Department of Revenue

Financial Audit
Fiscal Year 1994 Statewide Audit

April 1995

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

95-12

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
612/296-4708

Department of Revenue

Financial Audit
For The Year Ended June 30, 1994

Public Release Date: April 14, 1995 No. 95-12

Objectives:

- Evaluate Internal Control Structure: Tax assessments, collections, or refunds for individual and corporate income taxes, withholding taxes, insurance premium taxes, gasoline and special fuel taxes. Grant payments or credits for local government aids, homestead and agricultural credits, and renters property tax credits.

- Test compliance with certain finance-related legal provisions.

Conclusions:

We found five areas where the internal control structure needed improvement:

- The department does not adequately review certain withholding tax information.

- Edits used to detect overclaimed corporate taxes are not properly secured.

- Processing controls over sales tax remittances need improvement.

- Sales tax system design weaknesses have not been resolved.

- The department's review of insurance premium tax returns is insufficient.

We found one departure from finance-related legal provisions:

- Penalties and interest on electronic funds transfer tax payments are not assessed.

Contact the Financial Audit Division for additional information.
296-1235

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Matthew Smith, Commissioner
Department of Revenue

Audit Scope

We have completed a financial related audit of the Department of Revenue for the year ended June 30, 1994, as outlined below, and as further discussed in the Introduction. We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we consider the internal control structure in order to plan our audit, and that we perform tests of the department's compliance with certain material provisions of laws, regulations, and contracts. However, our objective was not to provide an opinion on the internal control structure or on overall compliance with finance-related legal provisions.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

Revenues:
- individual income and withholding taxes;
- sales taxes;
- corporate income taxes;
- gas and special fuel taxes;
- insurance premiums taxes;
- inheritance and estate taxes;
- document registration taxes;
- alcohol beverage taxes;
- tobacco taxes;
- pull tabs and charitable gambling taxes;
- health care access taxes; and
- petro tank cleanup fees.

Expenditures:
- individual, corporate, and property tax refunds;
- local government aid;
- homestead/agricultural credit aid.
- police and fire state aid; and
- disparity reduction aid.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Management Responsibilities

The management of the Department of Revenue is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and
- transactions are recorded properly on the statewide accounting system in accordance with Department of Finance policies and procedures.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusions

Our study and evaluation disclosed the conditions discussed in findings 1 and 3 through 6 involving the internal control structure of the Department of Revenue. We consider these conditions to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in financial statements.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we reported to the management of the Department of Revenue in a meeting held on March 22, 1995.

The results of our tests indicate that, except for the issues discussed in findings 2, 3, and 6 with respect to the items tested, the Department of Revenue complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that the Department of Revenue had not complied, in all material respects, with those provisions.

This report is intended for the information of the Legislative Audit Commission and management of the Department of Revenue. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 14, 1995.

We thank the Department of Revenue staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 27, 1995

Report Signed On: April 11, 1995

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Ken Vandermeer, CPA	Auditor Supervisor
Janet Knox, CPA	Senior Auditor
Mary Annala, CPA	Senior Auditor
Christina Weiss	Senior Auditor
Geniene Herrlich	Senior Auditor
Todd Baumgartner	Auditor Intern

Exit Conference

The findings and recommendations in this report were discussed with the following officials of the Department of Revenue at the exit conference held on March 22, 1995:

Matthew Smith	Commissioner
John Lally	Deputy Commissioner
Don Trimble	Assistant Commissioner
Dwight Lahti	Assistant Commissioner
Bev Driscoll	Assistant Commissioner
Steve Kraatz	Director, Revenue Accounting
George Hoyum	Director, Special Taxes
Larry Trimble	Director, Petroleum Tax
Jean Jochim	Revenue Accounting
Jim Maurer	Director, Internal Audit
Steve Krovitz	Auditor, Internal Audit
Stan Radosevich	Auditor, Internal Audit
Carole Wald	Income Tax System Manager
Vicki Dickinson	Supervisor
Larry Wilkie	Director, Sales and Use Tax
JoAnne Furey	Withholding
Dave Cline	Data Management
Kathleen Stewart	Director, Corporate Franchise Tax
Leaane Martin	Corporate Accounting
Dennis Louis	Director, Document Processing

Introduction

The Department of Revenue is responsible for providing administrative and enforcement services in the areas of tax collection and assessment. The department serves individuals and organizations required to pay taxes to the state and local governments. The department is undergoing a re-engineering process that started in fiscal year 1990. It placed a renewed emphasis on educating taxpayers on the tax requirements through various methods of taxpayer services and communications.

