

TO: MTC Strategic Planning Steering Committee
FROM: Compliance Work Team
SUBJECT: Recommendations for Compliance Goal Work Projects
DATE: October 1, 2012

Background

The Steering Committee asked the Compliance Work Team to develop recommendations for a project or projects that will enhance the MTC Audit Program to help the MTC achieve its compliance goal. The Work Team met in Grand Rapids, MI, on August 2 and 3, 2012. The team followed up with a telephone conference call on September 21, 2012.

The Compliance Work Team identified the following ways that the MTC Audit Program provides value to the states:

- Reach and scope: the MTC Audit Program supplements states audit resources
- Return on investment: the MTC Audit Program has a favorable ratio of cost to results
- Making connections: the MTC Audit Program enhances the connections between the states, and between the MTC auditors and state staff
- Consistency: the MTC Audit Program supports consistent audit policy development and audit practices

During the Grand Rapids meeting and shortly thereafter, the work team identified 17 possible projects to help improve the effectiveness of the MTC Audit Program. The work team evaluated those projects using six criteria:

- Non-cash benefit to the states (examples are training, connections and consistency).
- Amount of resources needed to complete a project.
- The difficulty or complexity of the project or implementation of a result.
- The effect of the project on the timeliness or efficiency of the audit process.
- The "ROI" or impact of the project on the level of audit assessments, or the quality of audit recommendations.
- The impact a project would have on taxpayer behavior or ease of compliance.

The work team members rated all of the possible projects using all six criteria, to help them select no more than three projects to recommend to the Steering Committee. The committee discussed the five projects that ranked the highest using the rating criteria. Those five projects were:

1. Conduct a comprehensive review of the audit nominating process.
2. Develop a process and standards for an MTC auditor to make a "no change" determination before preparing a complete audit report for all states participating in an audit.
3. Improve the exchange of information between the states and the MTC Audit Program.
4. Study the potential value of selecting some multistate audits for a "limited scope" audit for selected issues only.
5. Determine the value of having MTC auditors conduct follow-up or "second cycle" audits if material issues are likely to appear in tax returns filed after commencement of an MTC audit.

The Work Team selected the first two of these projects to recommend to the Steering Committee.

Summary of Recommendations

Detailed descriptions of the two projects being recommended are at the end of this report. Following are highlights of the two projects.

Audit Nominating Process

The current audit nominating process requires a minimum of five months and in some cases eight months to complete. The committee believes this process should be streamlined to more efficiently and more quickly secure a list of audit candidates. Also, the current process does not always result in a list of candidates that are of interest or value to a significant number of states. This project would review both the steps in the nominating process and the criteria that are used to develop and consider audit nominations that are placed in inventory.

Who should be involved: This project should involve representatives from the states and MTC audit program staff and IT staff from the states and/or MTC.

Possible Measures: the work team also identified some possible measures to evaluate the impact of changes in the audit nominating and selection process. Those measures are: time for processing audit nominations; quality of audit nominations (number of states indicating priority for the candidates, audit participation rates, state perception of benefit received); reduction in number of audits with few or no adjustments recommended.

Early “No Change” Determinations

Current audit procedures require that the MTC auditors complete a full audit report for every state that participates in a multistate audit. At the conclusion of some audits, there may be one or more states for which there are no audit adjustments proposed, or the proposed adjustments are minor. This project would develop criteria and procedures for the MTC auditors to make a decision early in the audit process whether any adjustments will be proposed for a participating state. After an early “no change” decision, the auditor would not be required to complete a full set of workpapers for the affected state or states.

Who should be involved: This project should involve representatives from the states, the MTC audit staff and taxpayers.

Possible Measures: the work team identified these possible measures to evaluate the impact of an early “no change” audit determination. Those measures are: savings of audit time or costs; reduced time per audit; savings of taxpayer audit review time; savings of state audit review time.

Next Steps

The Compliance Work Team members are available to answer any questions you have about these projects. The work team members also recommend that the Steering Committee seek input from the Audit Committee members on the scope and focus of these projects.

