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Auditor's Performance Review of the
Integrated Tax System's Processes Related to the
Timeliness of Tax Refunds and Deposits of Tax Payments

August 28, 2006

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EXECUTIVE SUMMARY

PURPOSE

Pursuant to requests made by Councilmembers Jack Evans and Kathy Patterson, and in accordance with Section 455 of Pub.L.No. 93-198, D. C. Code Section 1-204.55,[1] the District of Columbia Auditor (Auditor) conducted a performance review of the Integrated Tax System (ITS) within the Office of the Chief Financial Officer's (OCFO's) Office of Tax and Revenue (OTR). The purpose of this particular review was to assess the accuracy and timeliness of taxpayer refunds and payments processed through the ITS.

CONCLUSION

The Auditor's performance review of the Integrated Tax System (ITS) revealed several weaknesses in internal controls and instances of noncompliance with applicable District guidelines. These conditions resulted in inefficient ITS usage, presented opportunities for financial improprieties and, in some instances, facilitated the system's generation of inaccurate and unreliable information.

The Auditor found that staff in the OTR did not accurately calculate the eligibility period for paying interest to taxpayers for untimely refunds, and OTR personnel did not comply with OTR's policy for timely depositing tax payments received from District taxpayers. In addition, delayed tax payment deposits resulted in tax revenues not being timely available in the District's General Fund to support District programs and services.

The Auditor also noted several deficiencies in OTR's process for imaging tax returns and other related documents and deficiencies in OCTO's Checkwriting Unit and OTR's Revenue Accounting Administration. Specific deficiencies included: (1) a risk that taxpayer information could not be timely and efficiently researched and returns would be processed inaccurately, resulting in miscalculations of payments due from and refunds owed to taxpayers; (2) the absence of written standard operating procedures, at the time of our fieldwork, to clearly document the functions and required practices of OCTO's Checkwriting Unit; (3) a critical lack of segregation of duties in the Checkwriting Unit, which was staffed with only two employees; (4) inadequate measures in place to timely detect errors or improprieties made by Checkwriting Unit staff when assigning check numbers for checks to be issued by the District; and (5) the failure of OCTO's management to cross-train others to perform the Checkwriting Unit staff's functions.

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[1]*See* section 455 (b) of the District of Columbia Home Rule Act, approved December 24, 1973 (Pub. L. No. 93-198; 87 Stat. 803); D.C. Code §1-204.55 (b) (2001) which states: "The District of Columbia Auditor shall each year conduct a thorough audit of the accounts and operations of the government of the District in accordance with such principles and procedures and under such rules and regulations as he [she] may prescribe. In the determination of the auditing procedures to be followed and the extent of the examination of vouchers and other documents and records, the District of Columbia Auditor shall give due regard to generally accepted principles of auditing including the effectiveness of the accounting organizations and systems, internal audit and control, and related administrative practices."

The Auditor found that internal controls needed improvements to prevent opportunities for financial improprieties. In addition, OTR staff did not strictly adhere to applicable District guidelines and failed to ensure efficient performance of the ITS and the integrity of the information generated by the system.

MAJOR FINDINGS

1. OTR staff did not use the appropriate eligibility period to calculate interest on taxpayer refunds.

2. OTR personnel did not deposit payments received from District taxpayers within the 48 hours established in OTR's internal policies.

3. OTR's process for imaging tax returns and other documents was inefficient and inconsistently adhered to by OTR staff.

4. Lack of written standard operating procedures for OCTO's Checkwriting Unit and lack of adequate segregation of duties resulted in inadequate checks and balances to timely detect errors or improprieties.

5. Lack of adequate segregation of duties in OTR's Revenue Accounting Administration could result in improprieties in processing taxpayer refunds.

MAJOR RECOMMENDATIONS

1. OTR personnel set parameters within ITS whereby interest is automatically calculated beginning on the 91st day after the date received or after the required due date, as applicable, in accordance with District law.

2. OTR's Director of Returns Processing Administration (RPA) standardize the placement of date stamps on tax returns for imaging purposes.

3. OTR's Director of RPA, Chief of the Remittance and Data Capture Branch, and the Supervisor of the Scanning and Review Operations develop written standard operating procedures for scanning and imaging tax information received from District taxpayers.