The department operated under the direction of Morrie Anderson in fiscal year 1994. In December 1994, the Governor appointed Matthew Smith as the acting commissioner.

The financial activity of the department during fiscal year 1994 is summarized in the following table:

Department of Revenue
Financial Activity
Fiscal Year 1994

Revenues:	
Income taxes	$4,023,655,832
Sales taxes	2,594,457,653
Corporate taxes	614,095,855
Gas and special fuel taxes	477,364,717
Insurance premium taxes	148,386,880
Inheritance and estate taxes	43,803,311
Document registration taxes	103,110,827
Alcohol beverage taxes	56,138,982
Tobacco taxes	142,534,778
Pull tabs and charitable gambling taxes	57,534,840
Health care access taxes	53,524,603
Petro tank cleanup fees	63,064,954
Other receipts	121,996,548
Total	$8,499,669,780
Expenditures and Tax Refunds:	
Individual refunds	$ 451,540,034
Property tax refunds	164,783,022
Corporate refunds	64,573,380
Local government aid	291,172,875
Homestead/agricultural credit aid	423,134,310
Police and fire state aid	43,996,392
Disparity reduction aid	32,215,734
Other expenditures	261,056,236
Total	$1,732,471,983

Source: Estimated/Actual Receipts Report, Fiscal Year 1994 and the Managers Financial Report, Fiscal Year 1994.

Current Findings and Recommendations

1. PRIOR AUDIT RECOMMENDATION: The Department does not adequately review certain withholding tax information.

Withholding tax information submitted by employers is not compared to certain information on file with the department. Without this comparison, the accuracy of information submitted by employers is subject to question. The department needs to improve its annual reconciliation process. It does not investigate some withholding tax amounts overclaimed or review an employers wage detail for taxpayers submitting electronic data. In addition, wage detail submitted by employers is not compared to wage detail submitted by employees for electronic or paper returns.

Currently, employers withhold income taxes from employee payroll and submit the withheld amount to the department for deposit. Employers submit withholding taxes on a special form authorized by the department (MW-5 coupon) or through special wire transfer methods. The amounts submitted are supposed to be actual taxes withheld. The department verifies the amount deposited to the MW-5 coupon or wire transfer reports and records the information onto its computer system. The department also requires employers to submit quarterly MW-1 reports. This information is also recorded onto its computer system. The quarterly MW-1 report summarizes the employer's withholding and depositing activity. Computer edits identify any differences between the quarterly reports and the actual payments (MW-5 coupons or wire transfers). The department resolves the discrepancies and makes the necessary adjusting entries.

In response to our prior year audit recommendation, the department made minimal progress towards improving the annual reconciliation procedures. During fiscal year 1994, the department compared amounts reported on the annual returns (MW-3) to the quarterly returns and identified differences exceeding $500. However, the department only verified amounts posted and did not investigate amounts overclaimed for taxpayers submitting electronic data. The department did not review wage detail submitted electronically by employers. The department did not compare wage detail submitted by employers to wage detail submitted by employees for electronic or paper returns. This is an arbitrary review process and is not based on a systematic approach designed to reduce the risk of erroneous information.

The department also requires employers to submit annual MW-3 reports that reconcile withholding tax submitted for the calendar year. However, we discovered that the department could not account for approximately 5,000 or five percent of the MW-3 reports for calendar year 1993. The department could compare the population of withholding filers to annual reconciliations received, but has not done this for several years. As a result of the control issues raised, the department cannot ensure that adequate safeguards are in place to detect certain cases where additional taxes may be due or refunds may be payable.

Recommendation

- *The Department of Revenue should establish appropriate control procedures over the review of withholding tax information.*

2. PRIOR AUDIT RECOMMENDATION: Penalties and interest on Electronic Funds Transfer (EFT) tax payments are not systematically assessed.

