuals, and 1993 Annual Cash Report)
- Agency-generated data such as:
 - Audit selections by reason/source
 - Assessments associated with Priority I and prior productive audits
 - Taxpayers per field office
 - Uses/sources of information from other state agencies
 - Cases in redeterminations hearings

- Tax collections by local governments
- Sales tax collections by state entities
- Aging reports
- Third-party information from:
 - Universities
 - Other states
 - Texas Higher Education Coordinating Board

Procedures and tests conducted:

- Calculation of return-to-cost for type audits that could be increased
- Comparisons of audit field offices' productivity and coverage
- Test of dollars reported in redeterminations to case files
- Comparison of reported redetermination amounts to actual results of closed cases
- Comparison of time in process for closed cases in 1989 and 1994
- Test of revenue fluctuations within local funds
- Comparison of local taxes with statutory references
- Comparison of sales tax collections between similar size universities
- Survey of universities to determine sales taxes collected

Analysis techniques used:

- Control review
- Trend analysis
- Review of performance measures
- Fluctuation review
- Comparisons of common attributes

Criteria used:

- Marginal Productivity Theory
- Performance measures
- Other states
- Other standard audit criteria established prior to the beginning of fieldwork

Fieldwork was conducted from June 1, 1994, through September 16, 1994. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

There were no significant instances of noncompliance with these standards.

The audit work was performed by the following members of the State Auditor's staff:

- Worth S. Ferguson, CPA (Project Manager)
- Robert E. Campbell, CPA
- Michael Doerr
- Kimberly R. Emmerich
- Robin R. Key, CPA

- Monday N. Rufus, CPA
- Paul H. Hagen, CPA (Audit Manager)
- Craig D. Kinton, CPA (Director)

Appendix 2:

Background Information

Appendix 2.1:

Agency Profile And Financial Information

The Office of the Comptroller of Public Accounts' mission is, in part, "to serve the people of Texas by applying the tax and fiscal laws fairly and consistently."

The Comptroller's primary responsibilities include maintaining effective methods for accounting for the State's funds, administering and collecting the majority of the State's tax revenue, and performing research and compiling statistics necessary for revenue estimating and certification. The administering and collecting of the State's tax revenue was the focus of this revenue audit.

The Comptroller's Office collects over 95 percent of state taxes. The following are some of the larger dollar taxes collected by the Comptroller (shown in millions):

Type of Tax	FY 94 (A)	FY 93 (A)	FY 92 (A)	FY 91 (A)
Sales Tax	\$9,810	\$9,122	\$8,552	\$8,256
Motor Fuel Taxes	2,171	2,086	1,953	1,509
Motor Vehicle Sales/Rental Taxes	1,617	1,421	1,220	1,073
Franchise Tax	1,261	1,193	1,090	597
Insurance Occupation Taxes (B)	767			
Natural Gas Production Tax	554	683	497	663
Oil Production Tax	362	492	513	689
Other Taxes (C)	798	543	537	524
Total Tax Collections	\$17,340	\$15,540	\$14,362	\$13,311

Note (A): based on amounts reported in the Comptroller's 1994 Cash Report

Note (B): collected by the Texas Department of Insurance in prior years

Note (C): includes portions of the Alcoholic Beverages Taxes and Cigarette and Tobacco Taxes, which were collected by other agencies in prior years

The revenue process is primarily performed by two sections within the Comptroller's Office. A description of the related functions is provided below:

