Department of Revenue

Financial Audit
For the Period July 1, 1994, through June 30, 1995

May 1996

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

96-21

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

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Matthew Smith, Commissioner
Department of Revenue

We have audited selected areas of the Department of Revenue for the fiscal year ended June 30, 1995, as further explained in Chapter 1. The work conducted in the department is part of our Statewide Audit of the State of Minnesota's fiscal year 1995 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1995, includes our report, issued thereon dated December 1, 1995. The following Summary highlights the audit objectives and conclusions. We discuss our concerns more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the Department of Revenue complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Department of Revenue is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the 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 May 3, 1996.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 26, 1996

Report Signed On: April 26, 1996

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 Period July 1, 1994, through June 30, 1995

Public Release Date: May 3, 1996 No. 96-21

Background Information

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.

Audit Objectives

The primary objective of our audit was to render an opinion on the State of Minnesota's financial statements. These financial statements are included in the State of Minnesota's Comprehensive Annual Financial Reports for fiscal year 1995. Our objective included determining whether the Department of Revenue's financial activity was presented fairly in the State of Minnesota's financial statements including its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles.

As part of our work, we were required to gain an understanding of the internal control structure and ascertain whether the Department of Revenue complied with laws and regulations that may have a material effect on its financial statements. During our audit, we gained an understanding of the controls over the revenue and expenditure areas addressed in Table 1-1.

Conclusions

The Department of Revenue's financial activity for fiscal year 1995 was fairly presented in the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1995, which includes our audit opinion dated December 1, 1995. The department continues to work towards improving the verification of withholding taxes through its participation in an ongoing federal project. We found the department in compliance with most financial related statutes addressed in the scope of our audit. However, the department does not enforce the requirements of Minn. Stat. Section 289A.09, Subd. 2 (d) and (e), requiring employers to submit wage detail with their annual withholding summary. The department did not comply with Minn. Stat. Section 138.17 pertaining to record retention. Additionally, the department did not resolve system weaknesses affecting data integrity and adequate audit trails. The department did not assess late payment charges on all tax types as required in Minn. Stat. Section 289A.60, Subd. 1 and Section 270.75. The department also did not assess penalties against taxpayers that submit paper returns when the statutes require filing under the EFT method (Minn. Stat. Section 270.78).

Contact the Financial Audit Division for additional information.
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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 Director
Gail Thurmer, CISA	Senior Auditor
Geniene Herrlich	Senior Auditor
Jenny Lee	Staff Auditor
Leah Tetzlaff	Staff Auditor
Lucas Pannell	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 April 22, 1996:

Matthew Smith	Commissioner
John Lally	Deputy Commissioner
Don Trimble	Assistant Commissioner
Dwight Lahti	Assistant Commissioner
Bev Driscoll	Assistant Commissioner
Pat Lien	Assistant Commissioner
Steve Kraatz	Director, Revenue Accounting
Jean Jochim	Revenue Accounting
Steve Krovitz	Auditor, Internal Audit
Larry Wilkie	Director, Sales and Use Tax
JoAnne Furey	Director, Withholding
Dennis Louis	Director, Document Processing
Edward Eccleston	Director, Profile, Access & Security
Mary Jo Alexander	Management Analyst

Chapter 1. Introduction

The Department of Revenue is responsible for managing the state's tax systems. Minnesota relies on the voluntary compliance of its citizens with those tax laws. The department works to win compliance through a balanced interaction of efforts that focuses on developing sound tax policies, educating citizens, providing expedient customer service, and providing administrative and enforcement services in the areas of tax collection and assessment.

The department's tax system management is comprised of the three tax system areas as noted in Table 1-1. The department processes more than five million documents every year and collects over $9 billion in tax dollars. 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.

In fiscal year 1995, the department operated under the direction of Morrie Anderson from July 1994 until December 1994. In December 1994, the Governor appointed Matthew Smith as the acting commissioner.

Our audit scope focused on the 1995 revenues, expenditures, and tax refunds of the department included in Table 1-1. These financial activities were material to the state's financial statements.