The department does not consistently identify and assess penalties and interest against taxpayers that submit a late tax payment using the EFT payment method. Currently, penalties and interest are imposed only when a manual review identifies late payments. This manual review does not subject the entire population of EFT filers to a systematic review process. Thus, the department cannot assure that taxpayers are complying with the EFT statutory requirements. In addition, the department has not penalized taxpayers systematically for failing to submit taxes using EFT when required by statute.

During our testing, we noted tax payments paid beyond the due date, but processed as if they were timely. Inconsistent recording of the date a taxpayer submitted payment contributed to this issue. The department should assess late payment charges on all tax types as discussed in Minn. Stat. Section 289A.60, Subd. 1 and Section 270.75. Under Minn. Stat. Section 270.07, the department initially waived the enforcement of the interest and penalty charges for late payments from January through October of 1992. It waived charges based on the need for taxpayers to become familiar with the new reporting requirements.

Since October of 1992, when the department removed the waiver, the EFT processing section has tried to manually determine if payments are beyond the due date. However, because of the large number of EFT filers, it is difficult to review a significant number of transactions. Furthermore, the department has not formally assigned the responsibility to detect late EFT payments. The department should assign responsibility to either the EFT section or to each tax processing area to identify late payments. The number of taxpayers required to use the EFT method will increase substantially by fiscal year 1995. The increase is attributable to a reduction in the minimum annual tax liability threshold required to identify EFT filers. The anticipated increase in filers will make manual detection of late payments even more cumbersome.

Minn. Stat. Section 289A.26, Subd. 2a, requires businesses with an annual tax liability of $240,000 or more to submit their tax payments using EFT. Minn. Stat. Section 270.78 imposes a penalty of five percent on taxpayers failing to file using EFT. This statute was amended to allow a taxpayer to file a paper return instead of a EFT return if received three days prior to the EFT deadline. The department has not determined the level of compliance with this statute.

Recommendation

- *The department should review its process for determining and assessing penalty and interest on late EFT payments as required by Minn. Stat. Sections 289A.60, Subd. 1, Section 270.75, and Section 270.78 .*

3. Edits used to detect overclaimed taxes on corporate returns are not properly secured.

The department does not record the disposition of error messages displayed for adjustment filter detail identified by system edits in the taxpayer accounting (TPA) system. Minn. Stat. Section 289A, Subd. 4, requires the department to charge corporations interest on the underpayment of estimated taxes. The department records payments in the taxpayer accounting system after various processing edits verify the accuracy of data.

The department does not record actions taken to resolve system edits designed to detect various inconsistencies identified in the taxpayer history file. The edit displays an error message on the operator's terminal that prompts an action to correct the error. The computer program allows employees to either delete the message or make a correcting entry. The system does not currently record or log error messages that operators bypass. In addition, adjustments made by operators to resolve the error message are not linked to individual taxpayer files. Operators should enter a notation to explain the purpose of the adjustment. However, a link to the error message is not provided by the system, and operators do not always provide sufficient notation to link the transactions. Both instances result in inadequate audit trails. Until the department addresses this problem, it cannot ensure that adequate safeguards are in place to detect cases where additional taxes may be due or refunds may be payable.

Recommendation

- *The department should ensure that audit trails through history files exist for actions taken to resolve error messages for corporate tax .*

4. Processing controls over sales tax remittances need improvement.

Sales tax remittance posting errors were not resolved timely, and incomplete consolidated returns delayed processing which affected local government distributions. In addition, the department does not use their sequential numbering system to resolve unclaimed deposits.

The department did not promptly correct unclaimed deposits in the TPA system. As of June 1994, the department had approximately $ 215,537,414 in unclaimed deposits. This amount represents seven percent of the approximate $3 billion collected in annual sales tax revenues. The sales tax system processes the taxpayer remittances and returns. The sales tax system attempts to match the remittances with the appropriate return. If the system does not match the remittance to a return within five days, an unclaimed deposit occurs.

To correct unclaimed deposits, the department contacts taxpayers through demand notices. The demand notice requests a copy of the taxpayer's return for a specific period. In January 1995, the department sent demand notices for the October 1993 through September 1994 returns. Delayed mailings of demand notices affect the distribution of sales tax collections to local governmental units. Untimely resolution of unclaimed deposits limited the department's ability to measure the share of local governmental distributions. Minn. Stat. Section 297A.44, Subd. 44, requires that the distribution be made based on the actual amount received.

