Department of Revenue

For the Year Ended
June 30, 1999

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STATE OF TENNESSEE
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John G. Morgan
Comptroller

September 12, 2000

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Ruth E. Johnson, Commissioner
Department of Revenue
1200 Andrew Jackson Building
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Revenue for the year ended June 30, 1999.

We conducted our audit in accordance with generally accepted government auditing standards. These standards require that we obtain an understanding of management controls relevant to the audit, and that we design the audit to provide reasonable assurance of the Department of Revenue's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Department of Revenue is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the department's internal controls and/or instances of noncompliance to the Department of Revenue's management in a separate letter.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/cj
00/054

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Department of Revenue
For the Year Ended June 30, 1999

AUDIT SCOPE

We have audited the Department of Revenue for the period July 1, 1998, through June 30, 1999. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of Management Information Systems, Processing, Taxpayer Services, Taxpayer Accounting, Revenue Accounting, Tax Enforcement, and compliance with the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

AUDIT FINDINGS

Balancing Problems Are Still Occurring in RITS**
Out-of-balance situations are occurring with the Revenue Integrated Tax System (RITS). The debits and the credits of the Internal Tax Change columns did not balance 87% of the time (page 3).

Problems With RITS Delayed Disbursements to Other States for International Registration Plan Taxes*
The department's International Registration Plan tax balances contain amounts that are owed to other states and have not been disbursed in a timely manner (page 4).

Management Information Systems Policies and Procedures Manuals Need to Be Updated**
The Management Information Systems policies and procedures manuals were not up-to-date. The manuals did not contain the necessary policies and procedures for RITS, which was implemented in December 1995 (page 6).

Improved Controls Over Program Changes in MIS Are Needed**
Computer programs called SPUFIs (Sequential Processing User File Input) are being used by Management Information Systems staff to correct taxpayer accounts directly in RITS rather than through authorized and documented transactions (page 6).

The Exceptions Processing Unit Does Not Always Deposit Remittances Timely
Receipts are not always deposited timely. Testwork revealed remittances outstanding from four to seven business days after receipt (page 8).

The Department Did Not Properly Record New Corporations Into RITS
New corporations identified by the Secretary of State's office were not always entered correctly into RITS (page 10).

The Department Does Not Properly Track and Monitor Refund Claims in Order to Minimize Interest Paid*
Thirty-four of 60 refund claims over $50,000 tested took from 46 to 379 days to process before being turned over to the Attorney General's office for signatures (page 12).

Controls in the Tax Enforcement Division Need Improvement**
Diaries have not been consistently utilized, and cases are not always followed up in a timely manner (page 15).

* This finding is repeated from the prior audit.
** This finding is repeated from prior audits.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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Audit Report
Department of Revenue
For the Year Ended June 30, 1999

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For the Year Ended June 30, 1999

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Revenue. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated,* which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