The primary objective of the Statewide Audit is to render an opinion on the State of Minnesota's financial statements included in its Comprehensive Annual Financial Report for fiscal year 1995. This includes whether the financial statements of the state present fairly its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles. As part of our work, we are required to gain an understanding of the internal control structure and ascertain whether the state complied with laws and regulations that may have a material effect on its financial statements.

To address this objective, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of financial transactions or performed analytical procedures, as appropriate.

Our work in the Department of Revenue is completed as part of our audit to express an opinion of the state's fiscal year 1995 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1995 includes our report, issued thereon dated December 1, 1995. The Minnesota Financial and Compliance Report on Federally Assisted Programs, for the year ended June 30, 1995, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing this report in June 1996.

Department of Revenue

In addition to preparing those standard reports, we have also developed some audit findings and recommendations. In Chapters 2, 3, and 5, we discuss our findings regarding the controls and issues of noncompliance in the department.

The financial activity of the department during fiscal year 1995 is summarized in Table 1-1:

Table 1-1
Department of Revenue
Selected Financial Activity
Fiscal Year 1995

Income Tax System Revenues:	
Withholding taxes	$3,272,987,191
Income taxes	1,004,343,604
Corporate taxes	730,569,953
Income Tax System Refunds:	
Individual income tax refunds	$ 472,850,299
Property tax refunds	161,683,421
Sales tax refunds	71,964,182
Corporate tax refunds	61,132,758
Sales and Special Taxes System Revenues:	
Sales taxes	$2,789,601,438
Gas and special fuel taxes	491,788,290
Tobacco taxes	177,088,023
Insurance premium taxes	147,154,102
Health care access taxes	133,889,228
Document registration taxes	71,946,196
Pull tabs and charitable gambling taxes	64,262,233
Alcohol beverage taxes	54,649,803
Petro tank cleanup fees	53,257,988
Local sales taxes	52,783,898
Sports and health taxes	2,747,855
Property Tax and State Aid System Expenditures:	
Homestead/agricultural credit aid	448,869,601
Local government aid	333,071,141
Police and fire state aid	46,874,929
Disparity reduction aid	18,585,174

Source: Estimated/Actual Receipts Report, fiscal year 1995 and the Managers Financial Report, fiscal year 1995.

Chapter 2. Income Tax System

Chapter Conclusions

Income tax revenues collected by the department were fairly presented in the state's Comprehensive Annual Financial Report. The department continues to work towards improving the verification of withholding taxes through its participation in an ongoing federal project. However, the department does not enforce the requirements of Minn. Stat. Section 289A.09, Subd. 2 (d) and (e), requiring employers to submit wage detail with their annual withholding summary. The Department of Revenue should establish appropriate control procedures over the review of withholding tax information and corporate tax processing.

The income tax system includes taxes on individuals, withholding, corporations, small businesses, partnerships, fiduciaries, estates, limited liability companies, and refunds. The Department of Revenue established four divisions to account for the activity: 1) Individual Income Tax, 2) Withholding Tax, 3) Corporate Franchise Tax, and 4) Other Business Taxes. This activity serves over 3.1 million taxpayers annually, with 2.1 million in individual income tax filers alone. The financial activity of this system totals approximately $5 billion in revenues and $768 million in expenditure refunds as noted in Table 1-1. This project will not be finalized for several years. However, the department initiated one phase of the project that pertains to verification of returns on paper and electronic media.

Currently, the department is participating in a major national effort where federal and state agencies are working together to reduce the frequency of customer filing, along with reporting and payment burdens. The Internal Revenue Service, Social Security Administration, and state employment tax agencies will work to streamline wage reporting, filing and paying into one nationwide database. This project will not be finalized for several years. However, the department initiated one phase of the project that pertains to verification of returns on paper and electronic media.

The programs we reviewed under the income tax system were: 1) Individual Income Tax; 2) Withholding Tax; 3) Corporate Income Tax; and 4) Refunds for Individual, Property, Corporate, and Sales Tax.

The primary objective of our audit was to render an opinion on the state of Minnesota's financial statements. As part of our work, we were required to gain an understanding of the internal control structure and ascertain whether the Department of Revenue complied with laws and regulations that may have a material effect on its financial statements.