4. OTR's Director of RPA and the Supervisor of the Scanning and Review Operations immediately designate staff in OTR's Scanning Unit to review imaged returns for: (a) proper placement of date stamps; (b) readability of date stamps; and (c) accurate matching of supporting documents and imaged returns.

5. The Deputy CFO for Tax and Revenue, OTR's Director of RPA, and other designated OTR personnel consider the need to image W-2's and other forms that document the amount of income earned during the tax year, and collaborate with imaging consultants to identify alternatives for imaging such documents.

6. The immediate supervisor for OCTO's Checkwriting Unit develop and implement comprehensive written policies and procedures for the unit.

7. The immediate supervisor for the Checkwriting Unit train other OCTO staff to perform the Checkwriting Unit's functions and determine whether adding a staff person in the unit is warranted to ensure proper segregation of duties.

8. OTR's Director of Revenue Accounting and the Financial Reporting Manager immediately discontinue the practice of allowing one employee to both approve tax refunds for payment and input vouchers into the System of Accounting and Reporting (SOAR) to generate refund payments.

9. The Deputy CFO for Tax and Revenue and OTR's Director of the Information Systems Administration investigate the available alternatives and the associated costs for developing and implementing an automatic interface between the ITS and SOAR as an added security measure.

PURPOSE

Pursuant to requests made by Councilmembers Jack Evans and Kathy Patterson, and in accordance with Section 455 of Pub.L.No. 93-198, D. C. Code Section 1-204.55,[2] the District of Columbia Auditor (Auditor) conducted a performance review of the Integrated Tax System (ITS) within the Office of the Chief Financial Officer's (OCFO's) Office of Tax and Revenue (OTR). The purpose of this review was to assess the accuracy and timeliness of taxpayer refunds and payments processed through the ITS.

OBJECTIVES, SCOPE AND METHODOLOGY

The objectives of the audit were to determine whether:

1. taxpayer refunds and payments were processed in a timely manner, and in compliance with District of Columbia policies, and other applicable laws, regulations and guidelines;

2. taxpayer refunds and payments processed during the audit period were accurate and in agreement with the underlying supporting documentation (e.g. tax return); and

3. taxpayer payments received were timely deposited into the District's bank account.

The scope of the audit covered the period October 1, 1998 through March 31, 2004. In conducting this examination, the Auditor interviewed staff within OTR, the Office of Finance and Treasury (OFT), and the Office of the Chief Technology Officer (OCTO); reviewed applicable legislation, policies, and procedures regarding tax return processing; reviewed contract number DCFRA #99-C-004;[3] and examined taxpayer refunds and payments.

The audit was conducted in accordance with generally accepted governmental auditing standards and included such tests of the records as deemed necessary and appropriate under the circumstances.

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[2] *See* Section 455 of the District of Columbia Home Rule Act, ("Home Rule Act") approved December 24, 1973, (87 Stat.803; D.C. Code § 1-204.55 (2001)) D. C. Code 1-204.55 (b) states: "The District of Columbia Auditor shall each year conduct a thorough audit of the accounts and operations of the government of the District in accordance with such principles and procedures and under such rules and regulations as he [she] may prescribe. In the determination of the auditing procedures to be followed and the extent of the examination of vouchers and other documents and records, the District of Columbia Auditor shall give due regard to generally accepted principles of auditing including the effectiveness of the accounting organizations and systems, internal audit and control, and related administrative practices." *See* D.C. Code § 1-204.55 (c): "The District of Columbia Auditor shall have access to all books, accounts, records, reports, findings, and all other papers, things, or property belonging to or in use by any department, agency, or other instrumentality of the District government and necessary to facilitate the audit."

[3] Contract between the District of Columbia Financial Responsibility and Management Assistance Authority and Accenture (formerly Andersen Consulting), dated November 1998. Andersen Consulting subsequently changed the company's name to Accenture. The contract was modified in December 2002 to formally name Accenture as the contractor.

BACKGROUND

In November 1998, the District of Columbia Financial Responsibility and Management Assistance Authority (the Authority) entered into contract number DCFRA #99-C-004. This contract provided for the complete redesign and modernization of the District's computer-based tax processing system and the integration of the Business Tax, Individual Income Tax, and Real Property Tax systems.

