<u>Project: Audit Nominating Process:</u>

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.

Risks: These and other 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.

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.
- Describe the process steps or stages that could be made more efficient by using technology, or using it differently.

Who should be involved:

- Audit Committee
- MTC Audit Staff

Rating from scoring matrix – 13 points

- Non-cash benefit/value: 1.3 - Low
- Resources to complete: 2.5 - Low
- Difficulty of project: 2.7 - Low
- Effect on timeliness or efficiency of audit process: 2.9 - High
- Return on investment: 2.2 - Moderate
- Impact on taxpayers: 1.4 - Low

<u>Project: Early “No Change” Decision</u>

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 <u>before</u> 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 every participating state, even if the proposed adjustments are very small or no changes are proposed. The current process 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.

Issues for review:

- Should the MTC Audit Program have a minimum standard for the dollar value of adjustments for each state participating in an audit?
- What standards should be applied to determine the threshold amount for an MTC auditor to make a “no change” determination for a state during the course of an audit?
- Are there any existing 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?

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

Rating from scoring matrix – 14.8 points

- Non-cash benefit/value: 2.1 - Moderate
- Resources to complete: 2.8 - Low
- Difficulty of project: 1.9 - Moderate
- Effect on timeliness or efficiency of audit process: 2.8 - High
- Return on investment: 2.7 - High
- Impact on taxpayers: 2.5 – Moderate to high

Project: Improve Exchange of Information between the States and MTC Audit Program

This project would involve identification and development of best practices for sharing information between the states and MTC audit program staff. The specific focus of the project would be information needed by auditors to conduct joint audits on behalf of the states.

Problems: Auditors sometimes receive conflicting information about unpublished audit policy or practice from multiple sources within a single state.

Risks: Without accurate, up-to-date information, audit adjustments may be wrong; auditors may miss appropriate adjustments; auditors may spend too much time researching applicable law and policy; audits may be delayed or take more time than necessary to complete; states may have to “redo” parts of an audit; taxpayer cooperation and respect for MTC audits may suffer.

Issues for review:

- What practices or tools will improve the timeliness, accuracy and completeness of communication between the states and the MTC auditors with respect to joint audits?
- Identify best practices among the states that have high quality, consistent and timely internal communication.
- Are there any simple protocols that can be used (such as who to keep advised on communications about a joint audit within the state) to assure accurate and consistent technical advice from the states to MTC auditors?
- Are there technology-enabled communication tools that could be used to increase the effectiveness of communication between the states and the MTC audit staff?

Expected outcomes from the project:

- Communication practices that support timely, accurate and complete information exchange during the audit process
- Information exchange tools that provide timely access to data needed to conduct or complete a joint audit

Who should be involved:

- MTC Audit staff
- State Audit Committee members

Rating from scoring matrix – 12.9 points

- Non-cash benefit/value: 2.9 - High
- Resources to complete: 1.9 - Moderate
- Difficulty of project: 2 - Moderate
- Effect on timeliness or efficiency of audit process: 2.5 Moderate to high
- Return on investment: 2 - Moderate
- Impact on taxpayers: 1.8 - Moderate

<u>Project: Limited Scope Audits</u>

This project would involve studying the potential productivity gain and efficiency potential of selecting some multistate audits for a "limited scope" audit (audit only for selected issues). The project would also involve development of criteria and standards for selection of audit candidates and issues for limited scope audits, and development of procedures for conducting limited scope audits. <u>Note:</u> this project could be combined with either the "second cycle" or "early no change" projects.

Problems: In some audit nominations, there may be only a few significant issues identified by the nominating state(s). As a result, the audit may not be placed in inventory. If the audit is placed in inventory, it may be given a low priority. Finally, if the audit is placed in inventory and initiated, a significant amount of auditor time may be spent on insignificant or immaterial issues.

we could do a limited scope audit and this would be established at the start of the audit. The states and the MTC auditors would be on the same page as to what the scope and expectations of the audit are. The scope could be expanded if other large potential dollar issues are found.

Risks: Other significant issues might be missed in a limited scope audit. States might be reluctant to participate in limited scope audits.

Issues for review:

- Should the MTC Audit Program have a procedure for identifying audits that would be conducted on selected issues only?
- Would a pool of "limited scope" audits allow more efficient use of auditors' time?
- What standards should be applied to identify the issues to be reviewed in a limited scope audit?
- Are there any existing policies or procedures that would have to be changed if a "limited scope" audit process is developed?
- If a limited scope audit process is developed, should it be different in any way for Sales/Use tax from income tax?

Expected outcomes from the project:

- Standards for "limited scope" audit selection and audit plans.
- Process for "limited scope" audit selection, audit procedures and reports.
- Identification of expected productivity or efficiency gains from limited scope audits.

Who should be involved:

- MTC Audit staff
- Audit Committee members

Rating from scoring matrix: 13.4 points

- Non-cash benefit/value: 1.6 - Low
- Resources to complete: 2.3 - Moderate
- Difficulty of project: 2.2 - Moderate
- Effect on timeliness or efficiency of audit process: 2.3 - Moderate
- Return on investment: 2.6 - High
- Impact on taxpayers: 2.4 - Moderate

Project: Second cycle audits by MTC

This project would involve review of the value of having MTC auditors conduct “second cycle” audits or review of tax returns filed by a taxpayer while an audit is underway to identify and address material issues identified during the initial audit that would likely be present in the subsequent years.

Problems: Some audits take a long time to complete and the taxpayer has continued to file returns in the meantime, often taking the same audit positions as the years under audit. Current practice appears to be that “second cycle” audits (for tax years that follow a group of years audited by MTC) are left to the states to initiate. This may not happen, or if the states initiate follow up audits, the taxpayer must manage multiple auditors and audit visits.

Risks: Taxpayers may resist having additional years added to an MTC audit. Audits might take longer to complete. MTC auditors might conduct fewer audits over time.

Issues for review:

- What is the likelihood that material issues addressed in an audit will carry over to tax years that immediately follow the audit years?
- Could MTC auditors identify and propose changes for material issues in the “second cycle” more efficiently and effectively than the states?
- What effect would second cycle audits have on taxpayers?
- Are there any existing policies or procedures that would have to be changed if MTC auditors looked at tax returns for years immediately following the years reviewed in an initial audit?
- Are there differences between income tax and sales/use tax audits or issues that would require different standards or procedures?
- What effect might second cycle audits have on the states’ ability to audit subsequent years for other issues?
- Should states that participate in a multistate audit have the option of opting out of a “second cycle” review?

Expected outcomes from the project:

- Standards for “second cycle” audits by MTC auditors
- Procedures for initiating and conducting “second cycle” audits by MTC auditors
- Identification of benefits and risks of “second cycle” audits by MTC auditors

Who should be involved:

- MTC audit staff
- Audit committee members

Rating from scoring matrix: 14.7 points

- Non-cash benefit/value: 2.0 - Moderate
- Resources to complete: 2.1 - Moderate
- Difficulty of project: 2.6 – Low
- Effect on timeliness or efficiency of audit process: 2.4 - Moderate
- Return on investment: 2.9 - High
- Impact on taxpayers: 2.7 - High