We concluded that the department does not enforce the requirements of Minn. Stat. Section 289A.09, Subd. 2 (d) and (e), requiring employers to submit wage detail with their annual withholding summary. In addition, we concluded the department should assess its control procedures over the review of withholding tax information and corporate tax processing. Findings 1 and 2 address our conclusions in this area.

Department of Revenue

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

The department does not compare withholding tax information submitted by employers to certain information on file with the department. Without this comparison, the accuracy of information submitted by employers is subject to question. Currently, employers withhold income taxes from employee payroll and submit the withheld amount to the department for deposit. Employers submit most withholding taxes on a special form authorized by the department (MW-5 coupon) or through special wire transfer methods. The amount submitted may be either actual taxes withheld or estimates. The department verifies the amount deposited to the MW-5 coupon or wire transfer reports and enters the information onto its computer system.

The department requires employers to submit quarterly MW-1 reports and enters the information onto its computer system. The quarterly MW-1 report summarizes the employers' withholding and depositing activities. 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 enters the necessary adjusting entries. The department also requires employers to submit an annual MW-3 report that reconciles quarterly withholding tax submitted with the employers actual tax liability for the year. Minn. Stat. Section 289A.09, Subd. 2 (d) and (e), requires the employer to support the annual report with wage detail.

Currently, the department does not enforce the requirements of Minn. Stat. Section 289A.09, Subd. 2 (d) and (e). Approximately six percent of the employers do not submit wage detail with the annual report, and the department does not request the information from the employer. The department also does not contact employers that failed to submit an annual report. In response to our prior year audit recommendation, the department made progress towards improving the annual reconciliation procedures. For returns submitted, the department compared amounts reported on the annual returns to the quarterly returns and identified differences exceeding $25. However, the department does not review wage detail submitted electronically. The department limits its review to certain employers that submit wage detail on paper.

The department is working on a project to compare the annual reports to the supporting wage detail submitted by employers. The withholding section will combine data received from the federal government with data available in the department. This review will enable the withholding section to identify non-filers and differences in liability amounts for both the individual and employer levels. However, the department did not complete the project during fiscal year 1995. 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 assess its control procedures to ensure it establishes an appropriate review of withholding tax information.*

2. PRIOR AUDIT RECOMMENDATION: Corporate income tax processing controls need improvement.

The department's review of estimated taxes paid by corporations is weak in two areas. First, the department does not charge interest to corporations that submit delinquent quarterly estimated payments. Second, the department does not record the disposition of error messages displayed for underpayments identified by system edits.

Minn. Stat. Section 289A.26, Subd. 2, requires taxpayers to pay quarterly estimates on the fifteenth of March, June, September and December of each year. Currently, the department does not edit returns for timely payment. The department has authority to charge interest for late payments under Minn. Stat. 289A.55, Subd. 2. Minn. Stat. Section 289A.26, Subd. 4, requires the department to charge corporations interest on the underpayment of estimated taxes. Late payments automatically become underpayments for the same time period.

The commissioner has the authority to waive penalties and interest as stated in statute. However, we did not find any documentation on file to authorize the corporate tax division to waive interest charges for late payments. Corporations would calculate their estimated tax liability more accurately if the department enforced the interest penalty.

The department also does not record actions taken to resolve system edits designed to detect overclaimers 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. Typically, a log of deleted error messages provides evidence that edits are operating properly. A log also provides the opportunity for supervisory review of the decision to delete an error message. The department does not currently record or log error messages that operators bypass. In addition, the department does not link adjustments made by operators to resolve the error messages to the individual taxpayer files. 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.

Recommendations

- *The department should edit quarterly payments for timely submission and assess penalties as required by statute.*
- *The department should ensure that audit trails through history files exist for actions taken to resolve error messages.*

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Chapter 3. Sales and Special Taxes System

Chapter Conclusions

Financial activity of sales and special taxes was fairly reported by the department in the state's Comprehensive Annual Financial Report. However, the department did not comply with Minn. Stat. Section 138.17 pertaining to record retention. Additionally, the department did not resolve prior system weaknesses affecting data integrity and adequate audit trails.