The local distribution is also affected by processing errors encountered from incomplete consolidated returns. The new computer system does not properly process consolidated returns; it requires manual review and data entry. A taxpayer files a consolidated return when conducting business at more than one location. A consolidated sales tax return consists of a summary form and individual location forms. The total of all location forms should agree with the summary form. However, the department experienced a high incidence of errors resulting in the input of erroneous data. This affects the distribution of funding for local governments. The current year local government funding is not based on the current year data, but rather the prior year distribution.

Controls over incoming sales tax remittances also need improvement. The department currently uses a prenumbered system to identify the forms mailed to the taxpayer. The numbers are preprinted on the sales tax return and sales tax remittance stub. However, the prenumbered system was not used to identify outstanding receipts or unclaimed deposits because of the high incidence of errors that occurred. Additionally, the department does not require taxpayers to record the preprinted number on the remittance. Resolution of gaps in the sequence of preassigned numbers provide control when remittances are matched to returns, therefore reducing the number of unclaimed deposits. The department could use the current system to match remittances to returns, if taxpayers would record the prenumbered form on their remittance.

Recommendations

- *The department should resolve posting errors for unclaimed deposits and consolidated returns in a timely manner and properly distribute funds to the appropriate accounts.*
- *The department should use its prenumbered system to properly match remittances with taxpayer returns.*

5. Sales tax system design weaknesses have not been resolved.

The Profile system has several weaknesses affecting data integrity, such as improper record retention, improper computer access, and nonexistent summary logs. The department recently installed an optical scanning system to process sales tax returns and remittances. The information obtained through the optical scanning system feeds into the sales tax system (Profile), the taxpayer accounting (TPA) system, and the computerized accounting collection system (CACS). Incorrect data in the Profile system affects the accuracy of data in the TPA system and CACS.

The department destroyed the original documentation that supported sales tax returns from October 1993 through January 1994, and remittance stubs from October 1993 through March 1994. The department relied on the accuracy of the new optical scanning system to document sales tax reported by the taxpayer. The department felt it was not cost beneficial to keep the original sales tax return or a microfilm copy of the return after the department implemented the optical scanning system. The new system optically scanned and processed the documents and created an electronic image. The department encountered problems with the scanned data such as duplicate payments, taxpayer education issues, data entry errors, and printer problems. An electronic image is an acceptable substitute when system design weaknesses are reduced to an acceptable level. The department did not fully test the system and prove its accuracy, yet it proceeded to destroy the original documents. Minn. Stat. Section 138.17 states the department must receive prior approval from the Records Disposition Panel before the destruction of records. The department had not obtained prior approval before the destruction of the sales tax documents.

The department does not adequately limit access to the Profile system. For instance, the department does not provide inquiry access without the ability to alter data maintained in the system. Employees with access to the Profile system can enter data into any taxpayer account. The department believes allowing all employees to update taxpayer files is time efficient and cost beneficial. The Profile system is an on-line system. Any data entered into the system, either intentionally or accidentally, automatically updates the taxpayer's file. An employee could alter amounts recorded as penalties, interest, and taxes due. The system currently uses menus to limit users to types of transaction entries they can enter. The system does record the employee who made changes or adds data to the taxpayer's file. However, the restriction of inquiry only is not currently used by the department. There are numerous sales tax transactions, and the chances of finding error transactions are remote. A fundamental control over the integrity of data is maintained by limiting access to the computer system.

The department does not utilize exception reports generated from system log capabilities to manage and control the accuracy and completeness of sales tax returns and remittances. System logs are important to summarize returns and remittances in the computer system. System logs document the total number and individual customer accounts requiring edits, adjustments, and activity in suspense files. Exception reports, generated from system logs for suspense files, could provide information regarding data, or files that have been added or deleted from suspense files, and the length of time in edit. Other system logs could be generated to document missing returns, duplicate returns, unclaimed deposits, and refunds adjusted by penalties. Such logs would be beneficial to promptly identify and correct errors in taxpayer accounts.