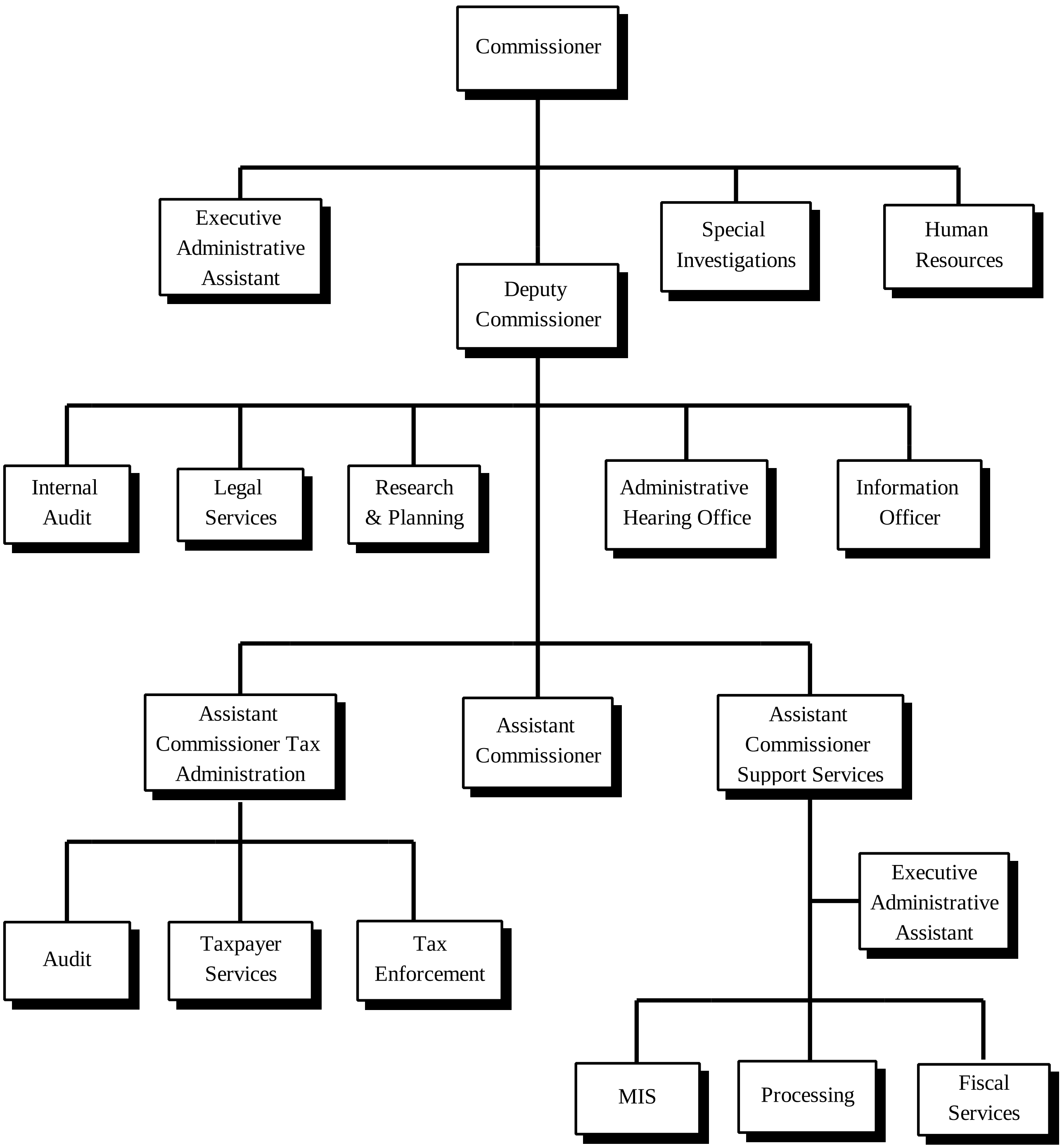
Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The mission of the Department of Revenue is to collect state revenue. Specifically, the department is responsible for the collection of most state taxes and fees, for enforcing the revenue statutes of the state to ensure that taxpayers are in compliance with all tax laws, and for preparing the monthly apportionment of revenue collections for distribution to various state funds and local units of government. The department also offers taxpayer assistance and taxpayer education. In an effort to perform its duties, the department has divided these functions into six divisions: Administration, Tax Enforcement, Management Information Systems, Taxpayer Services, Field Audit, and Processing.

An organization chart of the department is on the following page.

TENNESSEE DEPARTMENT OF REVENUE



AUDIT SCOPE

We have audited the Department of Revenue for the period July 1, 1998, through June 30, 1999. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of Management Information Systems, Processing, Taxpayer Services, Taxpayer Accounting, Revenue Accounting, Tax Enforcement, and compliance with the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

REVENUE INTEGRATED TAX SYSTEM (RITS)

The focus of the audit involved the Revenue Integrated Tax System (RITS). Due to the major impact RITS has on the department's operations, it is appropriate to provide some background on the system. RITS provides a consolidated database of taxpayer information of all taxes administered by the department. It enables centralized taxpayer registration, multiple tax form processing, taxpayer accounting, taxpayer auditing, automated collections and enforcement, and automated taxpayer correspondence across taxes. The system makes automatic posting of funds to revenue accounts possible and furnishes information for the disbursement of funds to different jurisdictions. The system was implemented in 1995 and last year processed 2,075,559 transactions and accounted for and distributed over $8 billion.

We determined that balancing problems are still occurring in RITS and that problems with RITS delayed disbursements to other states for International Registration Plan Taxes. In addition to the findings, other minor weaknesses came to our attention which have been reported to management in a separate letter.

