Department of Revenue
August 2002

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STATE OF TENNESSEE
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John G. Morgan
Comptroller

August 30, 2002

The Honorable John S. Wilder
Speaker of the Senate
The Honorable Jimmy Naifeh
Speaker of the House of Representatives
The Honorable Thelma M. Harper, Chair
Senate Committee on Government Operations
The Honorable Mike Kernell, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Department of Revenue. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated,* the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the department should be continued, restructured, or terminated.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/dw
02-012

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Performance Audit
Department of Revenue
August 2002

AUDIT OBJECTIVES

The objectives of the audit were to determine the authority and responsibility mandated to the department by statute and the extent to which the department has fulfilled that mandate and complied with applicable laws and regulations; to assess the efficiency and effectiveness of management's organization and use of resources; and to make recommendations that might result in more efficient and effective operation of the department.

FINDINGS

The Department Does Not Verify the Accuracy of the Data Used in Performance Accountability Measure (PAM) Calculations
The department's strategic plan has performance measures used by the agency to show results and ensure accountability. When data are not verified, management may report a strategy as completed that is not or may make management decisions based on inaccurate performance calculations. In addition, the divisions for which we reviewed the performance measures did not have written procedures specifying how to gather, compile, and report data (page 15).

The Audit Division Is Not Reporting Information Required by Divisional Procedure and the Strategic Plan
The department does not have information needed to monitor audit hours and determine whether it is improving the efficiency of the audit division (page 18).

Sampling Techniques Used by the Processing Division to Collect PAM Information Need to Be Improved
Data gathered to measure the percentage of timely deposits could be misleading because of a lack of written procedures, the way missing sample items are dealt with, and the presentation of the results (page 20).

OBSERVATIONS AND COMMENTS

The audit also discusses the following topics: the internal audit of the Division of Tax Enforcement, the out-of-state audit offices, and the Revenue Integrated Tax System (see page 6).

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Performance Audit
Department of Revenue

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INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Tennessee Department of Revenue was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-224, the Tennessee Department of Revenue is scheduled to terminate June 30, 2003. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the department and to report to the Joint Government Operations Committee of the General Assembly. The audit is intended to aid the committee in determining whether the agency should be continued, restructured, or terminated.

OBJECTIVES

The objectives of the audit were

1. to determine the authority and responsibility mandated to the department by the General Assembly,

2. to determine the extent to which the department has fulfilled its legislative mandate and complied with applicable laws and regulations, and

3. to recommend possible alternatives for legislative or administrative actions that might result in more efficient and effective operation of the department.

SCOPE AND METHODOLOGY

The activities and procedures of the Tennessee Department of Revenue were reviewed with a focus on procedures in effect during field work (August 2001 to February 2002). The audit was conducted in accordance with auditing standards generally accepted in the United States of America and included

1. review of applicable statutes and rules and regulations;

2. examination of the department's documents, and policies and procedures;

3. review of prior performance audits, financial and compliance audit reports, and audit reports from other states; and

4. interviews with department staff, tax practitioners, and staff of other departments in Tennessee state government using the department's lock box services.

ORGANIZATION AND RESPONSIBILITIES

The Tennessee Department of Revenue was created by Section 4-3-1901, *Tennessee Code Annotated*. The department is responsible for enforcing the state's revenue statutes and collecting tax revenues for the state. The department is supervised by a Commissioner, a Deputy Commissioner, and three Assistant Commissioners. (See the department's organization chart on the following page.)

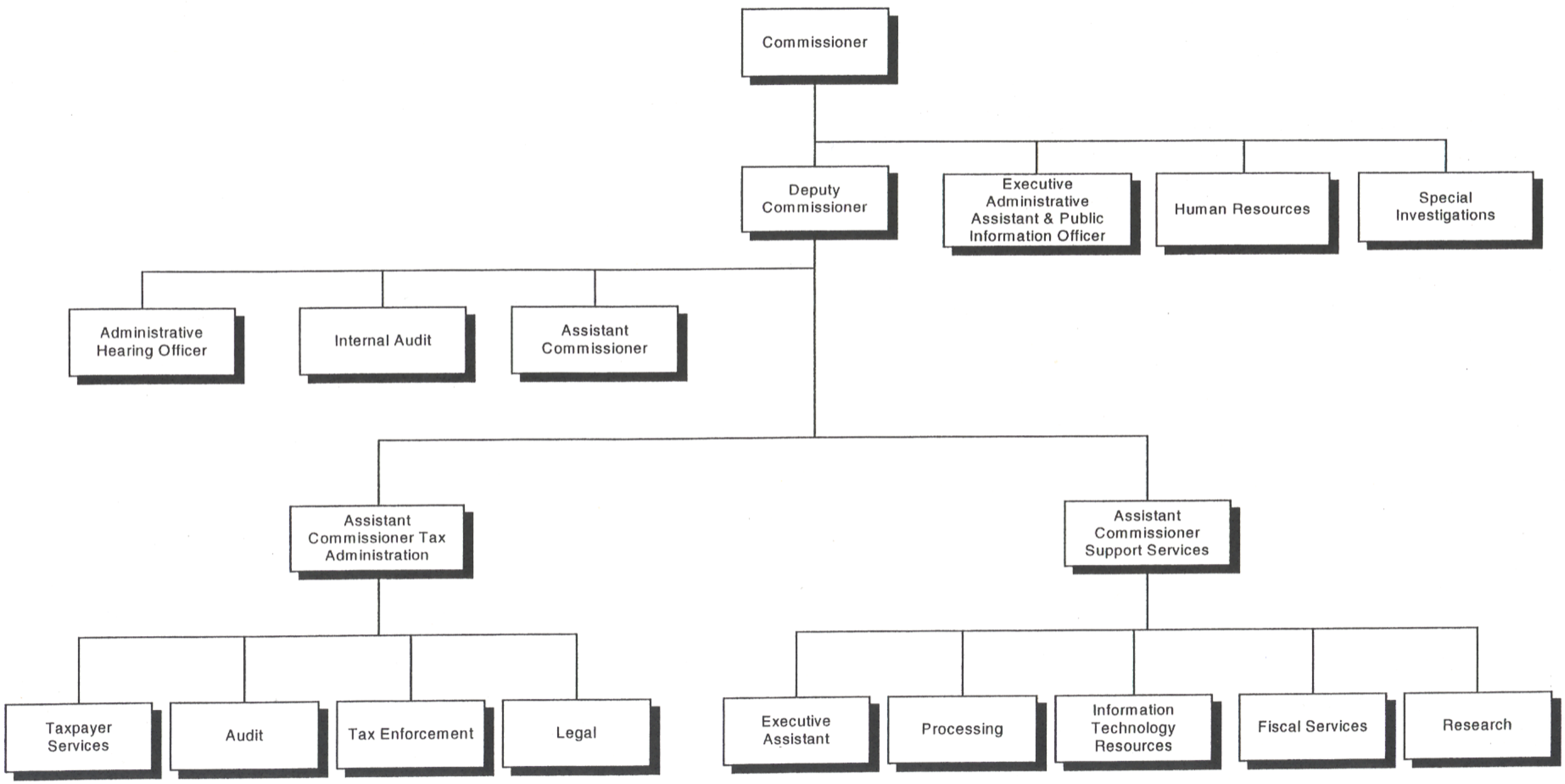
The Internal Audit, Special Investigations, and Human Resources divisions report to the Commissioner. The Administrative Hearing Office and the Public Information Office also report to the Commissioner. The Internal Audit Division conducts audits of the department; Special Investigations examines alleged tax fraud cases; and Human Resources provides payroll, training, and hiring services. The Administrative Hearing Office schedules and holds informal hearings with taxpayers regarding audit assessments. The Public Information Office is the liaison between the Commissioner and the press.

One of the department's Assistant Commissioners is assigned to the Department of Economic and Community Development to help in the recruiting of companies by providing state tax guidance. The Assistant Commissioner for Tax Administration is in charge of the Taxpayer Services Division, the Audit Division, the Tax Enforcement Division, and the Legal Division. Taxpayer Services provides assistance to taxpayers including registration, changes to accounts, and forms. The Audit Division performs audits of taxpayers, and the Tax Enforcement Division collects delinquent taxes. The Legal Division advises the department's management and staff on revenue laws, prepares legal documents, and represents the department in bankruptcy and court cases.

The Assistant Commissioner of Support Services is in charge of the department's Strategic Plan and the Divisions of Processing, Information Technology Resources, Fiscal Services, and Research. In charge of administering the annual plan for the department, the Strategic Planning Division also maintains data on the department's progress towards achieving the goals in the plan. The Processing Division receives and processes all tax documents and remittances including a lock box service for other state agencies. The Division of Information Technology Resources is responsible for all computer activities of the department and staff. In addition to apportioning taxes collected by the department on the behalf of local governments, the Fiscal Services Division accounts for the department's budget. The Division of Research conducts studies pertaining to the state's tax structure and analyzes information regarding proposed legislation.