Recommendations

- *The department should maintain original documentation until records have been properly audited.*
- *The department should secure access to the profile system.*
- *The department should use exception reports generated from system logs to monitor processing activity.*

6. PRIOR AUDIT RECOMMENDATION: The department's review of insurance premium tax returns is insufficient.

Insurance premium tax audits conducted by the department have several weaknesses. First, we question the department's method used in selecting returns for audit. Minn. Stat. Chapter 270B classifies the criteria used to select returns for audit as protected nonpublic data. Therefore, we cannot disclose a detailed explanation of this weakness.

In addition, interest and penalty charges for late payments and underpayment of the tax liability are not properly assessed. Currently, the department only assesses interest and penalties on audited returns. State statutes direct the department to assess interest and penalties for returns that do not meet certain requirements. Interest and penalties help control the timely reporting and payment of taxes. Without proper enforcement, the effectiveness of the control diminishes.

Recommendations

- *The department should develop meaningful criteria for the selection of returns for audit.*
- *The department should charge interest and penalties for either late returns or underpayments.*

April 10, 1995

Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
1st. Floor, Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

The following are our responses to the findings and recommendations, concerning the Department of Revenue, that are contained in your FY'94 statewide audit report.

1. PRIOR AUDIT RECOMMENDATION: The Department does not adequately review certain withholding tax information.

Recommendation

- *The Department of Revenue should establish appropriate control procedures over the review of withholding tax information.*

DOR RESPONSE

We agree with this finding and would like to respond to a few different points.

In response to improving our annual reconciliation process, we have already taken measures to improve the process. Last year we only reviewed over claimed withholding amounts. Since the exit conference, we generated lists that include both over claimed and under claimed amounts. The current review process includes looking at both over claimed and under claimed amounts.

In addition, we acknowledge the importance of reviewing the electronic wage detail submitted by employers. Because this information would be useful to areas outside the Withholding Tax Division, it is not practical to design a database application to satisfy only the withholding enforcement efforts. We will consider the possibility of making this a department wide information systems project and work it in among all the other DOR priorities. We would add the paper W2 information to the system as well. When we successfully process the wage detail, a computer match of withholding amounts reported by employers against withholding amounts reported by employees is feasible.

Finally, in response to DOR not demanding unfiled MW-3s, we feel we have taken steps to alleviate this problem. Prior to calendar year 1994, our processing procedures for MW-3s made it unrealistic to demand the filing of these forms. However, during calendar year 1994, we improved the processing of MW-3s and can now demand, in manageable numbers, filing of missing MW-3s. We will use the MW-3 demand process initially as an education process for employers. We will stress the importance of filing, obtain the MW-3 and explain the penalties for future noncompliance. In future years, we will enforce penalties on repeat offenders.

2. PRIOR AUDIT RECOMMENDATION: Penalties and interest on Electronic Funds Transfer (EFT) tax payments are not systematically assessed.

Recommendation

- *The Department should review its process for determining and assessing penalty and interest on late EFT payments as required by Minn. Stat. Sections 289A.60, Subd. 1, Section 270.75, and Section 270.78.*

<u>DOR RESPONSE</u>

During the past year, the sales tax system has been corrected to accurately assess penalties and interest on EFT payments systematically. Change controls were completed, tested, and moved into production. We currently have one person reviewing the EFT bills daily for the sole purpose of educating the mandated sales tax filers to correctly file and pay sales tax.

Assessing penalties and interest on late EFT payments, during processing, is not currently feasible for withholding taxes, due to system limitations and the fact that the employers' payroll periods are not known when a deposit is received. This must be done post-processing in a manual mode. With limited resources, we will have to set some tolerances which will allow us to systematically focus on certain violators in both categories (paper and EFT).

3. Edits used to detect overclaimed taxes on corporate returns are not properly secured.

Recommendation

- *The Department should ensure that audit trails through history files exist for actions taken to resolve error messages for corporate tax.*

DOR RESPONSE

Further discussion with the Legislative Auditor determined that this recommendation focuses on the lack of a complete audit trail for TPA transactions which get identified as having a potential error condition. This process is identified as a "filter" process in TPA. We agree with the finding as long as DOR determines that the transactions are considered "high risk". It is not our intention to create a log or audit trail for every decision made in DOR. As part of this division's business plan, we envision revamping our filter process. We will take into consideration the need for a log to identify DOR actions on filtered accounts. This system modification is of course dependent on resource availability. In the interim, we plan on communicating to all employees that resolve filters, the importance to properly document any resulting adjustments using the "comment" field. We will also explore the possibility of employee manually keeping track of actions taken to resolve filters.