During fiscal year (FY) 2000, the OTR began processing tax returns (individual income tax and corporate franchise tax) using the ITS. At that time, the District's Real Property Tax system had not been fully integrated into the ITS. Conversion of the Real Property Tax System into ITS was completed in January 2005.

Processing tax returns involves the collaborative efforts of OTR, OCTO, and OFT staff. Table I presents the responsibilities of the staff in each of these offices.

Table I
Tax Returns Processing Responsibilities Matrix

Agency	Function/Responsibility
Office of Tax and Revenue (OTR)	• Receives and processes tax returns of all tax types received from taxpayers through various sources, including mail, Electronic Taxpayer Service Center (eTSC), Tele-File and Gov One; • Generates vouchers to process tax refunds owed to tax filers; • Deposits payments received from District taxpayers; • Researches taxpayer accounts and handles customer inquiries; • Tracks tax revenues generated, collected, and owed; • Records tax payments in the System of Accounting and Reporting (SOAR); and • Generates and maintains financial reports.
Office of the Chief Technology Officer (OCTO) - Checkwriting Unit	• Assigns a range of numbers for tax refund checks to be issued; and • Transmits data to Wachovia Bank for tax refunds that are to be electronically transferred from the District to taxpayers' bank accounts.

Agency	Function/Responsibility
Office of Finance and Treasury (OFT)	• Prints checks using the check number range assigned by OCTO's Checkwriting Unit; • Works with OTR staff to ensure the accuracy of refund check information; • Mails refund checks to designated payees; • Processes "walk-in" tax payments received at 941 North Capitol Street for: individual income, withholdings, public space rentals, vendor tax, and sales tax; • Generates an Automatic Clearing House (ACH) register of tax refund direct deposits and initiates ACH transmissions; and • Ensures that monies collected from taxpayers are deposited into the District's custodial account.

Source: Interviews with staff at the Office of Tax and Revenue, Office of the Chief Technology Officer, and the Office of Finance and Treasury.

One of the purported advantages of the ITS is its ability to allow the OTR to process taxpayer information more efficiently and timely thus preventing a backlog in the number of returns to be processed. OTR staff was unable to provide data regarding the actual number of returns processed annually prior to the implementation of ITS. However, since the implementation of ITS, OTR has been able to maintain data on the number of returns processed annually. Data indicate that the number of tax returns processed by the OTR using the ITS increased from 61,676 to 477,624 between tax years 2000 and 2003. Appendix I presents the number of returns processed each year by tax type.

OTR managers and staff have recognized numerous other benefits and improvements as a result of ITS implementation, including improved methods for delivering services to local taxpayers. Additionally, OTR's internal filing and records retention practices have significantly improved because taxpayer information and supporting documents, including copies of tax returns, are retained electronically. Further, tax collection efforts have improved, resulting in increased tax revenues collected and made available in the General Fund to support District programs and services. Although the District has benefitted from the implementation of ITS, the Auditor identified issues relating to the system's performance and other deficiencies related to processing tax returns.

FINDINGS

OTR'S NONCOMPLIANCE WITH APPLICABLE TAX LEGISLATION AND OTHER DISTRICT GUIDELINES RESULTED IN OVERPAYMENTS OF INTEREST OWED TO TAXPAYERS

The Auditor's examination of sampled taxpayer refunds and payments revealed instances in which OTR staff did not comply with applicable legislation and guidelines regarding the processing of tax refunds and payments. For example, in some cases miscalculation of interest owed to taxpayers resulted in the overpayment of interest on taxpayer refunds. Consequently, less tax revenues were available in the District's General Fund to support District programs, services, and related activities.

OTR Staff Did Not Use the Appropriate Eligibility Period to Calculate Interest on Taxpayer Refunds[4]

For returns filed on or before the last date prescribed for filing (determined with regard to an extension), District legislation mandates that interest[5] is not to be allowed or paid before: (a) the 91st day after the due date of an individual income tax return, or (b) the 181st day after the due date of any other return.[6] The deadlines for filing individual income, business franchise, personal property, and real property tax returns are presented in Table II below.