1. Balancing problems are still occurring in RITS

Finding

As noted in the prior two audits, numerous balancing problems are occurring in the Revenue Integrated Tax System (RITS) accounting reports. From July 1, 1998, until June 30, 1999, RITS was out-of-balance 215 of 248 days, or 87% of the time. The debits and credits of the Internal Tax Change columns did not match, creating an out-of-balance condition. One type of out-of-balance condition can occur when the taxes are moved around in the system internally because of line-item adjustments, transfers, refunds, bad checks, conversion to RITS, and system problems. Management concurred with the prior finding and stated that program changes have been made in both Taxpayer Accounting and Revenue Accounting to help resolve some of the major balancing issues, but additional work is currently being done on processing of refunds and line-item adjustments.

Recommendation

The Commissioner should continue to monitor and document the problems associated with RITS out-of-balances and ensure that proper measures are implemented as quickly as possible to prevent out-of-balance conditions.

Management's Comment

We concur. Program changes have been made in both Taxpayer Accounting and Revenue Accounting to resolve some of the major balancing issues. The changes in RITS have reduced the number of out of balances; however, they still occur. The department continues to work with personnel from the Office of Information Resources (OIR) to resolve these issues.

Out of balances are monitored on a daily basis to ensure that repetitive conditions are identified and resolved as soon as possible. Out of balance situations are corrected each month before closeout.

2. Problems with RITS delayed disbursements to other states for International Registration Plan taxes

Finding

As noted in the prior audit, the Department of Revenue's International Registration Plan (IRP) tax balances contain amounts that are owed to other states and have not been disbursed in a timely manner. Management concurred with the prior finding, stating, "The problem with RITS and IRP fee disbursements was corrected and all state disbursements were brought up-to-date in December 1998." However, due to a program flaw, some disbursements were overlooked in this process. These amounts date back to 1997 and, as of March 2000, totaled between $10.2 and 10.3 million. This problem has existed since the implementation of the Revenue Integrated Tax System (RITS), when the department knew that approximately 5% of IRP disbursements were not being processed properly. Departmental employees had believed that these amounts were immaterial, but in December 1999 these amounts were discovered to be much larger than originally thought. The amounts should normally be remitted to other states within one month of collection.

Recommendation

The department should ensure that the other states receive their Motor Vehicle International Registration Plan taxes timely. Management should ensure that the RITS program flaw is corrected and that these overdue amounts are disbursed to the proper jurisdictions.

Management's Comment

We concur. The tax balances collected for the International Registration Plan (IRP) owed to other states are currently being disbursed in a timely manner when requested by the IRP Unit. The Unit continues to use RITS as its processing system even though IRP was transferred to the Department of Safety effective July 1, 1998.

The department will continue to work on correcting the problem 1997 registration supplements containing errors on RITS. A substantial amount of work has already been done to correct the problems with these accounts. Approximately 30 supplements totaling $1 million remain to be corrected and disbursed. The department will continue this course of action until all of these supplements have been disbursed.

MANAGEMENT INFORMATION SYSTEMS

The objectives of our review of the Management Information Systems (MIS) division were to determine whether

- relevant policies and procedures have been placed in operation;
- computer resources are planned, managed, and utilized effectively;
- an adequate disaster recovery plan had been implemented;
- user access to the Revenue Integrated Tax System (RITS) is adequately controlled;
- RITS application documentation is complete; and
- adequate controls are in place over RITS program changes.

We examined the policies and procedures manuals to determine if policies and procedures were current and reflected existing operational conditions and if the disaster recovery plan was current. We interviewed key personnel, observed operations, and reviewed support documentation to determine if application controls were appropriate and in place. We looked for proper security of access to RITS screens and the use of Sequential Processing User File Inputs (SPUFIs) to correct taxpayer account out-of-balances. We examined RITS documentation to determine if the system was adequately documented. Discrepancies were noted regarding inadequate MIS policies and procedures manuals and lack of controls over program changes. In addition to the findings, other minor weaknesses came to our attention which have been reported to management in a separate letter.

3. Management Information Systems policies and procedures manuals need to be updated

Finding

As stated in the prior two audits, Management Information Systems policies and procedures manuals were not up-to-date. Management concurred with this assessment and stated the department was "in the process of updating this manual. This project should be completed by the end of November 1999." Although progress has been made in this area, the manual update has not been completed nor adopted. The current manuals did not contain the necessary policies and procedures for the Revenue Integrated Tax System (RITS), which was implemented in December 1995. In past years, management has implemented some procedures such as requests for Sequential Processing User File Inputs (SPUFIs); however, the procedures are not adequate. Documented policies and procedures would help management plan, control, and evaluate its Management Information Systems. If management's policy directives are not developed and communicated, department staff may not understand and adhere to approved policies and procedures. Adequate policies and procedures for systems development and program changes could prevent problems.