The sales and special tax system includes: 1) state sales and use tax; 2) petroleum taxes; and 3) taxes on tobacco, liquor, wine and beer, solid and hazardous waste, and lawful gambling activities. It also includes taxes on receipts from insurance premiums and the Minnesota Health Care tax. The Department of Revenue established four divisions to account for the activity: 1) Sales and Use Tax, 2) Petroleum Taxes, 3) Special Taxes, and 4) Minnesota Care. This activity serves over 200,000 taxpayers annually. The financial activity of this system totals approximately $4 billion as noted in Table 1-1.

Currently, the department has developed new computer systems to process sales tax transactions more efficiently. The departments goals were to increase the speed of processing transactions, reduce the cost of recording the transactions, and make the information from the transactions available sooner. However, the department did not restrict access to data in the system.

We reviewed 11 programs under the Sales Tax System as noted in Table 1-1. The primary objective of our audit was to render an opinion on the state of Minnesota's financial statements. As part of our work, we were required to gain an understanding of the internal control structure and ascertain whether the Department of Revenue complied with laws and regulations that may have a material effect on its financial statements.

We concluded in Finding 3 that the department did not comply with Minn. Stat. Section 138.17 pertaining to record retention. Finding 3 also discusses our conclusion that the department did not resolve system weaknesses affecting data integrity and adequate audit trails.

3. PRIOR AUDIT RECOMMENDATION: The department did not resolve sales tax system design weaknesses.

The Profile System has several weaknesses affecting data integrity, such as improper record retention and an inadequate audit trail. The department uses 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 system (TPA) and the computerized accounting collection system (CACS). Incorrect data in the Profile System affects the accuracy of data in TPA and CACS.

Since February 1994, the department has retained the original source document for audit purposes. However, an audit trail does not exist between the original source document and the various subsystems where the department posts data. The department assigns a courier number to each scanned return. The department does not upload courier numbers to subsystems, nor print them on the original source document. Without a complete audit trail, it is not possible to verify the accuracy and the completeness of information recorded in the various subsystems. Previously, the department used a system to assign validation numbers to the documents after the taxpayer submitted payment to the department. Gaps in the sequence of validation numbers provided control over the processing of receipts. Validation numbers provide a method to match remittances to returns, therefore reducing the number of unclaimed deposits. The departments initial design of courier numbers did not replicate the controls offered by validation numbers.

Previously, the department did not utilize system log capabilities to manage and control the accuracy and completeness of sales tax returns and remittances. During fiscal year 1995, the department created several logs to monitor system activity. However, the department does not log the activity of each terminal operator. This log would be crucial in separating human errors from system errors and may aid in identifying training needs. Such logs would be beneficial to promptly identify the source of errors in taxpayer accounts. This log is critical due to risks involved with unlimited access granted by the department for the purpose of processing returns as expeditiously as possible.

Recommendations

- *The department should maintain original documentation until records are audited.*
- *The department should develop a method to properly match remittances posted to the subsystems with taxpayer returns.*
- *The department should maintain a system log to document processing activity by each individual terminal operator.*

Chapter 4. Property Tax and State Aid System

Chapter Conclusion

Financial activity for property tax and state aid expenditures were fairly presented by the department in the state's Comprehensive Annual Financial Report. Also, the department complied with the applicable statutes pertaining to the computation and payment of property tax aid to local governments.

The Property Tax and State Aid System includes support, evaluation, and oversight over Minnesota's locally administered property tax system. The system also includes computation and payment of state-paid property tax relief payments to local governments and administration of minerals tax. The financial activity of this system totals approximately $847 million as noted in Table 1-1.

The primary objective of our audit was to render an opinion on the state of Minnesota's financial statements. As part of our work, we were required to gain an understanding of the internal control structure and ascertain whether the Department of Revenue complied with laws and regulations that may have a material effect on its financial statements.

We concluded that the department complied with the applicable finance-related statutes.

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Chapter 5. Tax Operations

Chapter Conclusions

The department's financial activity of income tax, sales, special taxes, property tax, and state aid tax operations were properly recorded on the department's various tax systems. However, the department did not assess late payment charges on all tax types as required in Minn. Stat. Section 289A.60, Subd. 1 and Section 270.75. The department also did not assess penalties against taxpayers that submit paper returns when the statutes require filing under the EFT method (Minn. Stat. Section 270.78).