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[4]For individual income tax returns timely filed by the taxpayer by the April 15th due date, refunds should be paid to the taxpayer within 90 days, by July 14th; otherwise, interest is to be paid to the taxpayer on the refund amount. For all other types of returns, refunds are to be paid to taxpayers who file by the applicable due dates within 180 days after the return is filed; otherwise, interest is to be paid to the taxpayer.

[5]*See* D. C. Code § 47-4202 (c): " The overpayment [interest] rate is 6% per year simple interest."

[6]*See* D. C. Code § 47-4202 (b) (2) (B).

Table II
Tax Filing Deadlines and Payment Due Dates

Tax Type	Filing Deadline	Payment Due Date
Individual Income	On or before April 15th of the following year (Calendar Year returns) On or before the 15th day of the fourth month after the close of the fiscal year (Fiscal Year returns)	On or before April 15th of the following year On or before the 15th day of the fourth month after the close of the fiscal year
Corporate Franchise	On or before the 15th day of the third month following the close of a taxable year	On or before the 15th day of the third month following the close of a taxable year
Unincorporated Business Franchise	On or before the 15th day of the fourth month following the close of the taxable year	On or before the 15th day of the fourth month following the close of the taxable year
Personal Property	On or before July 31st of each year based on the current value of the property as of July 1	On or before July 31st of each year
Real Property	Assessment year begins on January 1 and ends on December 31st. Property owners receive notices of proposed assessments on or before the following February 1 and have until April 1st to appeal such assessments.	May be paid in full or in two equal installments; one half to be paid on or before March 31st and the other half to be paid on or before September 15th.

Source: Government of the District of Columbia, Office of the Chief Financial Officer, Office of Revenue Analysis, *D. C. Tax Facts*, pp. 47-50.

Similarly, for returns filed after the last date prescribed for filing (determined with regard to an extension) an amended return or a claim for refund or credit, interest is not to be allowed or paid before: (a) the 91st day after an individual income tax return is filed; or (b) the 181st day after any other tax return or claim is filed.[7] Moreover, if a tax adjustment initiated by the Mayor, such as a new tax credit, results in a refund of an overpayment, interest is to be computed for the following

[7] *See* D. C. Code § 47-4202 (b) (3) (B).

periods: (a) for individual income tax returns, the 91st day after the date of the adjustment to the date of the payment; or (b) for any other tax returns, the 181st day after the date of the adjustment to the date of the payment.[8]

The Auditor sampled 545 individual income tax refunds and 202 corporate franchise tax refunds to determine the accuracy of the refund amounts and whether the refunds complied with applicable tax law. The Auditor found $37,799 in miscalculated interest payments for 23 delinquent individual income tax refunds as a result of OTR staff using a date before the 91st day after the due date of the return. Appendix II presents miscalculations identified by the Auditor. In nine, or 39% of the 23 instances noted, the eligibility period used by OTR's staff began on July 14th (the 90th day after April 15th) rather than July 15th (the 91st day after April 15th). While the amounts for one day's interest on one individual taxpayer's account may be insignificant, the cumulative financial impact of this one-day discrepancy applied to multiple taxpayers can result in significant revenue loss when dollars are inappropriately paid to taxpayers in the total population of individual income tax refunds.

Similarly, the Auditor found $8,761.12 in interest payments for five delinquent corporate franchise tax refunds that were calculated from a date before the 91st day after the tax return was filed. Appendix III presents instances of miscalculated interest for corporate franchise tax refunds identified by the Auditor.

RECOMMENDATIONS

1. OTR personnel set parameters within ITS whereby interest is automatically calculated beginning on the 91st day after the date received or after the required due date, as applicable, in accordance with District law. This may require that the ITS refund screen be revised to reflect both the date on which the return was due and the date the return was received.

2. OTR officials, as part of OTR's quality assurance process, implement measures to periodically review the eligibility periods used to calculate interest on taxpayer refunds to ensure their accuracy.

3. For those eligibility periods which are established or otherwise adjusted as a result of an audit of a taxpayer's account, the compliance officer or tax auditor should note in the taxpayer's ITS file the reasons for establishing a certain eligibility period and how the eligibility period was determined.