Recommendation

Management should update the Management Information Systems policies and procedures manuals to include complete directives for the RITS system and ensure the updated manuals are distributed to the appropriate staff.

Management's Comment

We concur. The division has been continually working on the policies and procedures manual and currently estimates that the project is 80% complete. Completion has been delayed due to other pressing priorities such as the work required in response to tax reform legislation and updating the Information System Plan for the department. The goal is to complete the work during the 2000 calendar year.

4. Improved controls over program changes in MIS are needed

Finding

As stated in the prior two audits, computer programs called SPUFIs (Sequential Processing User File Input) are being used by Management Information Systems (MIS) staff to correct taxpayer accounts directly in the Revenue Integrated Tax System (RITS) rather than through authorized and documented transactions. Management concurred, stating that they would put controls in place. Improvements were made in documenting SPUFIs using a log and numbered forms for requests. In addition, a standard format request form for all SPUFIs was developed. However, as noted below, MIS did not consistently follow its own standard format for request approvals. Making changes directly to the system with a SPUFI, instead of correcting errors through transactions, circumvents the controls the system is designed to provide, leaving no audit trail for management to determine the activity in an account. Therefore, SPUFIs need to be properly documented so that an audit trail exists and management can review changes made with SPUFIs.

The department's Standard Practice Procedures for Data Fixes require the approval of the Assistant Director and MIS manager before changes are made in the system. Forty of 62 SPUFIs tested (65%) were not properly approved before the change was made.

In addition, MIS analysts are still running SPUFIs on production data. OIR programmers normally execute these types of programs. Analysts are responsible for program design and should not have access allowing changes to production data. With the ability to design programs and access production data, analysts could compromise taxpayer accounts.

Recommendation

The use of SPUFIs should be kept to a minimum, and proper controls should be in place. SPUFIs should be approved before changes are made to ensure changes are appropriate and in accordance with departmental procedures over the use of SPUFIs. Analysts should not make direct changes to data.

Management's Comment

We concur. Currently, the division uses SPUFIs only when needed to correct error conditions that cannot be resolved through normal processing or for situations so large that the resolution would place undue burden on the users. Information System Managers and one senior lead analyst in MIS are the only personnel authorized to run SPUFIs. The division is continually working to correct the problems causing these errors so that the need for SPUFIs is minimized.

The written procedures related to data fixes were revised in October 1999 and now provide for the approval of SPUFIs by a MIS manager and the user prior to making the change. The signature of the Assistant Director documents that management has reviewed the request. This step may occur after the change has been made. The RITS Data Correction Request Form was revised to reflect the change in the procedure. The revised data fix procedures were reviewed and approved by departmental management and by the Data Base Administration Director in the Department of Finance and Administration.

PROCESSING DIVISION

Our objectives in the area of the Processing Division were to determine whether

- policies and procedures that affect each unit of the Processing Division have been identified,
- the division is complying with the policies and procedures of the department,
- funds received by the Processing Division are properly safeguarded and deposited in a timely manner,
- remittances are being properly recorded by the Exceptions Processing Unit, and
- the Exceptions Processing Unit adequately safeguards funds and makes deposits in a timely manner.

An understanding of the procedures and controls of the division was obtained and documented. The process of safeguarding revenue received was observed and discussed with the appropriate personnel. A sample of cash receipts was tested to determine if deposits were made timely by the Processing Division and the Exceptions Processing Unit. We determined the exceptions processing unit does not always deposit remittances timely.

5. <u>The Exceptions Processing Unit does not always deposit remittances timely</u>

Finding

The Exceptions Processing Unit does not always deposit receipts timely. The unit receives tax returns and payments that are not processable in the original form in which they were received or that have other special handling requirements. For all tax collections not on the Revenue Integrated Tax System (RITS) sent by the Processing Division to this unit, the amount, date received, tax type, and deposit date are recorded in a logbook. For these items, the unit either obtains the information necessary to complete processing or forwards a copy of the payment and related support to the appropriate tax section for follow-up. While the processing or follow-up occurs, the payment should be deposited immediately. Section 9-4-301(a), *Tennessee Code Annotated*, states,

> It is the duty of every department, institution, office and agency of the state and every officer and employee of state government, including the state treasurer, collecting or receiving state funds, to deposit them immediately into the treasury or to the account of the state treasurer in a bank designated as a state depository or to the appropriate departmental account.