The department has a central office in Nashville and regional offices in Jackson, Memphis, Knoxville, Chattanooga, Columbia, Cookeville, Johnson City, and Shelbyville.

Department of Revenue
Organization Chart
May 2002



The department also has offices in Houston; Chicago; New York City; Atlanta; and Newport Beach, California, to assist taxpayers and aid in the administration of tax laws.

For the fiscal year ending June 30, 2001, the department had 880 positions and expenditures of $58 million.

Collection of Taxes

In fiscal years 1999-2001, the department collected state taxes in the amounts of $7,010,502,489.08, $7,573,689,526.74, and $7,675,100,561.62, respectively. See Table 1 for the collected revenues by tax type for those years.

Table 1
Tennessee Department Of Revenue
Collected Revenues
Fiscal Years Ending 1999-2001

Tax (1)	FY 1999	FY 2000	FY 2001
Franchise	$323,376,720.81	(2) $494,088,568.13	$480,241,982.40
Excise	571,427,795.50	(2) $613,924,261.66	673,464,754.29
Income	160,179,905.63	180,277,749.53	198,071,185.90
Inheritance, Gift and Estate	89,126,875.95	92,449,185.27	84,139,785.93
Gasoline	568,527,152.90	577,497,415.34	563,958,329.66
Petroleum Special Tax	58,198,689.61	60,656,786.00	61,575,536.12
Tobacco	84,941,246.41	82,589,221.27	81,671,412.81
Beer	16,025,773.84	15,990,402.73	16,018,361.09
Motor Vehicle Registration	199,546,049.95	219,724,734.13	210,677,718.54
Motor Vehicle Title	10,872,894.08	11,092,472.93	10,617,077.33
Mixed Drinks	30,512,056.36	32,181,305.05	34,136,997.28
Business	17,497,503.92	21,984,531.93	21,746,903.39
Privilege	190,077,693.50	187,262,559.55	187,886,051.16
Gross Receipts	199,877,126.85	213,619,212.42	216,547,280.46
Alcoholic Beverage	28,844,126.63	29,702,338.32	30,590,300.16
Sales and Use	4,317,430,739.87	4,589,628,063.24	4,653,412,226.94
Motor Vehicle Fuel	143,185,876.58	150,020,393.55	149,155,416.46
Coal Severance	589,336.25	593,642.39	599,163.74
Gas & Oil Severance	213,422.97	362,655.91	531,627.47
Coin Amusement	51,501.47	44,027.39	58,450.49
Total State Taxes Collected	$7,010,502,489.08	$7,573,689,526.74	$7,675,100,561.62
Local Sales Tax (3)	$1,370,629,127.75	$1,451,450,813.95	$1,478,950,955.56
Mineral Tax (3)	$5,755,385.84	$5,856,110.91	$6,040,094.49

(1) Definitions of the taxes are in Appendix A.
(2) *TCA* 67-4-2001 et seq. passed, which subjected limited liability corporations to the tax.
(3) Collected for and remitted to local governments.

DEPARTMENT'S STRATEGIC PLAN

The Tennessee Department of Revenue prepares an annual strategic plan as part of the state's Executive Branch Initiative, which began in 1998. At that time, strategic planning was started in the Executive Branch by the Governor and his staff with the help of the Center for Effective Government in the Department of Finance and Administration, which has published a Strategic Business Planning guide for use by the Executive Branch Agencies. Participation in this initiative is not required by statute. The department won the Governor's Award for Outstanding Strategic Plan for 1999.

The department's plan has the goals, objectives, strategies, and Performance Accountability Measures (PAMs) used by the agency to show results and ensure accountability. Goals are defined as the desired ends or results that the agency wants to achieve in a given time frame. Objectives are specific measurable targets that the agency achieves towards reaching its goals. Strategies define how the agency will achieve the objectives. PAMs are measurable data. For example, in the 2001 plan, Goal 1 is "To simplify voluntary compliance and to educate and assist taxpayers." One of the objectives for this goal is "Reduce taxpayer problems and issues." A strategy for this objective is "Evaluate the informal conference process to ensure that conferences are consistently conducted with the letter and spirit of the law." Consequently, one of the PAMs for this goal is "Measure the percentage of conference requests that are not resolved within 75 days."

Goal 2 for the plan is "To enforce the tax laws fairly and consistently." An objective is "Increase voluntary compliance with tax laws through increased criminal investigative activity." A strategy for this objective is "Formulate improved methods of collecting and processing information associated with retail inspections and monitor all fuel sales by 12/31/2001." A PAM for this goal is "Determine the effectiveness of motor fuel enforcement efforts by measuring the number and percentage of compliant taxpayers in the following categories: on-road stops, off-road stops and retailer inspections."

The department tracks plan progress on each individual goal, objective, and strategy through the use of Strategic Planning Tracking Forms and posts this information on a shared directory on the department's computer network. The Executive Summary of the department's 2001 strategic plan states that the department completed a number of strategies in prior plans as indicated in Table 2.

Table 2
Tennessee Department of Revenue
Strategic Plans
Strategies Completed

Plan Year	Total Strategies	Number Completed
1998	87	20
1999	133	21
2000	171	28

OBSERVATIONS AND COMMENTS

The issues discussed below did not warrant a finding but are included in this report because of their potential effect on the operations of the department and on the citizens of Tennessee.

INTERNAL AUDIT OF THE DIVISION OF TAX ENFORCEMENT

In May 2002, the Internal Audit Section of the Tennessee Department of Revenue provided us a draft of their audit of the Tax Enforcement Division's Policies and Procedures. The audit covered, for financial purposes, the period July 1, 1998, through June 30, 2001. Operational activities were reviewed through November 2001. The internal audit addressed concerns raised during the planning for this performance audit.

The final audit has findings categorized into three areas: (1) collections of delinquent taxes, (2) pending dormant and dormant accounts, and (3) partial payment agreements.

Collections of Delinquent Taxes

The internal audit had six findings summarized in the audit as follows: Tax Enforcement procedures over processing, tracking and reporting collections should ensure adequate financial and internal control. "Lack of procedures in the area of reconciling collections could lead to misappropriations of monies and erroneous information being reported. Accurate and timely decisions cannot be made without timely and accurate information. Procedures should be updated to include some form of collection reconciliation and reporting verification for Tax Enforcement. Employees need to be made aware of procedures and the necessity for adherence to those procedures." The division needs to place more emphasis on collecting delinquent taxes—the average case collection percentage on field cases and partial payment agreements was 15% ($10,833,869.58 of $70,996,865.61) for the period April 2001 through March 2002. This does not include any bankruptcy or other case type balances.

Pending Dormant and Dormant Accounts

The audit had five findings summarized as follows: "Tax Enforcement has extensive and well-written procedures on processing 'dormant' accounts." (Dormant accounts are accounts for which the division cannot locate assets of the business to levy against including bank accounts, motor vehicles, real property, and any other assets that belong to the business.) "However, there appeared to be many times when the procedures were 'broadly' interpreted, and generally accepted rules were used instead of the formal written procedures." As shown in previous internal audit reports and in this report, informational and financial reports are often not very useful in managing Tax Enforcement's cases. "The improvement of reporting on dormant cases and their effect on taxpayer accounts should be a priority of Tax Enforcement and Information

Technology Resources. Without timely, accurate, and useful information, it is very difficult to assess situations or track changes or problems occurring in the system."

Partial Payment Agreements

Partial payment agreements (PPAs) allow taxpayers who can and should continue in business a chance to survive as a going concern. The internal audit had four findings summarized in the audit report as follows: "The manual processing required by the PPA Unit creates delays in processing that the current staffing level may not be able to eliminate. In addition, they are limited by the current automation level in the process and a lack of timely and informative reports. The system should be reviewed for ways to improve the processing and handling of Partial Payment Agreements and installment payments made to these agreements. The department needs to develop a means to ensure that payments on the agreements remitted by Revenue Officers are posted accurately."

OUT-OF-STATE AUDIT OFFICES

The department's Division of Audit has five offices outside the State of Tennessee. They are located in New York; Atlanta; Chicago; Houston; and Newport Beach, California. These offices have 6 to 12 staff each including auditors, accounting technicians, and a supervisor. In addition, the division has a group of "satellite auditors" who are located in Cleveland, Ohio; Cincinnati; Boston; Charlotte, North Carolina; and Philadelphia. The satellite auditors work from home and are supervised by a senior auditor in Philadelphia. According to division management, these locations were selected based on the concentration of tax accounts in the geographic area.

The major purpose of the out-of-state program is to ensure that the corporations audited are in compliance with Tennessee tax laws. In order to audit sales, business, excise, and franchise taxes from corporations that do business in Tennessee but whose headquarters are not located in the state, auditors examine documents such as tax returns, sales invoices, general ledgers, sales journals, and purchase invoices.