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[8] *See* D. C. Code § 47-4202 (b) (4) (B).

<u>OTR Personnel Did Not Deposit Payments Received from District Taxpayers Within the 48 Hours Established in OTR's Internal Policies</u>

During the course of the audit, OTR staff informed the Auditor that payments received from taxpayers are to be deposited within 48 hours of receipt. The Auditor was provided an excerpt from the OCFO's Strategic Business Plan - FY 2004 to 2005,[9] which indicates that one of OTR's performance measures is the percentage of payments deposited within the prompt deposit target of 48 hours after receipt. Although this performance measure was established for fiscal years 2004 and 2005, the Auditor noted that the 48 hour timeframe stated in the OCFO's Strategic Business Plan is the same timeframe OTR used in previous fiscal years.

The Auditor found, however, that OTR managers do not routinely monitor actual timeframes tax payments are deposited. Thus, although OTR officials established a prompt deposit target of 48 hours, they have not established a methodology to track and measure adherence to the 48-hour deposit goal. The Auditor also found that OTR officials do not monitor and hold staff accountable for untimely depositing payments received from District taxpayers.

Of 663 individual income tax payments examined by the audit team, 527, or 79%, were deposited after 48 hours of receipt, or an average of 11 days after receipt. Of 232 corporate franchise tax payments examined, 179, or 77%, were deposited after 48 hours of receipt, or an average of 10 calendar days. Delays in depositing payments received from taxpayers may result in less funds being timely available in the General Fund to support District programs and activities. Failure to timely deposit payments also may result in a loss of interest income that could have been generated from the investment of these funds. Table III presents the number deposits made after 48-hours of receipt (by year and tax type) that were identified by the Auditor.

[9] *See* Office of the Chief Financial Officer, Strategic Business Plan, revised as of 1/27/04, pg. 42.

Table III
Number of Sampled Deposits Made After 48 Hours of Receipt

Individual Income Tax				
Year	Number of Deposits Tested	Number of Deposits Made After 48 Hours of Receipt	Percentage of Deposits Made After 48 Hours of Receipt	Average # of Days Late
1999	4	2	50%	1 Day
2000	14	12	86%	7 Days
2001	267	228	85%	14 Days
2002	261	204	78%	15 Days
2003	117	81	69%	15 Days
Total	**663**	**527**	**79%**	**11 Days**
Corporate Franchise Tax				
Year	Number of Deposits Tested	Number of Deposits Made After 48 Hours of Receipt	Percentage of Deposits Made After 48 Hours of Receipt	Average # of Days Late
1999	15	12	80%	24 Days
2000	77	55	71%	11 Days
2001	60	50	83%	5 Days
2002	72	56	78%	5 Days
2003	8	6	75%	4 Days
Totals	**232**	**179**	**77%**	**10 Days**

Source: The Auditor's review of sampled taxpayer payment transactions as recorded in ITS.

INADEQUATE INTERNAL CONTROLS MAY RESULT IN INEFFICIENCIES IN TAX RETURN PROCESSING

Internal control is defined as follows:

> A process–effected by an entity's board of directors, management, and other personnel–designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting; (b) effectiveness and efficiency of operations; and (c) compliance with applicable laws and regulations.[10]

The Auditor found that accountable OTR personnel failed to establish internal control policies and procedures for imaging tax returns and related information filed by taxpayers. The Auditor further found that OFT and OCTO officials did not develop and implement an adequate system of internal controls for processing tax refund checks. Within a deficient control environment, OTR officials did not establish an effective system of internal controls and sound financial management practices. As a result of weak internal controls, there was a high degree of risk as to whether imaged information contained in ITS was accurate and complete; and whether OFT and OCTO managers adequately supervised those employees responsible for timely processing tax refund checks.

Although the ITS was implemented to provide more efficient and timely returns processing, the Auditor found several deficiencies that ultimately could result in processing delays and errors. The Auditor found the following deficiencies in procedures used to image tax returns: (1) some returns were imaged without the required date stamp showing date received; (2) some returns were imaged with illegible date stamps; and (3) in some cases information imaged as supporting documentation did not match the return.