The Department of Finance and Administration defines the term “immediately” in Section 9-4-301 as follows:

> For departments, institutions, offices and agencies within 5 miles of a state depository, "immediately" means the same day.

The written criteria for the Exceptions Processing Unit differs from this policy. According to Exceptions Processing Unit staff, items received with a dollar value of $500.00 or more that cannot be cleared within 48 hours require that the funds be deposited at that time. Items with a value of less than $500.00 will be held for no longer than five business days.

During a review of the suspense file and logbook for the period beginning March 1, 1999, and ending June 30, 1999, auditors noted that 19 of 60 items tested (32%), totaling $63,692.40, were not deposited within 24 hours of receipt as required by state policy. It was noted that 6 of these 60 items (10%) also did not meet the Exceptions Processing Unit's more liberal criteria for deposit. This resulted in $10,810.31 remaining undeposited for four to seven business days.

When receipts are not deposited immediately as required by state law and recorded in the suspense account, the risk of loss or misappropriation increases, and interest income is lost.

Recommendation

The Director of the Processing Division should assign specific responsibility to ensure that all funds received in the Exceptions Processing Unit are deposited and recorded in the suspense account within 24 hours of receipt. The Exceptions Processing Unit policy should be amended to conform with state policy.

Management's Comment

We concur. A review of the unit's operational procedures relating to the deposit of remittances revealed deficiencies which were immediately corrected by division management. The revised written procedures now conform to the State's policy requiring that all funds be deposited within twenty-four (24) hours. In addition, management worked with the staff to better organize the workflow of items received and processed to ensure statutory compliance.

TAXPAYER SERVICES

The objectives of our audit in the area of Taxpayer Services were to determine whether

- certain rules, regulations, and laws that affect taxpayer registration have been identified;
- taxpayer applications for registration for the audit period have been correctly coded and processed;

- the section's managerial controls over corrections and changes to taxpayer account balances in the Revenue Integrated Tax System (RITS) are effective; and
- the procedures for adding and deleting taxpayer accounts are proper.

We interviewed key personnel to gain an understanding of the department's procedures and compliance with rules and laws. Certain rules, regulations, and laws that affect taxpayer registration were identified and reviewed. We obtained a sample of corporations doing business in Tennessee from Secretary of State records and traced these entities to the taxpayers listed on RITS to determine if the corporations were properly recorded or properly removed. Employees having access to make corrections and changes to taxpayers' accounts on RITS were reviewed for proper authorization. We determined that the department did not always record the corporations properly in RITS. In addition to the finding, other minor weaknesses came to our attention which have been reported to management in a separate letter.

6. The department did not properly record new corporations into RITS

Finding

The department did not properly record new corporations obtained from the Secretary of State's office. In 7 of 60 cases tested (11.67%), the new corporations were not recorded properly on the Revenue Integrated Tax System (RITS) at the Department of Revenue. In five of these cases, the corporation's charter was omitted from the system entirely. Some of these cases were corporations that will owe franchise and excise taxes for 1999, and because of this system error, possibly could have avoided remitting a 1999 return in April 2000. In the other two cases, the corporation was entered onto RITS but had a step missing that links the account to the Secretary of State information by including a control number.

The Secretary of State's office communicates daily with the Department of Revenue, providing a list of new corporations that are granted either a corporate charter or a certificate of authority. A domestic corporation would be issued a corporate charter, and a foreign corporation doing business in Tennessee would be issued a certificate of authority. RITS should indicate that a corporation is in the same status at both the Secretary of State's office and the Department of Revenue.

A duplication of information processing appears to be the cause of this problem. The Secretary of State's office and the Department of Revenue have personnel who process almost identical information. The difference is that the Secretary of State's office requires much less information for processing a corporate charter than the Department of Revenue needs for proper tax collection. Because of these dual sources of information, some taxpayers are not properly accounted for in RITS. Procedures should be followed by the department to ensure that all information from the Secretary of State is entered into RITS.