4. Processing controls over sales tax remittances need improvement.

Recommendations

- *The Department should resolve posting errors for unclaimed deposits and consolidated returns in a timely manner and properly distribute funds to the appropriate accounts.*

- *The Department should use its prenumbered system to properly match remittances with taxpayer returns.*

DOR RESPONSE

The large number of unclaimed sales tax deposits reflects the impact delays in processing and running demands can have. We agree that these two processes need to be given a higher priority. We realize that even if these delays are resolved, we will continue to have some unclaimed deposits. We will incorporate the identification of these unclaimed deposits in the redesign of our filter criteria. If resources are not available, we will explore the possibility of creating lists which will identify these credits. Revenue Accounting Division personnel will than be given the responsibility to resolve these credits.

It is true that the sales tax system could not properly process consolidated returns. However, we are currently in the process of addressing this problem.

We are currently exploring ways to use the prenumbered system to properly match remittances with taxpayer returns.

5. Sales tax system design weaknesses have not been resolved.

Recommendations

- *The Department should maintain original documentation until records have been properly audited.*
- *The Department should secure access to the ProFile system.*
- *The Department should use exception reports generated from system logs to monitor processing activity.*

DOR RESPONSE

The department has agreed to retain original filings until such time as scanning and optical storage design issues have been resolved to produce an acceptable electronic image and record. Destruction of records will be processed through the ProFile, Access & Security Division in conformity with Minn. Stat., Sect. 138.7.

The various modules of the reengineered sales tax system were not designed to limit access to inquiry only. The cost of rebuilding to create these limitations would be prohibitive. All users of the system have "a need to know" in their position descriptions. The users have been delegated the authority to make necessary changes. The design decisions were made to allow employees to serve taxpayers at the first point of contact, thus avoiding time consuming and costly hand-offs, up and down hierarchies, until someone with appropriate authorities was found to make a decision.

For the purposes of security, several features exist. Supervisors must request access to the system for their employees, specifying that they have the need to know and authority to make changes to the system. the level of specification determines which screens users have access to. Before issuance of access, prospective users must receive training on operations and responsibilities of system usage. To access the system, users are issued a unique identifying password. The password is tied to an individual user, a particular machine and a particular serving ring. The system has built in reporting capabilities, available to immediate supervisors and to various levels of management, and security to allow monitoring of system use and violations. Supervisors retain the responsibility for oversight of employee activities. The system retains a record of changes to any account including the time of the change, the user implementing the change, and reasons for changes.

Performance measurements are built into the sales tax filing system. Data elements resulting from any actions in the sales tax system are captured and downloaded to the "information warehouse" on a periodic basis. Ad hoc reports can be generated upon demand that will document the total number and individual customer accounts requiring edits, adjustments, duplicate returns, etc.

In the scanning subsystem, the program that accounts for all returns in a "suspended" state allows for screen prints. Screen prints are maintained to document these problems.

6. PRIOR AUDIT RECOMMENDATION: The Department's review of insurance premium tax returns is insufficient.

Recommendations

- *The department should develop meaningful criteria for the selection of returns for audit.*
- *The department should charge interest and penalties for either late returns or underpayments.*

DOR RESPONSE

The department subjects all premium tax returns to a series of automated processes that duplicate the former manual desk audits. Further, within the coming year the department is planning to initiate a field audit program.

We ran a program to assess penalties and interest for the years 1990, 1991, 1992, and 1993 and are now current. We will assess penalty and interest timely in the future.

Sincerely,

Matthew G. Smith
Commissioner

c.c. John Lally, Deputy Commissioner
Dwight Lahti, Assistant Commissioner
Bev Driscoll, Assistant Commissioner
Don Trimble, Assistant Commissioner
Jim Maurer, Office of Internal Audit