The Auditor also found inadequate segregation of duties and a lack of policies and procedures in OCTO's Checkwriting Unit. At the time of our fieldwork, the unit's two employees performed the same functions which included assigning check numbers for checks issued by OTR and transmitting data to banks for electronic transfer of refunds to specific taxpayer accounts. Because both individuals performed the same functions, there was no system of checks and balances to timely identify errors or improprieties.

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[10] *See* Vincent M. O'Reilly et. al, *Montgomery's Auditing, 12th Edition*, Wiley Publishers, April 1998, p. 9-2.

The duties and responsibilities assigned to the two staff were not documented in writing and other OCTO staff had not been trained to perform the Checkwriting Unit's functions. This internal control weakness may affect the process for timely issuing refund checks to District taxpayers. Moreover; the generation of checks to District employees, contractors, and vendors may be adversely affected if the two staff were unavailable because they initiate and establish the check number ranges for all payments made by the District.

OTR's Process for Imaging Tax Returns and Other Documents Was Inefficient and Inconsistently Applied by OTR Staff

Upon receipt of tax returns and supporting items from taxpayers, staff in OTR's Returns Processing Administration (RPA) scan the information into the ITS imaging system. RPA staff typically scan documents that may be needed by staff in OTR's Compliance Division. These documents include the tax return, copies of checks received from taxpayers, requests for an extension of time to file, and other similar documents. Imaged tax returns must clearly show a date stamp that indicates the date all documents were received. Without the appropriate date stamp, OTR staff may miscalculate the amount of interest owed to or by District taxpayers.

The Auditor's review of 1,642 imaged returns (1,208 individual income and 434 corporate franchise) revealed significant deficiencies in the imaging process. In some instances, returns that were imaged, could not be retrieved. The Auditor also found:

- tax returns imaged without a date stamp indicating when the OTR received the return from the taxpayer;
- imaged tax returns bearing a date stamp that could not be read because it was positioned over other information on the tax return;
- W-2's to support tax returns not imaged; and
- imaged returns that were accompanied by documents that did not match the return.

During the review, the Auditor found that OTR staff were not required to image Form W-2, Withholding Statements (W-2's), Form 1099, Miscellaneous Income (1099's), or other forms that documented taxpayer income, as support for tax returns. However, the original (hard copy) forms were retained in OTR's taxpayer information files. The Auditor noted that due to the various sizes of W-2's, OTR experienced problems capturing W-2 images. The Auditor believes that the W-2 is one, if not the most, important document supporting the tax return and should be imaged and readily available for review when researching taxpayer data in ITS.

The Auditor also found numerous instances in which a check imaged as support for one taxpayer's payment actually supported the payment for another taxpayer. As a result, the Auditor questioned whether: (a) the sampled payment recorded in ITS was actually received, and (b) a payment that was actually received was erroneously applied to the sampled taxpayer's account.

RECOMMENDATIONS

1. OTR's Director of the Returns Processing Administration (RPA) standardize the placement of date stamps on tax returns for imaging purposes. OTR's Director of the RPA should inform, in writing, staff in OTR's Receipt and Control Unit of the date stamp requirement.

2. OTR's Director of RPA, Chief of the Remittance and Data Capture Branch, and the Supervisor of the Scanning and Review Operations develop written standard operating procedures (SOP's) for scanning and imaging tax information received from District taxpayers. These SOP's should include a methodology for identifying the person who imaged the documents so that when errors are discovered, the appropriate individual can be held accountable. OTR's Director of RPA, Chief of the Remittance and Data Capture Branch, and the Supervisor of the Scanning and Review Operations should distribute these written policies and procedures to OTR staff and discuss them as needed.

3. OTR's Director of RPA and the Supervisor of Scanning and Review Operations immediately designate staff in OTR's Scanning Unit to review imaged returns for: (a) proper placement of date stamps; (b) readability of date stamps; and (c) accurate matching of supporting documents and imaged returns.

4. The Deputy CFO for Tax and Revenue, and OTR's Director of RPA consider the need to image W-2 forms, and other forms that document the amount of income earned during the tax year. To the extent that problems regarding the varying sizes of W-2's can be resolved, staff in OTR's Information Systems Administration should work with imaging consultants to identify alternatives.