According to division management, Tennessee's out-of-state tax auditor program is not unique. They indicated other states have similar programs including California, Florida, Georgia, Michigan, New Jersey, New York, North Carolina, Texas, Washington, and Wisconsin. In 2001, Department of Revenue staff surveyed 12 states regarding their use of out-of-state auditors: Alabama, Arkansas, Georgia, Idaho, Kentucky, Louisiana, Michigan, Mississippi, North Carolina, South Carolina, Wisconsin, and Washington. Of the 12, 4—Louisiana, Michigan, Wisconsin, and Washington—indicated that they had offices in other states. Some of the offices were located in the same cities as Tennessee's offices (e.g., Atlanta and New York). Of the 12, 7—Alabama, Idaho, Michigan, North Carolina, South Carolina, Wisconsin, and Washington—had out-of-state auditors who worked out of their homes. Four states that kept assessment statistics said out-of-state audit assessments were higher than in-state assessments.

Comparison of Expenditures

We compared the in-state and out-of-state offices using the expenditures for Department of Revenue offices for the fiscal year ended June 30, 2001, and the number of filled positions in each of the offices or locations as of September 1, 2001. We did not evaluate the turnover in the auditor positions or attempt to compute the full-time-equivalent employees for each office for the year.

As shown in the table below, the Department of Revenue has 265 tax auditors—41 located out of state and 224 in Tennessee. Of those 224 in-state auditors, 152 are in regional audit offices in Nashville, Jackson, Memphis, Cookeville, Chattanooga, Shelbyville, Johnson City, and Knoxville. The Nashville central office has 72 auditors assigned to division administration, audit support and operations, waivers and refunds, terminations processing, inheritance and gift tax auditing, and petroleum and motor fuel tax auditing.

Table 3
Tennessee Department of Revenue
Division of Audit
Positions and Expenditures Comparison

	Nashville Central Office	In-State Offices	Out-of-State Offices	Total
Auditors (1)	72	152	41	265
Support Personnel (1)	25	19	7	51
Administrative Personnel (1)	9	2	0	11
Total Expenditures (2)	$6,109,127	$10,534,774	$4,069,894	$20,713,795

(1) Per payroll records on September 15, 2001, from Department of Revenue, Human Resources Division.
(2) Department Expenditures Report for FYE June 30, 2001, from the Fiscal Services Division.

The total cost of the out-of-state program for fiscal year 2001 was $4,069,894. This amount represented the salary, benefits, and other expenditures for 41 tax auditors and 7 support personnel. The total cost for the eight regional offices in the state was $10,534,774. This amount represented the salary, benefits, and other expenditures for 152 tax auditors, 19 support personnel, and 2 administrative personnel. The total cost of the central office for the Audit Division for fiscal year 2001 was $6,109,127, which represents salary, benefits, and other expenditures for 72 auditors, 25 support personnel, and 9 administrative personnel.

The out-of-state offices spent $2,919,379 for salaries and benefits for the 41 auditors. The cost of travel ($354,163) and rent ($335,703) accounted for 82% of the remaining expenditures. See Table 4.

The in-state regional offices spent $8,749,560 for auditor salaries and benefits. The cost of travel ($408,720) and rent ($433,631) accounted for 76% of the remaining expenditures. (The rent amount is understated because the department did not allocate rent for the regional offices in Memphis, Chattanooga, or Knoxville to the Audit Division.)

For fiscal year 2001, the average out-of-state tax auditor cost the division $91,781 compared to $64,823 for a tax auditor assigned to one of the regional offices in the state. The difference in the average expenditure per auditor can primarily be attributed to salary, travel, and rent.

Table 4
Tennessee Department of Revenue
Division of Audit
Expenditures Comparison – In-State and Out-of-State Offices

Category	In-State Offices	Out-of-State Offices
Auditor Salary and Benefits	$8,749,560	$2,919,379
Travel	$408,720	$354,163
Rent	$433,631	$335,703
Total Expenditures Other Than Salary and Benefits	$1,103,536	$843,657
Percent of Travel and Rent to Other Expenditures	76%	82%
Average Salary Per Auditor	$57,562	$71,204
Average Total Cost Per Auditor	$64,823	$91,781

The division pays out-of-state auditors on a different pay scale than in-state auditors, recognizing the differences in the cost of living in cities such as New York and Chicago. When the out-of-state auditor program was started, the Department of Revenue asked for and the Department of Personnel approved for the out-of-state auditors to be non-civil service positions with higher salary levels than the in-state tax auditor positions. According to division management, out-of-state auditors are more highly qualified and typically have more experience than in-state auditors. Based on information provided by the division, a higher percentage of out-of-state auditors have an advanced degree (17% versus 4%) or are Certified Public Accountants (22% versus 16%).

The average annual travel expenditure for an in-state auditor is $2,689, compared to $8,638 for an out-of-state auditor. Most of the travel expenditures for the in-state auditors are for mileage reimbursement, whereas the out-of-state auditors are more likely to have motel and meal reimbursements in addition to mileage. Even though the out-of-state auditors are located in geographic areas with a large concentration of tax accounts, the audits of these businesses still require some travel, and the out-of-state auditors are more likely than in-state auditors to be assigned to travel audits.

The rental expenditures for the in-state tax auditors are about half that of the out-of-state auditors. The average rent for out-of-state auditors was $8,188, and the average rent for in-state auditors was $2,853.

Audit Production

The division uses an amount called "total production" as the criteria to measure audit results in monetary terms. Total production includes the dollar amount of assessments, error adjustments, overpayments, and refund reduction. Overpayments are added rather than shown as a reduction. The division believes this is providing credit for the auditor for finding an error irrespective of whether it adds to or subtracts from the state's revenues. Table 5 indicates the production for the fiscal year ending June 30, 2001.

Table 5
Tennessee Department of Revenue
Audit Division
Comparison of Audit Production by Audit Section
FYE June 30, 2001

Division Section	Amount	Percentage of Total
In-State Regional Offices	$82,802,931	28%
Out-of State Regional Offices	124,302,283	42%
Discovery Tax Section	47,000,012	16%
Inheritance and Gift Tax Section	6,557,351	2%
Motor Fuel Tax Section	20,269,003	7%
Refund Reductions Section	15,531,657	5%
Total	$296,463,237	100%

As indicated above, out-of-state regional office total production for FYE 2001 was $124,302,283 (42% of the total production of $296,463,237). According to management, there were 41 out-of-state auditors who accounted for 15% of the division's 265 total auditors and the 42% of total production.

However, in FYE 2000, the in-state regional offices and out-of-state offices both assessed about 27% of the total production. As of April 2002, division management indicated that the out-of-state offices accounted for 34% of total production to date for the fiscal year ending June 2002.

Economic Benefit of the Program

The cost per auditor is greater for the out-of-state employees; however, an evaluation of the value of the out-of-state auditor program must also include a comparison of the production (assessments) that the tax auditors generate and recognition of the value of Department of Revenue presence in other states.

The following chart provides the total and average production for tax auditors for the fiscal year ending June 30, 2001.

Tennessee Department of Revenue
Division of Audit
Calculation of Average Production
Fiscal Year Ended June 30, 2001

	Number of Auditors	Amount of Production	Percent of Production to Total	Average Production Per Auditor
In-State Auditors	152	$ 82,802,931	28%	$ 544,756
Out-of-State Auditors	41	$124,302,283	42%	$3,031,763
Nashville Central Office	72	$ 89,358,023	30%	*

*Average Production Per Auditor cannot be determined—some of the 72 auditors are support and administrative staff. The amounts assessed by some of the staff in the central office are not obtained by auditing taxpayers' records but reviewing information obtained by the department.

According to division management, the fact that out-of-state auditors are located where there are typically larger tax accounts can, in part, explain the significant difference in the average production per auditor. The division does not compile data for the actual amounts collected based on the total production (assessments) for a given year, so it is not possible to give a correlation between amounts assessed and amounts actually collected. In a comprehensive cost/benefit analysis, this comparison should be made to determine if the significantly larger assessments result in significantly larger collections.

According to the division, the presence of the out-of-state audit offices improves voluntary compliance with Tennessee tax laws. Another intangible benefit is the advantage out-of-state auditors have in monitoring activities of businesses in their region. The auditors read regional newspapers and business journals, and obtain audit leads regarding new business lines, expansions, and office openings.

Cost/Benefit Analysis

Although the program has been in operation since 1983, the division has not conducted a comprehensive cost/benefit analysis of the out-of-state program. The division and the department have justified the program to the Legislature and to the Department of Personnel by comparing the cost per out-of-state auditor to the increased tax assessments that are generated by these auditors. The division periodically evaluates the number and geographic location of large tax accounts and makes decisions to increase or redistribute the number of auditors in out-of-state offices or to add new satellite locations. However, the division has not conducted a cost/benefit analysis of the program giving consideration to the effects of changes in technology on the program (i.e., electronic submission of documentation needed for the audit). Division management believes that the large amount of audit assessments attributed to the out-of-state program is sufficient to justify the program. However, the out-of-state offices did not account for any larger percentage of assessments (production) than the in-state offices in the fiscal year ending June 30, 2000, and, based on December 31, 2001, data, had a smaller percentage of assessments for the current fiscal year.