Tax Operations comprise several divisions that are integral parts of the Income Tax System, Sales and Special Tax System, and the Property Tax and State Aid System. The division provides services on an agency-wide basis for most types of taxes. The document entry, edit and cash depositing processes were re-engineered over the last few years. This system redesign incorporates acceptance of a variety of electronic data interchange (EDI) mechanisms for greater efficiency, accuracy, and speed. EDI includes electronic filing (EFS), electronic funds transfers (EFT), scanning, direct FAX filing, and filing by touch-tone telephone.

Refinement of EFT and EFS will enable more taxpayers to file and pay electronically, thereby increasing the transaction speed. Further refinements will reduce the transaction cost, making information available sooner. Although EFT and EFS have the potential for improving efficiency in the department, many taxpayers are unable or unwilling to move into the technological age. The department, therefore, must maintain two separate systems for filing and paying: the traditional paper-based system and the modern electronic system.

The department subjects EFT and non-EFT transactions to criteria that treats taxpayers as monthly filers, which results in the most lenient penalty assessment. Currently, the department enforces penalties on non-EFT transactions and does not enforce penalties on EFT transactions.

The primary objective of our audit was to render an opinion on the state of Minnesota's financial statements. As part of our work, we were required to gain an understanding of the internal control structure and ascertain whether the Department of Revenue complied with laws and regulations that may have a material effect on its financial statements.

We concluded that the department does not enforce the requirements of Minn. Stat. Section 289A.60, Subd. 1 and Section 270.75. The department also did not assess penalties against taxpayers that submit paper returns as required by Minn. Stat. Section 270.78. Finding 4 addresses our conclusions on this area.

4. PRIOR AUDIT RECOMMENDATION: The department did not assess penalties and interest on Electronic Funds Transfer (EFT) tax payments.

The department does not consistently identify and assess penalties and interest against taxpayers that submit a late tax payment using the EFT payment method. During our testing, we noted tax payments paid beyond the due date that were not assessed penalties and interest. 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.

Minn. Stat. Section 289A.26, Subd. 2a, requires businesses with an annual tax liability of $120,000 or more to submit their tax payments using EFT. 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, 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 department also does not assess penalties against taxpayers that submit paper returns and checks when the statutes require payment under the EFT method. Minn. Stat. Section 270.78 imposes a penalty of five percent on taxpayers failing to pay using EFT. This penalty has not been enforced by the department since its enactment on October 1, 1993. In 1995, new legislation allowed EFT required depositors to submit a paper return with a check three days prior to the EFT filing due date. The department believes the new legislation complicates enforcement, and therefore has decided to continue their policy of not enforcing the five percent penalty. Currently, over 60 percent of all payments submitted use the EFT payment method. The number of taxpayers required to use the EFT method will increase substantially by fiscal year 1996. The increase is attributable to a reduction in the minimum annual tax liability threshold required to identify EFT filers.

Recommendations

- *The department should develop procedures to routinely identify late EFT tax payments.*

- *The department should assess penalties and interest on EFT payments as required by Minn. Stat. Sections 289A.60, Subd. 1, Section 270.75, and Section 270.78.*

- *The department should sponsor legislation to remove the five percent penalty, or begin enforcement procedures to identify any taxpayers that fail to comply with the statutes.*

MINNESOTA Department of Revenue

April 26, 1996

Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
1st Floor, Centennial Office Building
658 Cedar Street
St. Paul, MN 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'95 statewide audit report.

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

Recommendation

- *The Department of Revenue should assess its control procedures to ensure it establishes an appropriate review of withholding tax information.*

DOR RESPONSE

We agree that we have not enforced Minn. Stat. 289A.09 Subd. 2(d) and (e). However, we believe that current changes we are making to the withholding process and system will make enforcement efforts efficient and effective.

Starting with tax year 1996, there will no longer be a separate annual reconciliation form. We have combined the fourth quarter return and annual reconciliation into one return. The return will undergo processing similar to that currently used for the quarterly returns. This includes the edit process as well as the demand process.