Lack of Written Standard Operating Procedures for OCTO's Checkwriting Unit and Lack of Segregation of Duties Resulted in Inadequate Checks and Balances to Timely Detect Errors or Improprieties

As previously noted, staff in OCTO's Checkwriting Unit determine the range of check numbers to be used for all checks prepared and printed by the OFT. Accordingly, OCTO's Checkwriting Unit sets the check number ranges for tax refund checks, payroll checks, and payments to vendors, contractors, and suppliers. The Checkwriting Unit also coordinates with financial institutions for the electronic transfer of tax refunds from the District to taxpayers' accounts.

Because Checkwriting Unit staff perform duties that affect the issuance of checks on a District-wide basis, it is essential that effective internal controls are implemented. The Auditor found that OCTO officials had failed to develop and implement adequate and effective written internal controls for the unit. The Auditor also found that neither the immediate supervisor of the Checkwriting Unit nor the employee responsible for the operation of the unit knew the full range of tasks performed by the unit's employees, and there was no secondary oversight by a responsible OCTO supervisor of the work performed by Checkwriting Unit staff. Accordingly, OCTO officials have no security or performance measures for holding Checkwriting Unit staff accountable for properly performing their specific functions.

The Auditor found a high risk that expertise could be lost or the processing of District checks could be interrupted or adversely affected if the current staff were to leave the Checkwriting Unit. They are the only two District employees who possess in-depth knowledge of their duties and how to carry out their functional responsibilities. The Checkwriting Unit staff have worked in that unit for many years, and may be considering retirement from District service. In the event that both staff members discontinue employment with OCTO or otherwise become unavailable, OCTO would not have available other OCTO staff with the requisite knowledge and experience to perform these specific duties.

The Auditor also found that having only two staff in the Checkwriting Unit, with other OCTO staff not being cross-trained on the Checkwriting Unit's functions, does not allow for the proper segregation of duties. Currently, both employees assign check numbers for checks that are issued by the District and transmit data to banks for the electronic transfer of funds to specific bank accounts, including tax refunds to taxpayer accounts. The Auditor found that Checkwriting Unit staff do not review each other's work for accuracy and completeness. Further, there is no effective system of checks and balances within the Checkwriting Unit to timely detect errors or possible improprieties.

RECOMMENDATIONS

1. The immediate supervisor for the Checkwriting Unit develop and implement comprehensive written policies and procedures for the unit.

2. The immediate supervisor for the Checkwriting Unit train other OCTO staff to perform the Checkwriting Unit's functions and determine whether adding a staff person in the unit is warranted to ensure proper segregation of duties.

3. OCTO officials consider the need to have an independent reviewer document the Checkwriting Unit's functions and responsibilities.

<u>Lack of Segregation of Duties in OTR's Revenue Accounting Administration Could Result in Improprieties In Processing Taxpayer Refunds</u>

Manual input of tax refund vouchers into the District's System of Accounting and Reporting (SOAR) is required because there is no electronic interface between the ITS and SOAR. An Accounting Technician in OTR's Revenue Accounting Administration performs this function by manually preparing and entering tax refund vouchers into SOAR. The Auditor noted that the same Accounting Technician reviews and authorizes refund vouchers for processing.

<u>Assigning or permitting an Accounting Technician or any other employee to review, approve, and enter refunds into the District's financial management system for payment.</u> Allowing one individual to perform incompatible or conflicting functions such as these violates the basic principle of segregation of duties, and is contrary to an effective system of internal control. There should be effective checks and balances in place to timely detect errors and irregularities.

Although the Auditor did not note any improprieties, this lack of proper segregation of duties could result in errors or improprieties occurring and not being timely detected. Without a separation of duties, the system is vulnerable to fraudulent schemes to misdirect funds to unauthorized payees or to the creation of dummy taxpayer accounts. OTR officials should immediately take the necessary steps to ensure that adequate internal controls are in place to prevent theft or misuse of government funds.

<u>RECOMMENDATIONS</u>

1. OTR's Director of Revenue Accounting and the Financial Reporting Manager immediately discontinue the practice of allowing the same staff person to handle more than one phase of the tax refund transaction. One employee should not be allowed to both input tax refund vouchers into SOAR and approve the refunds for payment. OTR's Director of Revenue Accounting and the Financial Reporting Manager should immediately assign different individuals the duty of inputting refund payment vouchers into SOAR and approving refunds for payment.