Analysis of Potential Cost Savings of the Out-of-State Program

Given the significant cost of the salary, travel, and rent associated with the out-of-state tax auditors, a recommendation could be made to shift all or at least some of the work to in-state staff. However, in redistributing the audit work, the department should not compromise the quality of the audit work performed or the value of the production generated on those out-of-state audits.

There are several problems associated with reducing the number of out-of-state auditors. Expertise would be lost if current out-of-state employees would not or could not relocate to Tennessee. The number of auditors willing to transfer would be greatly impacted by the department's decision concerning whether or not the transfer would result in a reduction of salary.

There are also problems associated with the retrieval of sufficient information to perform audits. Although technology allows for the transfer of information, a certain amount of on-site audit work would still be required. Travel costs for these audits could be the same or more because of the greater distance from the audit site. The department would have to overcome any unwillingness on the part of businesses to trust electronic submission of records. Currently, the department does not have statutory authority to require electronic submission of information for audit purposes.

The Department of Revenue should perform a comprehensive cost/benefit analysis of the out-of-state tax auditor program, including technology and travel considerations mentioned above, to determine if shifting some of the audit work to in-state staff could result in cost savings. In addition, the division should compile data correlating assessments made and amounts actually collected. Division management's justification for the out-of-state program based merely on production is not sufficient. Although the production for those offices was higher during fiscal year ending June 30, 2001, the out-of-state offices did not account for any larger percentage of assessments in the fiscal year ending June 30, 2000.

REVENUE INTEGRATED TAX SYSTEM (RITS)

During the prior performance audit, the department was in the process of implementing a new computer system, the Revenue Integrated Tax System (RITS), and replacing its remittance processing equipment. According to department management, this combination was expected to reduce processing errors, expedite taxpayer record updates, and improve taxpayer information flow. Operational since 1995, the system stores all taxpayer account information in one central database and incorporates taxpayer registration, document and return processing, taxpayer accounting, case management, and revenue accounting.

The department's Division of Internal Audit completed a Case Management Post Implementation Analysis of RITS in January 2001. We reviewed that report and other information provided by the department, and we conducted interviews with staff and management to determine if RITS has reduced processing errors, expedited taxpayer record updates, and improved taxpayer information flow.

Taxpayer Information and Record Updates

Based on the information reviewed above and interviews conducted, we determined that RITS has improved the flow of taxpayer information and expedited record updates.

Taxpayer Services said RITS improved customer service because it provides immediate access to taxpayer information. Before RITS, the Processing Division could not access information posted by other divisions. However, with RITS, taxpayer information is centralized and accessible to all divisions. This centralized information allows department staff in any division to review a taxpayer's complete records, filings, indebtedness, etc., which, according to departmental staff, helps increase taxpayer compliance.

Record updates are more efficient with RITS. According to the department, data are available for inquiry, update, and adjustment by Taxpayer Services personnel in all regional offices, eliminating the need to prepare manual documents and submit them for central office staff to enter updates. RITS allows notations to be made that document updates and changes to taxpayer accounts, reducing the amount of paper used and stored. Centralized account information allows staff to correct errors on-line. Rather than forwarding items through several people for changes, staff can determine the current status of an account and take appropriate action in one step.

Processing Errors

Based on information reviewed and interviews conducted, we found that the department has not determined whether RITS has reduced processing errors. The Division of Internal Audit's Case Management Post Implementation Analysis did not address this issue.

We reviewed and analyzed an Outstanding Suspended Transactions report dated December 4, 2001. The Outstanding Suspended Transactions Report is printed daily and lists processing transactions that contain errors either by the taxpayer or by Processing Division staff. For instance, the taxpayer's identification number or address on a return may not match the information contained in the department's RITS system. The Processing Division staff may enter amounts from the return incorrectly, causing the payment submitted not to match the amount indicated on the return.

The report contained 4,551 suspense items ranging from 0 to 2,258 days outstanding and totaling $3,781,225. We noted the following:

Outstanding Suspended Transactions

Date In	Number of Transactions	%	Dollars
1995	2	0.04	$ 4,834
1996	1	0.02	$ -
1997	9	0.20	$ 409
1998	20	0.44	$ 586
1999	39	0.86	$ 1,043
2000	197	4.33	$ 53,837
2001	4,240	93.17	$3,719,360
2002*	43	0.94	$ 1,156
	4,551	100	$3,781,225

*These returns were actually received and keyed in 2001. Management stated that erroneous future dates were entered for these transactions due to faulty or nonexistent edit checks. Management has verified that edit checks are now in place and working correctly.

According to division staff, the origin of these errors, such as taxpayers, data entry, or system problems, cannot be verified.

The department should develop and implement a system for monitoring why suspense errors occurred. It is likely that consistent taxpayer and data entry errors can be identified and corrected through form changes and system edit checks, improving efficiency in the Processing Division.

FINDINGS AND RECOMMENDATIONS

1. The department does not verify the accuracy of the data used in Performance Accountability Measure (PAM) calculations

Finding

The Department of Revenue's 2001 Strategic Plan contains 27 Performance Accountability Measures (PAMs). The auditors reviewed the 12 of these that apply to the Processing, Audit, Special Investigations, Tax Enforcement, and Administrative Hearing Office divisions. See Appendix B. We interviewed personnel in these divisions to verify how data are collected, maintained, and calculated. We reviewed the data to determine reliability and found discrepancies.

<u>Processing Division Performance Accountability Measures</u>

Four of the PAMs we reviewed are used by the Processing Division to measure

- percentage of timely deposits,
- timely posting of returns,
- percentage of suspended returns, and
- percentage of returns filed by electronic means.

The department's Processing Division uses RITS computer-generated data for most of these measures but manually transfers information from RITS reports or RITS screens and enters that data into spreadsheets for PAM calculations. Auditors found discrepancies between the computer data and the spreadsheet entries. Auditors observed several similar files with computer-generated reports which could result in information being extracted from the wrong file. This would alter PAM results and could result in management decisions based on inaccurate data.

<u>Administrative Hearing Office Performance Accountability Measures</u>

The data for two of the PAMS we reviewed are used by the Hearing Office to determine the percentages of

- cases that go to litigation without a conference and cases that go to litigation after a conference, and
- conference requests not resolved within 75 days.

The Administrative Hearing Office maintains a logbook in which manual entries for all conference requests are made in sequential-date order. Over a period of two quarters (six months), we found 4 of 191 entries out of sequence. This contributed to conference request totals for the quarters reported being under- or overstated. This is not a significant error but does indicate the need to verify data.

Special Investigations Division Performance Accountability Measures

We reviewed two PAMS used by the Special Investigations Division. The first one was to measure the effectiveness of fraud investigation efforts in four ways: (1) percentage of cases resulting in fraud or prosecution, (2) the average time to investigate a case, (3) the percentage of time spent investigating tax fraud, and (4) the percentage of cases where fraud/prosecution is not established within 120 days. No problems were found with the data used for this measure.

The second measure was to determine the effectiveness of motor fuel enforcement efforts by measuring the number and percentage of compliant taxpayers based on on-road stops, off-road stops, and inspections. We reviewed 2001 Motor Fuel Inspection Logs and compared the log totals to a spreadsheet used to calculate PAMs. We found that the division had performed 58 more inspections in the calendar year 2001 than the division had reflected in PAM calculations. This change caused the compliance percentages for two categories of inspections—on-road stops and off-road stops—to change. This discrepancy did not significantly affect PAM results for the year; the division performed .5% better than the original measure indicated. However, the results for the last quarter (October–December 2001) had a significant discrepancy in the number of on-road inspections conducted. The number of on-road inspections for October 2001 was 29 more than reported, or a 30% shortage of inspections for this PAM for the quarter.

Audit Division Performance Accountability Measures

We reviewed two PAMs used by the Audit Division to measure

- the percentage of audits completed within budgeted hours, assessments receiving subsequent adjustments, and audits resulting in change versus no change; and
- the amount of interest paid on refund claims and the amount of time to process refund claims.

The Audit Division manually counts the number of assessments adjusted because the information is not generated by a RITS computer report. According to division staff, RITS does not produce a report which tracks assessment adjustments. The division has been manually counting the adjustments, but starting in February 2002, the division began tracking adjustments using a spreadsheet. According to staff, using the spreadsheet to list adjustments and additional information should permit better data verification of the manual count. Although we did not find any discrepancies in the PAM data, the manual count could result in discrepancies.

Division management and the Strategic Plan coordinator stated that they rely upon the staff preparing the information for the PAMs and do not verify the data submitted. When data are not verified, department management may report a strategy as completed that is not or may make management decisions based on inaccurate performance calculations.

In *Service Efforts and Accomplishments Reporting: Its Time Has Come*, the Government Accounting Standards Board recommended that verification be performed for all performance indicators. The board suggested that for internal reporting, verification could be performed by another organizational unit within the entity that is independent of the responsible unit.

The divisions for which we reviewed PAMs did not have written procedures stipulating how to gather, compile, and report data. This made it difficult to verify data collected.