Recommendation

The department should establish procedures for the verification of completeness in regard to new corporate charters. These procedures should be adequate to ensure that all new corporate charters are added to RITS. This would ensure that all taxpayers are accounted for in the system and would aid in the processing of tax returns that have been received.

Management's Comment

We concur. The department recently completed a record match program between the Secretary of State's office (SOS) and Department of Revenue to ensure that all corporations, partnerships and limited liability companies have been properly recorded on RITS. Currently, the department receives a monthly tape of every entity processed by the SOS rather than receiving paper documents on a daily basis. The Taxpayer Services Division has designated a quality control person who reviews the monthly printout to ensure that every account has been properly added to RITS.

A long-term goal for the department is to implement an automatic interface with the SOS eliminating the duplication of processing. RITS would automatically update during the nightly SOS Processing.

TAXPAYER ACCOUNTING

The objectives of our work in the area of taxpayer accounting were to determine whether

- certain rules and laws that affect tax collections have been complied with;
- controls over the refund process for taxpayer accounting are adequate;
- reconciliations are performed and are properly reviewed;
- refunds have been reviewed, properly approved, and recorded to the correct taxpayer account;
- transactions and conversation screens are secure from unauthorized use; and
- State of Tennessee Accounting and Reporting System (STARS) and Revenue Integrated Tax System (RITS) refunds reconcile.

We interviewed key personnel to gain an understanding of the department's procedures and compliance with rules and laws that affect tax collections. Security over access to RITS was reviewed. The refund process was reviewed, and a sample of refunds was tested for proper documentation and approval. We determined that the department does not properly track and monitor refund claims in order to minimize interest paid. In addition to the finding, other minor weaknesses came to our attention which have been reported to management in a separate letter.

7. <u>The department does not properly track and monitor refund claims in order to minimize interest paid</u>

Finding

As noted in the prior finding, the department does not properly monitor timeliness of individual refund claims to prevent excess interest from being paid. Management concurred with the prior finding stating, "The Refund and Penalty Waiver (RPW) Unit has a tracking system that is used to monitor the status of each refund received by the unit. The Audit Division will request enhancements to the system for aging refunds over a specific number of days. . . . Written procedures will be established for supervisors in the Unit to require a closer monitoring of refunds." However, the current audit revealed that 34 of 60 refund claims over $50,000 (56.67%) took from 46 to 379 days to process in the Refund and Penalty-Waiver Unit before being sent to the Attorney General's office for signatures. Two of 62 claims tested (.03%) had missing dates, and the time period could not be determined. Eight of the 60 refunds tested did not have the date necessary to calculate the interest entered in the Revenue Integrated Tax System (RITS). Consequently, the taxpayers did not receive interest on the refunds. Also, 11 of 60 refunds (19%) could not be located on RITS. These refunds could only be found on the department's tracking database.

It appears that the Refund and Penalty-Waiver Unit is still not closely monitoring refunds to ensure that they are sent through the signature process and to ensure payment is made within 45 days of the claim date. The claim date is the date on which the Refund and Penalty-Waiver Unit establishes a refund claim as a valid refund. Procedures still have not been established by the department to ensure that a refund is sent through the signature process and refunded within 45 days as required by state law. Section 67-1-801(b), *Tennessee Code Annotated*, states:

> When it is determined by administrative review or court order that any person is entitled to a refund or credit of any tax collected or administered by the commissioner, interest shall be added to the amount of refund or credit due, beginning forty-five (45) days from the date of filing a claim for refund.

When refunds are not processed within 45 days of the claim date, the state is assessed interest on the refund amount. The minimum amount of interest the state could have saved if these 32 refunds were processed timely amounted to $170,551.76.

Recommendation

The department should establish procedures for tracking and monitoring refund claims. These procedures should be adequate to ensure that the refund will be approved and will have all required signatures within 45 days to comply with the statute. This would allow the department to appropriately track the refund during the process to ensure the refund does not remain in one area for an excessive amount of time.

Management's Comment

We concur. As part of the Strategic Plan, the department established Strategy 2.3.3.2 providing for the appraisal and evaluation of the refund procedures for the purpose of implementing improvements in the process. When this phase is completed, the department will be in a better position to develop and implement more efficient procedures for processing and monitoring refunds within the department.