Tax Administration

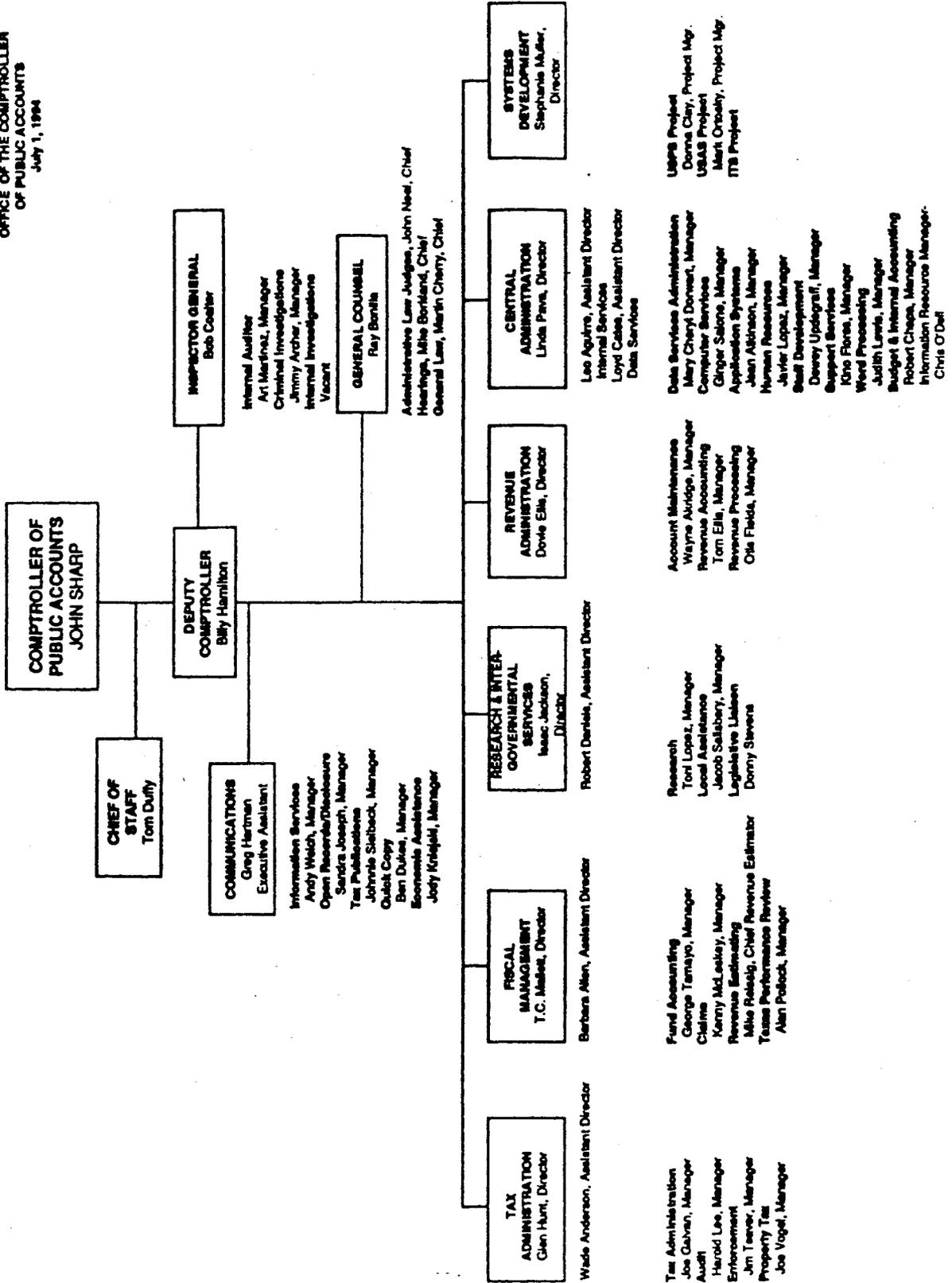
Tax Administration consists of the Tax Administration Division, Audit Division, Enforcement Division, and Property Tax Division. This section is responsible for educating taxpayers who want to voluntarily comply with tax requirements. In addition, they enforce the laws through audits, the collection of delinquent taxes, and the identification of non-filers.

Revenue Administration

Revenue Administration consists of the Revenue Processing Division, the Revenue Accounting Division, and Account Maintenance Division. This section is responsible for depositing and processing the tax and fee payments and returns. They are also responsible for maintaining the taxpayer's accounts.

Appendix 2.2:
Organizational Chart

ORGANIZATION OF THE
OFFICE OF THE COMPTROLLER
OF PUBLIC ACCOUNTS
July 1, 1994



Reference List

The reports listed below are relevant to the tax revenue issues included in this report:

State of Texas, Office of the Comptroller of Public Accounts. *Breaking the Mold: New Ways to Govern Texas*. 1991.

_____. Office of the State Auditor. *A Review of the Comptroller's Revenue Management Process*. 1992.

_____. Select Committee on Tax Equity. *Rethinking Texas Taxes*. 1989.

Copies of this report have been distributed to the following:

Legislative Audit Committee

Honorable James E. "Pete" Laney, Speaker of the House, Chair
Honorable Bob Bullock, Lieutenant Governor, Vice Chair
Senator John Montford, Chair, Senate Finance Committee
Senator Kenneth Armbrister, Chair, Senate State Affairs Committee
Representative Robert Junell, Chair, House Appropriations Committee
Representative Tom Craddick, Chair, House Ways and Means Committee

Governor of Texas

Honorable Ann W. Richards

Legislative Budget Board

Sunset Advisory Commission

Comptroller of Public Accounts

John Sharp, Comptroller
Billy Hamilton, Deputy Comptroller
Bob Coalter, Inspector General
Art Martinez, Internal Audit Manager
Glenn Hunt, Director of Tax Administration
Dovie Ellis, Director of Revenue Administration