Recommendation

The department should implement policies and require divisions to verify the data used for PAMs. Divisions should track data verification results and report to the Strategic Plan coordinator regularly. Verification of data used in PAMs will provide department management with an accurate summary of overall performance. The Audit Division should work with the Information Technology Resources Division to make changes in RITS so that it can produce a report to track audit adjustments. In addition, the department should require the divisions to document the methods used to compile PAM data.

Management's Comment

Processing Division Performance Accountability Measures

We concur. The Processing Division will prepare procedures detailing the selection of the data utilized for PAM calculations, and these procedures will be added to the Incoming Mailroom procedures. The division will also develop a verification process to ensure the accuracy of information transferred from source data to the PAM spreadsheets. Verification results will be maintained and reported to the Strategic Planner.

Administrative Hearing Office Performance Accountability Measures

We concur. The count of conference requests received in a specific quarter should be verified. We will continue to have the office's legal assistant review all entries thoroughly. It should be noted however that the manual logbook is not completely sequential, nor has it been expected to be. Taxpayers sometimes send their conference requests to other Revenue offices, which has caused delays in the Hearing Office receiving the conference request. These requests are logged according to the date received with a notation indicating the date of the original conference request, in accordance with the *Rules of the Department of Revenue* 1320-1-2-.05. Historically, the postmark (relevant under the rule and relevant for determinations of timeliness) may be in the first quarter, but we report for PAMs using the date it is received by this Office, which could have been in the second quarter. This can result in what may appear to be an error.

Special Investigations Division Performance Accountability Measures

We concur. As pointed out in the finding, there was a 30% shortage of on-road inspections reported in one of the performance measures (PAMs) for the quarter ended December 2001. In other words, we did more work than we had claimed credit for in the performance measure. The error occurred primarily because the Nashville Office did not receive December's information from a field inspector until after the cut-off date for the quarterly PAM report. It should also be noted that the error rate for the entire year was only 1.74%.

To correct the finding, Special Investigations has implemented a new procedure that requires inspectors to fax on-road inspection information to the Nashville Office no later than a week after month end. This procedure, along with the implementation of a new excel worksheet function that prevents the counting of header rows, will ensure accurate quarterly PAM reporting in the future.

Audit Division Performance Accountability Measures

We concur. The Audit Division will work to implement policies and procedures to ensure that data verifications are performed on Performance Accountability Measures (PAMS) compiled by the division. The Audit Division will also work with the Information Technology Resources Division to make changes in RITS in order that audit adjustments can be automatically tabulated/reported. It is important to point out that many audits (work papers) are adjusted prior to being posted to the system. Thus, some manual tracking will have to remain in place. However, Division Management will ensure that the data used in the PAMs, whether manual or automated, is accurate.

Information Technology Resources Division Response

We concur. In the future, the department will utilize RITS capability to track adjustments made to an audit after the assessment has been recorded. The ITR and Audit Divisions will work to identify reporting requirements to meet the PAM specification.

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2. The Audit Division is not reporting information required by divisional procedure and the Strategic Plan

Finding

The Audit Division is not reporting information on the monitoring of audit hours even though management has adopted a procedure to do so and has PAMs in the department's strategic plan requiring such information. The Audit Division released Procedural Bulletin 99-04 on August 6, 2002, stating management's intent to establish, report, and monitor audit hours.

The goal is to ensure the optimum use of audit resources and to promote efficiency of each individual auditor as measured through an employee performance evaluation process. The procedure also stipulates that the Audit Support Section is supposed to disseminate a monthly Audit Time Management Summary (report) to division management for further dissemination. The report should reflect, at a minimum, the completed audit cases for each region and display the actual versus budgeted hours for each case completed. Additionally, the 2001-2005 Strategic Plan also requires the division to report the number of audits completed within budgeted hours. We requested this information, but the division could not provide it. According to Audit Division management, the Information Technology Resources Division (ITR) has not been able to compile a report that would provide this information.

According to Audit Division management, they set the priority of all reports they request from ITR, and this report received a lower priority. ITR management stated that they have worked on the report and have an estimated completion date of July 2002.

Recommendation

The Divisions of Audit and Information Technology Resources should work to ensure that the July 2002 report target is met to comply with divisional procedures as well as strategic plan requirements. Monitoring these time variances could provide additional information that will aid in streamlining audits by maximizing audit efficiency and coverage. Variances could also provide valuable information about auditor performance, providing the department with another basis for auditor evaluation.

Management's Comment

We concur. The Audit Budget Hours report DGR611B was moved into the Revenue Integrated Tax System (RITS) production in early July 2002. The Audit Division will now be in a position to record Performance Accountability Measure (PAM) information relative to budget hours allotted to audits. This information along with the division's Audit Time Summary report and other monitoring measures should allow for improved monitoring of audit cases and aid in streamlining audits by maximizing audit efficiency and coverage.

Information Technology Resources Division (ITR)

We concur. The Audit Budget Hours Report, DGR611B, was placed in production on July 2, 2002. Additional problems have been identified, and ITR is currently making the necessary revisions.

3. Sampling techniques used by the Processing Division to collect PAM information need to be improved

Finding

The Processing Division receives tax returns and payments and follows their progress through the RITS system by using a sample of the returns and payments. This information is used to collect data for the division's PAMs. Based on our observations of the procedures used to track the progress, the sampling methods used could result in misleading PAM calculations.

Each day, the Processing Division sorts mail received into trays. The mail is composed of tax returns and payments. Sales taxes are sorted into trays containing only sales taxes. Other trays contain a mixture of taxes.

PAM 3.2 calls for the Processing Division to measure the timeliness of deposits and returns to assess the receipt, deposit, and return processes. To help fulfill this requirement, the division uses a sample of two items from each mail tray. Staff photocopy the contents and return the original items back to the appropriate tray(s). Sampled items are not distinguished from other mail and, therefore, proceed through the process with all other items.

A staff person selects two items from each mail tray that contains only sales taxes. Because the other trays contain a mix of taxes, the staff person chooses two items from those trays and tries, according to division management, to include a variety of tax types.

Written Sampling Procedures

This method used to choose a sample of returns and receipts is not written and is not representative of all mail received, based on interviews with division management. Additionally, the occurrence of sample results in PAM spreadsheets could appear misleading to someone unfamiliar with the way data are calculated.

Processing Division management indicated that the method used has been passed on to staff by "word of mouth." This increases the probability that data may not be reliable. In addition, if data are invalid, the sample should not be used to monitor performance or be used as a basis for decision making. Moreover, the lack of procedure documentation not only affects sampling methods, but it also affects calculation methods. Consequently, the results of sampling could be misstated.

Tracking of Sample Items

Sample item information is entered manually on a Daily Mail Tracking Sheet by Processing Division staff. Division staff then use RITS reports to obtain information on the processing of the sample items and enter that information on the Daily Mail Tracking Sheet. This includes the date the item was deposited, the date all return information is entered, etc. Information on the tracking document is used to calculate PAM 3.2 results.

An auditor spoke with division personnel and reviewed Daily Mail Tracking Sheets and PAM results for January 2002. The auditor found several sample items that were not used. According to personnel, some sampled items, on occasion, cannot be located on RITS and are therefore replaced with extra sample items which are accessible on RITS. Furthermore, missing sample items are not reviewed to determine why they are not available on RITS. The previous Processing Director stated that extra sample items should only be used if original items were sent to the department in error. In addition, the missing items should be reviewed by the Director to determine what prevented processing so that if problems do exist, they can be identified and corrected. Replacing missing sample items with extra sample items could cause PAM results to be over- or understated and could hinder the early detection of processing problems.

Sampling Methods

According to division staff, the use of sampling to track money through processing was supposed to be temporary after the implementation of RITS in 1995 but has continued ever since. Based on auditor observations, the sampling methods employed are judgmental. For mailroom staff to obtain a mix of taxes, they must be selective about which envelopes they choose. By using this selection method, a random sample is not obtained.

Presentation

Sampling results, as previously mentioned, are used to report data for quarterly PAM updates. However, PAM result spreadsheets appear misleading. For example, PAM 3.3 lists the number of returns received and attempts to measure the number of days required to process 95% of those returns (see Figure 1). Literally interpreted, this presentation shows that it took two days to process 114,643 returns. However, the data calculating the number of days are actually based on the samples taken for the month. The sample for December 2001 included 398 pieces of mail; therefore, it actually took an average of two days to process 95% of 398 items sampled. Consequently, the presentation in Figure 1 could be misleading.

Figure 1

Number of Returns Received	95% of Returns	Number of Days to Process 95% of Returns
120,677	114,643	2

To aid the reader in interpreting PAM results, the division should indicate that the information presented is based on a sample used to project results to the population.

Recommendation

The department should review sampling methods and adopt sampling techniques that are representative of the items processed. Additionally, since the sample results are used to report a portion of two performance measures, the Processing Division should compile written sampling procedures that specify the methods for obtaining the physical sample and for calculating the results. Not only should this aid in improving sampling results, it should also provide a basis for testing data reliability. The procedures should require staff to research missing sample items and include these items in the sample if they are not errors. This should provide the division with another avenue to identify possible problems.