The department, as a whole, has not implemented a tracking system for refunds. The Refunds and Penalty Waivers Unit within the Audit Division has a system to monitor and track refunds assigned to personnel in the unit. The supervisors in the unit will continue to monitor the age of refunds assigned to the unit and will work to minimize any delays.

In addition, the supervisor of the unit has implemented procedures for comparing a report of all refunds on RITS to the refunds recorded on the Refund Tracking System. This process ensures that the Refund Unit is aware of all refunds recorded on RITS.

REVENUE ACCOUNTING

The objectives of our review of the Revenue Accounting section were to determine if

- certain rules, regulations, and laws that affect tax revenues have been identified;
- the cashier's Daily Summary of Collections Report is being properly completed;
- deposit slips are reconcilable to the Bank Deposit Report, the Daily Summary of Collections Report, and the Daily Balancing Report;
- revenues available and measurable have been properly recorded and classified by tax type in the monthly collection reports;
- reconciliations are being performed and are properly documented;
- procedures used to report financial data and prepare collections are proper;
- collections are being reported in the monthly collection report on a consistent basis;
- access to the Revenue Integrated Tax System (RITS) conversation screens is properly authorized and approved;
- error reports are used to ensure errors are corrected properly;
- procedures used for monthly closeouts are proper; and
- procedures used to reallocate undistributed funds for RITS are proper.

We interviewed key personnel, observed their duties during walkthroughs, and reviewed the RITS manual to determine the functions of revenue accounting and if the duties were segregated. Also, the procedures used for monthly closeout and for reallocation of undistributed funds for RITS were reviewed to determine if they were proper. RITS conversation screens were tested to determine if access was properly segregated. A sample of monthly collections reports was reviewed and tested to determine if they are reconciled to revenue reports issued by the Department of Finance and Administration and if collections are reported on a consistent basis. A sample of out-of-balance reports was tested to determine if appropriate actions were taken to correct the problems. For several tax classes reported in the daily summary of collections report, we tested the monthly reports to determine if the current date, month-to-date, and year-to-date totals for each tax type were proper and if the report was reliable. It was noted that out-of-balances are still occurring in RITS (see finding 1 in this report). In addition to the finding, other minor weaknesses came to our attention which have been reported to management in a separate letter.

TAX ENFORCEMENT DIVISION

For the Tax Enforcement Division, our objectives were to determine whether

- rules and regulations of the department and the applicable *Tennessee Code Annotated* sections are complied with;
- regional Tax Enforcement offices are mailing receipts to the department's mail room timely, and the receipts are deposited by the department timely;
- the classification of delinquent Revenue Integrated Tax System (RITS) accounts as dormant, pending dormant, or unenforceable is properly supported and approved;
- bankruptcy claims are filed timely by the department, and the claims are properly computed and tracked by the department;
- the division is attempting to collect current delinquencies in a timely manner and is following the appropriate collection procedures;
- Tax Enforcement officers' receipt books are properly completed and reviewed by their supervisors;
- cash received by Tax Enforcement officers is deposited at a local bank timely;
- Tax Enforcement officers' diaries are properly completed and reviewed by their supervisors; and
- Tax Enforcement officers are properly monitored by their supervisors, regional manager, and the Central Office.

We interviewed key personnel and reviewed tax enforcement's procedures manual and the applicable *Tennessee Code Annotated* sections to determine if the Tax Enforcement Division is in compliance with rules and regulations. A sample was selected for testwork to determine if RITS accounts classified as dormant, pending dormant, or unenforceable are properly supported and approved. A sample of bankruptcy claims was tested to determined if proper action was taken to collect funds, if the funds are deposited properly, if the receipt books are handled properly, if diaries are reviewed properly, and if revenue field officers' work is monitored properly. We determined that controls in the division need improvement. In addition to the finding, other minor weaknesses came to our attention which have been reported to management in a separate letter.

8. Controls in the Tax Enforcement Division need improvement

Finding

The department is not maintaining adequate control over certain activities of the Tax Enforcement Division. Diaries have not been consistently utilized, and cases are not always followed up in a timely manner.

As noted in the three prior audits, several weaknesses were found during the regional office visits. The tax enforcement officers use diaries to record their daily collection activities. In the prior audit, weaknesses were noted at the Nashville, Columbia, Memphis, and Jackson regional offices. The following weaknesses were noted in the current audit at the Chattanooga, Nashville, Columbia, Memphis, and Jackson regional offices.