We currently demand the quarterly returns on a regular basis, and we will include the new return in this process.

We also agree that we have failed to enforce Minn. Stat. 289A.09 concerning wage detail. However, we are reviewing our current requirements for wage detail submission. Once we have decided what the requirements will be, we will install procedures to enforce those requirements.

Finally, we are continuing our efforts on the federal project as well as accessing and using the wage detail submitted on magnetic media. The process is slow and cumbersome, but we continue to move forward.

2. PRIOR AUDIT RECOMMENDATION: Corporate income tax processing controls need improvement.

Recommendation

- *The department should edit quarterly payments for timely submission and assess penalties as required by statute.*
- *The department should ensure that audit trails through history files exist for actions taken to resolve error messages.*

DOR RESPONSE

We agree with your recommendation regarding the edit of quarterly payments and have decided to explore methods for improvements in voluntary compliance, as well as the detection of the worst offenders in this area, as current resources permit.

We are also anticipating a future rewrite of our computer systems and plan to include a request for such functionality that will permit automatic identification of late payments and automatic assessment. This of course will depend largely on the availability of resources devoted to the development of this system.

At the time that we develop this new computer system we will also identify the audit trails necessary to record actions taken to resolve error messages.

3. PRIOR AUDIT RECOMMENDATION: The department did not resolve sales tax system design weaknesses.

Recommendation

- *The department should maintain original documentation until records are audited.*
- *The department should develop a method to properly match remittances posted to the subsystems with taxpayer returns.*
- *The department should maintain a system log to document processing activity by each individual terminal operator.*

DOR RESPONSE

The department is just completing an audit plan that will test the accuracy and completeness of information recorded in the various subsystems of the sales tax system. The department will maintain the original sales tax source documents until it obtains adequate satisfaction from its testing that information per the sales tax returns is properly recorded in the sales tax system. At that time the department will resume its plan for destroying these records.

Future changes in our business, as well as greater utilization of electronic funds transfer, electronic filing systems, and telephone filing options, are expected to make physical documents less relevant if we can verify the data capture. In order to attain this objective, we intend to put in place the necessary mechanisms to test the quality of our data capture systems.

Subsequent to the period of your audit a process was put in place within Sybase that matches sales tax remittances to taxpayer returns. In addition, once the audit trail enhancement is completed (referred to in the following paragraph), it will be possible to track back from remittances (posted to the subsystems) to their related source documents.

The department is adding two enhancements to the current system. One of these improvements will provide for system logging of processing activity by each individual terminal operator. The second improvement will allow for an improved audit trail between the original source document and data maintained on the various subsystems.

4. PRIOR AUDIT RECOMMENDATION: The department did not assess penalties and interest on Electronic Funds Transfer (EFT) tax payments.

Recommendation

- The department should develop procedures to routinely identify late EFT tax payments.
- The department should assess penalties and interest on EFT payment as required by Minn. Stat. Sections 289A.60, Subd. 1, Section 270.75, and Section 270.78.
- The department should sponsor legislation to remove the five percent penalty, or begin enforcement procedures to identify any taxpayers that fail to comply with the statues.

DOR RESPONSE

The department is currently considering changes to the withholding, MinnesotaCare tax and corporate income tax computer systems to enable assessment of the EFT penalty. The withholding and corporate income systems are old and complex, and the department has received funding for FY97 to make the necessary changes.

At this time the department does assess this penalty on sales tax, petroleum, and special tax taxpayers that violate the EFT requirements.

The department is currently reviewing all of the penalties imposed on tax violations to determine if the current penalties are effective and consistent with sound tax policy. After completion of that review, the department will recommend legislative changes. The department's intention is to begin enforcing the EFT penalty for all tax types as soon as computer system changes have been completed.

Sincerely,

Matthew G. Smith
Commissioner

c.c. John Lally, Deputy Commissioner
Dwight Lahti, Assistant Commissioner
Don Trimble, Assistant Commissioner
Beverley S. Driscoll, Assistant Commissioner
Patricia A. Lien, Assistant Commissioner