To reduce the probability that information is misinterpreted, the division should indicate on the PAM spreadsheet that sample data are used. This should provide enough information so that someone unfamiliar with the PAM process understands that information relating the number of days required to process returns is based on sampled information rather than the entire population.

Management's Comment

We concur. Current operating procedures require that when mail is received, with or without a payment, it be sorted by coded information located on the front of the envelope. If the taxpayer uses the preprinted envelopes provided to them, those items are sorted and put into a tray like the sales tax items referred to in the finding. These trays predominantly contain the tax type that is due at the time of sample selection. Generic envelopes received sort to a reject tray and can contain any type of tax or correspondence. Since employees do not know the contents of the generic envelopes until selected, it will sometimes be necessary to select another envelope in order to meet the tracking requirements described in the PAM.

<u>Written Sampling Procedures</u>

We agree that procedures should be written to ensure that we are consistent in how we handle the sampling process. We will work to ensure that our samples are representative of all mail received.

<u>Tracking of Sample Items</u>

The employee that selects the sample does not enter any data onto a spreadsheet. The samples are copied, placed back in the tray and the copies are forwarded to a member of the division's administrative staff where the process of documenting the spreadsheet begins, and we will account for all items received. This will be corrected in the written procedures.

<u>Sampling Methods</u>

Processing believes that some discretion should be allowed when pulling a sample of mail from the mixed trays. However, every item selected in the sample will be recognized on the spreadsheet to maintain the integrity of the sample itself. If an envelope selected does not contain a payment or does not contain the needed sample item, it will be documented as selected and an additional item will be selected for tracking purposes. Selecting an item containing only some type of correspondence does not necessarily accomplish what we are trying to measure, but we will enlarge the sample to ensure we select items whose tracking is identified in the PAM. A complete random sample will always be our goal.

Presentation

The division will prepare a written procedure detailing the process by which sample items are selected and how we account for missing items within the sample. The Processing Division will also add a footnote to the PAM spreadsheet to indicate that sample data has been used for PAM updates.

RECOMMENDATIONS

ADMINISTRATIVE

The following areas should be addressed to improve the efficiency and effectiveness of the Department of Revenue's operations.

1. The department should implement policies and require divisions to verify the data used for performance accountability measures (PAMs). Divisions should track data verification results and report to the Strategic Planner regularly. Verification of data used in PAMS will provide department management with an accurate summary of overall performance. The Audit Division should work with the Information Technology Resources Division to make changes in RITS so that it can produce a report to track audit adjustments. In addition, the department should require the divisions to document the methods used to compile PAM data.

2. The Divisions of Audit and Information Technology Resources should work to ensure that the July 2002 report target is met to comply with divisional procedures as well as strategic plan requirements. Monitoring these time variances could provide additional information that will aid in streamlining audits by maximizing audit efficiency and coverage. Variances could also provide valuable information about auditor performance, providing the department with another basis for auditor evaluation.

3. The department should review sampling methods and adopt sampling techniques that are representative of the items processed. Additionally, since the sample results are used to report a portion of two performance measures, the Processing Division should compile written sampling procedures that specify the methods for obtaining the physical sample and for calculating the results. Not only should this aid in improving sampling results, it should also provide a basis for testing data reliability. The procedures should require staff to research missing sample items and include these items in the sample if they are not errors. This should provide the division with another avenue to identify possible problems.

   To reduce the probability that information is misinterpreted, the division should indicate on the PAM spreadsheet that sample data are used. This should provide enough information so that someone unfamiliar with the PAM process understands that information relating the number of days required to process returns is based on sampled information rather than the entire population.

Appendix A

Tax Definitions and Descriptions

Tax	*TCA* Reference	Definition/Description[1]
Franchise	67-4-2105 through 2109	$.25 on each $100 of stock surplus or undivided profits of entities for the privilege of doing business within the state. The tax applies to business entities that enjoy some form of limited liability protection. The minimum tax is $100.
Excise Tax	67-4-2006 and 2007	Applied at a rate of 6% on annual net earnings or the larger of stock or real and tangible property from business corporations, co-operatives conducted for profit, joint stock associations, business trusts, state banks, national banks, and savings and loan associations.
Income Tax	67-2-102	6% per annum on personal income derived from dividends and interest on stocks and bonds.
Inheritance, Gift, and Estate	67-8-101 through 106, 204, 303, 314, and 316	Applies to all property, real and personal, with certain exemptions. Rates range from 1.4% to 9.5 % at different dollar values.
Gasoline	67-3-1301 and 60-4-102	$.20 Charged on each gallon of gasoline or distillate refined, manufactured, sold, stored, or distributed in Tennessee, as well as gasoline or distillate imported into the state.
Petroleum Special Tax	67-3-1303, 1304, and 1305; and 68-215-110	$.01 for each gallon of gasoline and most other volatile fuels sold, used, or stored; an additional $.004 per gallon for an environmental assurance fee; and an export fee of 1/20 of one cent on fuels subject to the special tax
Tobacco	67-4-1002 through 1005, 1015, 1020, and 47-25-311	$.0065 per cigarette or $.13 per package of 20; $.0005 per cigarette pack enforcement fee; 6% of wholesale price on other tobacco products; license fees of $10 to $20 per location for sellers, distributors, and handlers; proceeds of sale of confiscated goods; and penalties of $100 to $5,000 for violations of the Unfair Cigarette Sales Law.
Beer	57-5-102 and 201	Registration fees imposed on beer wholesalers of $20 and manufactures $40 as well as a privilege tax of $3.90 per 31-gallon barrel of beer manufactured or sold in the state.
Motor Vehicle Registration	55-4-103, 111 through 113, 115, and 132; and Title 55, Chapter 4, Part II	Fees received from registration and licensing of motor vehicles. Rates are based on classification of the vehicles. Rates range based on the class of the vehicle
Motor Vehicle Title	55-6-101	$5 certificate of title fee and other fees received for the issuance of motor vehicle titles and noting of liens.
Mixed Drinks	57-4-301	A license tax of $300 to $1,500 for the privilege of selling alcoholic beverages for consumption on premises and a 15% gross receipts tax on sales.
Business	67-4-701, 704, 705, 707 through 709, 714 through 717, and 724	A minimum tax of $15 imposed principally by local units of government on certain businesses, vocations, and operations carried on within this state.
Privilege	16-15-5007; 36-3-610; 39-13-709; 67-4-409, 411, 602, 803, 804, 1603, 1701 through 1703, 1901; 40-24-107; and 68-211-1006	Various taxes on litigation in the courts, $.37 per $100 realty transfer tax; 11.5 cents per $100 mortgage recordation tax; tire tax of $1 per tire; occupational tax of $200; marriage license fee of $15; automotive oil fee of $.02 per quart; a 3% surcharge tax on rental cars; and a bail bond tax of $12 per bond.
Gross Receipts	67-4-402, 405, 406, 410, 506; 39-17-1316; and 16 USC 831(1)	Taxes levied on the gross receipts of certain types of businesses operating in the state including the following: 1.9% on soft-drink bottlers, 3% on gross receipts over $5,000 of intrastate water and electric power distribution companies, 1.5% on manufactured or natural gas intrastate distributors, 15% on mixing bars and clubs, 2.5% on vending machine tobacco items, 1.5% on other vending machine items if the price of the items purchased is $5.00 or less, and a $10 per year firearms dealer permit fee.
Alcoholic Beverage	57-3-202, 203, 204, and 302	$1.10 per gallon on wine and $4 per gallon on spirits, plus license and permit fees for manufacturers of $1000, wholesalers of $1000, retailers of $500, and their representatives ranging from $2 to $50.
Sales and Use	67-6-201 through 205, 212, 213,216- 221, and 225-227	The general rate of 6% that applies to the sale, use, consumption, distribution, lease or rental of tangible personal property and certain services. There are also varying rates ranging from 1% to 8.25% that apply to other items and services, such as telecommunications and cable services.
Motor Vehicle Fuel	67-3-1302, 2202, 2206, 2213, and 2409	$.17 on each gallon of diesel fuel and all fuel other than gasoline, except dyed fuel under IRS rules; a prepaid annual agricultural diesel tax ranging from $56 to $159 based on registered gross weight; $.13 on each gallon of compressed natural gas used for motor vehicles on public highways; $.14 on each gallon of liquefied gas used for motor vehicles on public highways; and an annual vehicle tax on liquefied gas users

[1] Information taken from *Tennessee Code Annotated*, 2001-02 Budget Document: Revenue Sources and Basis of Apportionment, and 2001 *Comprehensive Annual Financial Report*, page 183.