Respectfully submitted,

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Project description: Audit Nominating Process Review

This project would involve a comprehensive review of the process for nominating audit candidates.

Problems: The current nominating process takes anywhere from 5-8 months to complete. There are several stages of the process that take significant amounts of time. These include: state submission of detailed data about nominees; the voting process; and the scheduling of an Audit Committee meeting to finalize the audit inventory. In addition, the current audit nominating process does not always produce audit candidates that will be of high value to a significant number of states.

Risks: Time delays in the nominating process create the risk of losing audit years to statutes of limitations, or at least create the need to ask taxpayers for waivers. Time delays in the nominating process can tie up audit resources and preclude spending time on other audits. Time delays can create a risk that there won't be sufficient audits in inventory to have sufficient work for audit staff until a new nomination process can be conducted. Time delays also create risks that states will not participate in audits. When audit nominations are not of high value to a significant number of states, fewer states participate and MTC auditors do not spend their time in the most productive ways.

Issues for review:

- Should the nominating process be conducted on a different time sequence?
- Would it be possible to create an electronic repository of state tax returns to evaluate potential audit issues for nominations, and improve the pool of potential audits?
- Are there any other efficiencies in the process that could be achieved using technology?
- How might information about issues that could affect large industry groups or significant taxpayers be used to improve the pool of possible audit nominees?
- How effective were the changes that were made to the nominating process within the last two years? Have there been any unexpected effects (e.g., audit inventory too small)?
- Should MTC audit staff be involved in providing information about audit candidates during the nominating process? If so, how?
- Should the nominating process or criteria be different for Sales/Use tax versus Income tax?

Expected outcomes from the project:

- Streamlined nomination process that would take no longer than 120 days to complete.
- Recommendations for improving the quality of the pool of audit nominees.
- Recommendations for quality indicators for the audit pool.
- Describe the process steps or stages that could be made more efficient by using technology, or using it differently.

Who should be involved in the project:

- Audit Committee
- MTC Audit Staff
- IT person (from MTC or the states)

Project description: Early “No Change” Decision

This project would involve development of a process and standards for an MTC auditor to make a “no change” determination for a state or states after commencement of an audit, but before the development of a complete audit report and without the need to prepare full audit schedules. The “no change” determination would end the audit process for the affected states.

Problems: When a large number of states participate in an audit, the MTC auditor must prepare a complete audit report for each participating state, even if the proposed adjustments are very small or no changes are proposed for one or more of the participating states. The current practice of preparing a complete audit report for each state regardless of the results of the audit adds a substantial amount of time to the audit process for little additional return. The auditor is not available to start a new audit until all reports are complete.

Risks: Auditors are delayed in starting new audits; states can lose years to statutes of limitation if cases wait in inventory too long. Auditors will not be able to maximize the value of their time, and the number of audits completed will be reduced. States and taxpayers spend more time reviewing audit workpapers that do not address material issues. One risk that the work team recognized for this kind of a project is that states may lose confidence in MTC audits if they don’t see completed work papers that explain an early “no change” determination.

Issues for review:

- Should the MTC Audit Program have a procedure and standards for auditors to make an early determination, before completing a full set of audit workpapers, that there is very little or no change to the tax returns for a participating state?
- Do any states have legal constraints that must be considered in determining materiality or the documentation required for a tax audit?
- What standards should be applied to determine whether an MTC auditor can make, or recommend, a “no change” determination for a state during the course of an audit?
- Are there any existing MTC policies or procedures that would have to be changed if an early “no change” process is developed?
- If an early “no change” process is developed, should it be different in any way for Sales/Use tax from Income tax?
- Would a “no change” audit process affect state participation in audits? If so, how?
- What efficiencies (time or cost) could be obtained by using a no change process?

Expected outcomes from the project:

- Process by which MTC auditors can make an early “no change” determination and communicate that to participating states.
- Standards for making an early “no change” determination.

Who should be involved:

- MTC Audit staff
- Audit Committee members
- Taxpayer representative