Diaries are not always being reviewed quarterly and are not always reviewed by the supervisors. Seventeen of 60 diaries tested (28.34%) were not reviewed quarterly by the supervisor. Tax Enforcement policies and procedures state that the supervisors must review officers' diaries at least quarterly. Of the 17 diaries where weaknesses were noted, 12 were not reviewed on a quarterly basis and 5 were not reviewed by the supervisor for the quarter ending September 1998. These weaknesses were found in the Nashville, Columbia, and Memphis offices.

For 17 of 60 diaries tested (28.34%), the officers were not recording the information that should be in the diary. The *Tax Enforcement Procedures Manual*, Diary Objective, states, "The diary is a valuable tool which creates a Permanent record of all field visits, leave and attendance, mileage and collections. The diary must be completed properly in order to provide an accurate accounting of all of the above. The diary must be maintained up to date and available for review at all times."

Also, as noted in the prior audit, the Tax Enforcement Division is not following up on cases in a timely manner. Documentation in the Revenue Integrated Tax System (RITS) showed that 13 of 60 tax enforcement cases (21.67%) were not followed up in a timely manner. The case history screen in RITS shows that no action was taken on these cases for four to nine months. Chances of collecting revenue decrease when an account is not followed up regularly.

Recommendation

Regional managers and supervisors in all regional offices should review the policies and procedures manual regarding required procedures for diary reviews. Regional managers should review the supervisors' work to ensure that policies and procedures are being properly carried out. Supervisors and regional managers should ensure that all cases are followed up in a timely manner.

Management's Comments

We concur. Tax Enforcement management will continue to emphasize to the regional managers and supervisors the importance of the policies and procedures regarding diary review.

Of the cases identified where timely follow-up was not performed, the majority were out-of-state cases. With a full staff in the unit, division management continues to review and implement procedures and methods to work these cases more quickly. One example is the implementation of the predictive dialer system currently in progress.

FINANCIAL INTEGRITY ACT

The Financial Integrity Act of 1983 requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30, 1999, and each year thereafter. In addition, the head of each executive agency is also required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

The objectives of our review of the Department of Revenue's compliance with the Financial Integrity Act were to determine whether

- the department's June 30, 1999, responsibility letter and December 31, 1999, internal accounting and administrative control report were filed in compliance with the Financial Integrity Act of 1983;
- documentation to support the department's evaluation of its internal accounting and administrative control was properly maintained;
- procedures used in compiling information for the internal accounting and administrative control report were adequate; and
- corrective actions have been implemented for weaknesses identified in the report.

We interviewed key employees responsible for compiling information for the report to gain an understanding of the department's procedures. We also reviewed the supporting documentation for these procedures and the June 30, 1999, responsibility letter and December 31, 1999, internal accounting and administrative control report submitted to the Comptroller of the Treasury and to the Department of Finance and Administration.

We determined that the Financial Integrity Act responsibility letter and internal accounting and administrative control report were submitted on time and support for the internal accounting and administrative control report was adequate.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Revenue filed its report with the

Department of Audit on May 1, 2000. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Department of Revenue has corrected previous audit findings concerning Revenue Integrated Tax System (RITS) overall system problems, disaster recovery, RITS security, refunds not being processed correctly and reflected in taxpayer accounts, and procedures for changes to taxpayer accounts.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning out-of-balance situations, delayed disbursements for IRP taxes, MIS policies and procedures, controls over changes to RITS data, refunds not being processed within 45 days, and controls in the Tax Enforcement Division. These findings have not been resolved and are repeated in the applicable sections of this report.

OBSERVATIONS AND COMMENTS

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Tennessee Code Annotated, Section 4-21-901, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30, 1994, and each June 30 thereafter. The Department of Revenue filed its compliance report and implementation plan on June 30, 1999.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds.

On October 15, 1998, the Commissioner of Finance and Administration notified all cabinet officers and agency heads that the Human Rights Commission is the coordinating state agency for the monitoring and enforcement of Title VI.

A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans,* issued annually by the Comptroller of the Treasury.

APPENDIX

DIVISIONS AND ALLOTMENT CODES

Department of Revenue divisions and allotment codes:

347.01	Administration
347.02	Tax Enforcement
347.11	Management Information Systems
347.13	Taxpayer Services
347.14	Audit Division
347.16	Processing Division