Tax	*TCA* Reference	Definition/Description[1]
		ranging from $70 to $114, based on registered gross vehicle weight.
Coal Severance	67-7-103 and 104	Twenty cents per ton of severed coal in the state.
Gas and Oil Severance	60-1-301	3% of the sales price of severed oil and natural gas in the state.
Coin Amusement	67-4-507	$350 per year on each Class I coin-operated amusement device (a video game containing a free-play feature for additional games) operated for commercial purposes, or a $10 special occasion tax for each device for one 30-day period per year, in lieu of the annual tax; and $100 for each "Story Castle" device in lieu of the annual tax.
Local Sales Tax*	67-6-702	Any county by resolution of its county legislative body is authorized to levy a tax not to exceed 2 ¾ percent on the same items taxed under the state sales tax law.
Mineral*	67-7-201	Any county legislative body, by resolution, is authorized to levy a tax on all sand, gravel, sandstone, chert, and limestone and shall not exceed 15 cents per ton.

* Collected for and remitted to local goverments.

Appendix B

Listing of Goals and Objectives and Associated Department of Revenue Performance Accountability Measures Reviewed by the Auditors Strategic Plan 2001-2005

Goal	Objective	Performance Accountability Measure Reviewed	Responsible Division
1. To simplify voluntary compliance and to educate and assist taxpayers.	**1.1** Increase accessibility of tax information and education to all citizens. **1.2** Provide quality service to every citizen. **1.3** Reduce taxpayer problems and issues. **1.4** Revise and update departmental rules and regulations. **1.5** Identify, pursue, and enhance partnerships with other government agencies and/or other organizations.	**1.2** Assess the effectiveness of the informal conference process by measuring the percentage of cases that go to litigation without a conference and the percentage of cases that go to litigation after a conference.	Hearing Office
		1.3 Measure the percentage of conference requests that are not resolved within 75 days.	Hearing Office
		1.4 Measure the number of new taxpayers resulting from efforts of the Audit Division's Discovery Unit and track by project type or referring organization.	Audit Division
2. To enforce the tax laws fairly and consistently.	**2.1** Be responsive to changes or potential changes in the state tax structure or tax laws and effectively administer all tax laws as established by the legislature. **2.2** Evaluate and improve the efficiency and effectiveness of the audit program. **2.3** Continually review all departmental operations, processes, and procedures. **2.4** Improve the efficiency of delinquent tax collection. **2.5** Increase voluntary compliance with tax laws through increased criminal investigative activity.	**2.2** Measure effectiveness of fraud investigation efforts in four ways. Those ways are to (1) determine the percentage of selected cases resulting in fraud or prosecution; (2) identify the average time to investigate a case; (3) determine the percentage of time spent investigating tax fraud compared to other duties; and (4) determine the percentage of cases where fraud/prosecution was not established within 120 days.	Special Investigations
		2.3 Determine the effectiveness of motor fuel enforcement efforts by measuring the number and percentage of compliant taxpayers in the following categories: on-road stops, off-road stops, and retailer inspections.	Special Investigations
		2.4 Measure (1) the percentage of tax enforcement cases in immediate priority (over 90 days old), (2) the percentage of tax enforcement cases in inventory resolved monthly, (3) the percentage of tax enforcement receivables collected, and (4) the average cost of collection to optimize delinquent tax collection efforts.	Tax Enforcement

Goal	Objective	Performance Accountability Measure Reviewed	Responsible Division
		2.7 Measure (1) the percentage of audit cases completed within budgeted audit hours, (2) the percentage of assessments that receive subsequent adjustments after completion, and (3) the number and percentage of audits resulting in change versus no change to assess the effectiveness of the audit program.	Audit Division
		2.8 Measure the amount of interest paid on refund claims by tax type and signatory threshold and track the flow and average amount of time it takes in each of the three processing thresholds.	Audit Division
3. To account for all collected funds.	**3.1** Maximize and streamline the procedures for document and remittance processing. **3.2** Improve business processes of the Fiscal Office.	**3.2** Measure the percentage of timely deposits to assess the receipt and deposit process.	Processing
		3.3 Measure the timely posting of returns to assess the receipt and return process.	Processing
		3.4 Measure the percentage of suspended returns that result in an exception and the percentage of suspended returns.	Processing
		3.5 Measure and track the percentage of sales and use tax returns filed by Electronic Data Interface (EDI) to all returns.	Processing

Note: There are actually five Goals for the Strategic Plan, but Goals 4 and 5 did not have Performance Accountability Measures associated with the divisions reviewed.

Appendix C

Title VI Information

All programs or activities receiving federal financial assistance are prohibited by Title VI of the Civil Rights Act of 1964 from discriminating against participants or clients on the basis of race, color, or national origin. In response to a request from members of the Government Operations Committee, we compiled information concerning federal financial assistance received by the Tennessee Department of Revenue, and the department's efforts to comply with Title VI requirements. The results of the information gathered are summarized below.

For fiscal year 2000-2001, the Tennessee Department of Revenue was the recipient of federal assistance through one grant, the Motor Fuel Tax Evasion Grant. Since 1993, the department has received $321,480.00 in funding. The remaining balance at the close of fiscal year 2000-2001 was $13,841.16.

The Tennessee Department of Revenue does not report to any state or federal agency concerning Title VI with the exception of the Title VI hearings held by the Tennessee Black Caucus Title VI Subcommittee.

The department's Title VI coordinator is Jaqueline Safstrom. As Title VI coordinator, she is the responsible contact for all Civil Rights issues. She also works with the department to create public display posters stating departmental non-discriminatory policies. These posters are located on all departmental bulletin boards. Approximately ten percent of her time is directed toward the creation and maintenance of non-discriminatory practices.

According to the department, the main areas of Title VI compliance review fall into four categories. These categories include employment (both public and "in-house"), seminars and workshops, training, and audit selection. No preaward reviews were specifically conducted in the areas of employment, seminars/workshops, and training. However, in the area of employment, the Department of Personnel dictates policy as is allowed through Civil Service rules and regulations. Post-award reviews have been utilized in the form of evaluation reports completed by workshop/seminar attendees. These evaluations have also been routinely used in departmental training exercises. In the area of audit selection, all audits are selected by an Audit Selection Unit, created specifically to devise objective criteria for audit selection. In the area of training, workshops, and seminars, the frequency of activity is not set, as budget constraints and work load must be considered in scheduling such events.

Title VI complaints must be filed in writing with the department's Title VI coordinator. Pertinent information regarding the nature of the complaint must be included. Anyone alleging discrimination on the basis of race, color, or national origin should contact the coordinator to receive the necessary forms for completion. Completed complaint forms will be reviewed upon receipt and routed appropriately. According to the department's Title VI coordinator, the department has not received any Title VI or related complaints in the last two years.

The following is a list of minority contracts held by he Department of Revenue as compiled by the Department of General Services. Included in the list is the vendor name, amount awarded, and the ethnicity. This list covers fiscal year 2001-2002.

Vendor	Amount Awarded	Ethnicity
Everready First Aid Corp	$ 119.11	Unknown
Linsco, Inc.	$ 2,581.29	African American
Accuvoice, Inc.	$ 4,100.00	Caucasian
Edcor Safety Equipment	$ 51.84	Unknown
Datamaxx Applied Tech.	$ 300.00	Unknown
Goldner Associates, Inc.	$ 741.50	Caucasian
Handymaps Inc.	$ 144.50	Unknown
Madison Trophy Shop	$ 123.41	Unknown
Sanders Mfg. Co.	$ 1,167.32	Caucasian
Peripheral Computer Supply	$ 318.60	Caucasian
The Stamp Works	$ 1,527.89	Caucasian
Imagination Spec. Inc.	$ 311.52	Caucasian
Micromedia Co.	$ 140.00	Native American
Automated Mail & Ship. Sys.	$ 119.08	Caucasian
Copies in a Flash	$ 936.00	Caucasian
Central Time Systems	$ 122.00	Caucasian
Imaging Sys. & Services	$29,104.18	Caucasian
Daily Office Supplies	$10,847.17	Caucasian
Clarksville Internet Services	$10,776.01	Caucasian
Elixer Technologies	$37,185.00	Other

The following list is also of contracted services within the department. However, information on these contracts is broken down by contract, amount of contract, and type of contract (i.e., small business, female-owned, corporation, etc.).

Contract	Amount of Contract	Type of Contract
Global Payment Systems	$950,000.00	Corporation
Center for Human Dev.	$430,000.00	Female Owned
Richard W. Kulp	$ 10,000.00	Small Bus. Provider
Charles T. Moore	$ 60,000.00	Small Bus. Provider
XyzTax, LLC	$ 90,290.00	Corporation
DB Software, LLC	$ 21,000.00	Small Bus. Provider
Scan-Optics, Inc.	$93,3000.00	Corporation

Staff of the Department of Revenue by Title, Gender, and Ethnicity
As of March 2002

	Gender		**Ethnicity**					
Title	Male	Female	Asian	Black	Hispanic	Indian	White	Other
ACCOUNT CLERK	2	8	0	4	0	0	6	0
ACCOUNTING TECH 1	5	29	2	8	0	0	24	0
ACCOUNTING TECH 2	1	6	0	2	0	0	5	0
ACCOUNTANT 2	0	1	0	0	0	0	1	0
ACCOUNTANT 3	0	1	0	0	0	0	1	0
ASST COMMISSIONER 1	1	0	0	0	0	0	1	0
ASST COMMISSIONER 2	1	0	0	0	0	0	1	0
ADMINISTRATIVE ASST 1	0	4	0	2	0	0	2	0
ADMINISTRATIVE ASST 2	0	1	0	0	0	0	1	0
ADMIN SERVICES ASST 2	1	5	0	0	0	0	6	0
ADMIN SERVICES ASST 3	1	4	0	1	0	0	4	0
ADMIN SERVICES ASST 4	1	2	0	0	0	0	3	0
ADMIN SERVICES ASST 5	1	2	0	0	0	0	3	0
ADMIN SECRETARY	0	3	0	2	0	0	1	0
ATTORNEY 3	6	1	0	1	0	0	6	0
ATTORNEY 4	1	1	0	0	0	0	2	0
AUDITOR DIR 2	1	0	0	0	0	0	1	0
AUDITOR 3	0	2	0	1	0	0	1	0
AUDITOR 4	0	2	0	0	0	0	2	0
BLDG MAINTENANCE WKR 1	1	0	0	1	0	0	0	0
CLERK 1	1	0	0	0	0	0	1	0
CLERK 2	4	20	1	11	1	0	11	0
CLERK 3	0	21	0	6	0	0	14	1
COMPUTER OPERATIONS MGR 1	1	1	0	1	0	0	1	0
COMPUTER OPERATIONS MGR 2	1	2	0	2	0	0	1	0
COMPUTER OPERATIONS MGR 3	1	1	0	2	0	0	0	0
COMPUTER OPERATIONS SUPERVISOR	0	1	0	0	0	0	1	0
COMMISSIONER 3	0	1	0	1	0	0	0	0
DEPUTY COMMISSIONER 2	1	0	0	0	0	0	1	0
DATA PROCESSING OPERATOR 2	6	31	0	20	0	0	14	3
DATA PROCESSING OPERATOR 3	1	10	0	7	0	0	4	0
DATA PROCESSING OPERATOR SUPERVISOR	0	5	0	2	0	1	2	0
DISTRIBUTED COMPUTER OPERATOR 2	3	1	0	0	0	0	4	0
DISTRIBUTED COMPUTER OPERATOR 3	1	6	0	5	0	0	2	0
ECON RESEARCH DIRECTOR	1	0	0	0	0	0	1	0

	Gender		Ethnicity					
Title	Male	Female	Asian	Black	Hispanic	Indian	White	Other
EXEC ADMIN AST 2	1	1	0	0	0	0	2	0
EXEC SEC 3	0	1	0	0	0	0	1	0
FISCAL DIR 1	1	0	0	1	0	0	0	0
FISCAL DIR 3	1	0	0	0	0	0	1	0
GENERAL COUNSEL 3	1	0	0	0	0	0	1	0
INFORMATION RESOURCE SUPPORT SPECIALIST 2	1	2	0	0	0	0	3	0
INFORMATION RESOURCE SUPPORT SPECIALIST 3	2	1	0	1	0	0	2	0
INFORMATION RESOURCES SPECIALIST 4	4	1	0	1	0	0	4	0
INFORMATION RESOURCES SPECIALIST 5	2	4	0	0	0	0	6	0
INFO SYSTEMS ANALYST 2	6	1	0	0	0	0	7	0
INFO SYSTEMS ANALYST 3	2	1	0	0	0	0	3	0
INFO SYSTEMS ANALYST 4	2	3	0	0	0	0	5	0
INFO SYSTEMS CONSULTANT	1	3	0	0	0	0	4	0
INFO SYSTEMS DIRECTOR 2	1	0	0	0	0	0	1	0
INFO SYSTEMS DIRECTOR 3	1	0	0	0	0	0	1	0
INFO SYSTEMS MANAGER 2	1	2	0	0	0	0	3	0
INFO SYSTEMS MANAGER 3	3	0	0	0	0	0	3	0
LEGAL ASST	0	3	0	1	0	0	2	0
OFFICE AUTO SPECIALIST	0	1	0	1	0	0	0	0
OFFICE SUPERVISOR 1	0	1	0	0	0	0	1	0
PERSONNEL ANALYST 2	0	2	0	1	0	0	1	0
PERSONNEL DIRECTOR 3	0	1	0	0	0	0	1	0
PERSONNEL MANAGER 1	0	1	0	0	0	0	1	0
PERSONNEL TECH 3	0	2	0	0	0	0	2	0
PROCUREMENT OFFICER 1	1	0	0	0	0	0	1	0
PROCUREMENT OFFICER 2	0	1	0	0	0	0	1	0
PROPERTY OFFICER 1	1	0	0	0	1	0	0	0
REVENUE AUDIT TECH	6	39	0	8	0	0	36	1
REVENUE ENFORCEMENT ASST DIRECTOR	1	0	0	0	0	0	1	0
REV EN DIR	1	0	0	1	0	0	0	0
REVENUE ENFORCEMENT MGR	3	1	0	0	0	0	4	0
REVENUE ENFORCEMENT OFFICER 3	14	10	0	2	1	0	21	0
REVENUE ENFORCEMENT OFFICER 2	24	34	1	14	0	0	43	0
REVENUE ENFORCEMENT SUPERVISOR	9	4	0	0	0	0	13	0

Title	Gender		Ethnicity					
	Male	Female	Asian	Black	Hispanic	Indian	White	Other
REVENUE FIELD AUDIT ASST DIR	1	0	0	0	0	0	1	0
REV FIELD AUDIT DIRECTOR	0	1	0	0	0	0	1	0
REV PROCESSING ASST DIRECTOR	0	1	0	0	0	0	1	0
REV PROCESSING DIR	0	1	0	1	0	0	0	0
REV PROCESSING MGR	1	0	0	0	0	0	1	0
REV PROCESSING QUALITY ASSURANCE REVIEWER	1	14	1	5	0	0	8	1
REV PROCESSING SUPERVISOR 1	0	5	0	1	0	0	4	0
REV PROCESSING SUPERVISOR 2	0	4	0	2	0	0	2	0
REV PROCESSING SUPERVISOR 3	0	1	0	1	0	0	0	0
REVENUE SPECIAL AGENT 2	9	3	1	1	1	0	9	0
REVENUE SPECIAL AGENT 3	6	0	0	0	0	0	6	0
REVENUE SPECIAL AGENT SUPERVISOR	3	0	0	0	0	0	3	0
REVENUE SPECIAL INVESTIGATIONS DIRECTOR	1	0	0	0	0	0	1	0
REVENUE ADMINISTRATIVE HEARING OFFICER 1	1	1	0	0	0	0	2	0
REVENUE ADMINISTRATIVE HEARING OFFICER 2	0	1	0	0	0	0	1	0
REVENUE SPECIAL INVESTIGATIONS ASST DIRECTOR	1	0	0	0	0	0	1	0
SECRETARY	0	4	0	2	0	0	2	0
STATISTICAL ANALYST 3	2	0	0	0	0	0	2	0
TAX AUDIT 1 SPECIALIST	9	6	1	2	0	0	10	2
TAX AUDIT 2 SPECIALIST	12	8	4	2	0	0	13	1
TAX AUDIT 2	9	19	0	3	0	0	25	0
TAX AUDIT 3	56	49	1	15	0	0	88	1
TAX AUDIT 4	34	22	0	3	0	0	53	0
TAX AUDIT MANAGER 1	3	2	0	0	0	0	5	0
TAX AUDIT MANAGER 2	3	2	0	0	0	0	5	0
TAX AUDIT MANAGER 3	2	0	0	0	0	0	2	0
TAX AUDIT SPECIALIST SUPERVISOR	5	1	1	1	0	0	4	0
TAX AUDIT SUPERVISOR	16	11	0	3	0	0	24	0
TAXPAYER SERVICES SUPERVISOR 1	1	7	0	4	0	0	4	0
TAXPAYER SERVICES SUPERVISOR 2	2	3	0	3	0	0	2	0
TAXPAYER SERVICES SUPERVISOR 3	0	3	0	0	0	0	3	0

	Gender		Ethnicity					
Title	Male	Female	Asian	Black	Hispanic	Indian	White	Other
TAXPAYER SERVICES ASST DIRECTOR	1	0	0	0	0	0	1	0
TAXPAYER SERVICES DIRECTOR	0	1	0	0	0	0	1	0
TRAINING OFFICER 2	0	2	0	1	0	0	1	0
TRAINING SPECIALIST 2	0	1	0	0	0	0	1	0
TAXPAYERS SERVICES INFORMATION ASSISTANT	0	8	0	1	0	0	7	0
TAXPAYERS SERVICES REPRESENTATIVE 1	3	27	0	14	0	0	16	0
TAXPAYERS SERVICES REPRESENTATIVE 2	0	10	0	3	0	0	6	1
TAXPAYERS SERVICES REPRESENTATIVE 3	0	6	0	3	0	0	3	0
TAXPAYER SERVICES TECHNICIAN	5	21	0	10	1	0	14	1
Totals	321 ===	537 ===	13 ===	191 ===	5 ===	1 ===	636 ===	12 ===