2. The Deputy CFO for Tax and Revenue and OTR's Director of the Information Systems Administration investigate the available alternatives and the associated costs for developing and implementing an automatic interface between ITS and SOAR as an added security measure.

CONCLUSION

The Auditor's performance review of the Integrated Tax System (ITS) revealed several weaknesses in internal controls and instances of noncompliance with applicable District guidelines. These conditions resulted in inefficient ITS usage, presented opportunities for financial improprieties and, in some instances, facilitated the system's generation of inaccurate and unreliable information.

The Auditor found that staff in the OTR did not accurately calculate the eligibility period for paying interest to taxpayers for untimely refunds, and OTR personnel did not comply with OTR's policy for timely depositing tax payments received from District taxpayers. In addition, delayed tax payment deposits resulted in tax revenues not being timely available in the District's General Fund to support District programs and services.

The Auditor also noted several deficiencies in OTR's process for imaging tax returns and other related documents and deficiencies in OCTO's Checkwriting Unit and OTR's Revenue Accounting Administration. Specific deficiencies included: (1) a risk that taxpayer information could not be timely and efficiently researched and returns would be processed inaccurately, resulting in miscalculations of payments due from and refunds owed to taxpayers; (2) the absence of written standard operating procedures, at the time of our fieldwork, to clearly document the functions and required practices of OCTO's Checkwriting Unit; (3) a critical lack of segregation of duties in the Checkwriting Unit, which was staffed with only two employees; (4) inadequate measures in place to timely detect errors or improprieties made by Checkwriting Unit staff when assigning check numbers for checks to be issued by the District; and (5) the failure of OCTO's management to cross-train others to perform the Checkwriting Unit staff's functions.

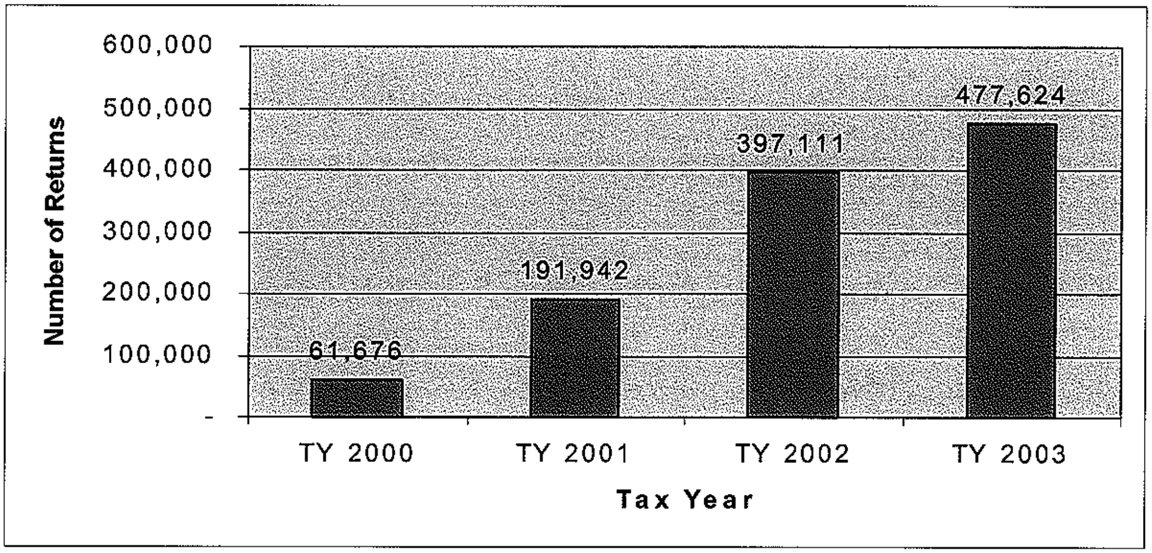
The Auditor found that internal controls needed improvements to prevent opportunities for financial improprieties. In addition, OTR staff did not strictly adhere to applicable District guidelines and failed to ensure efficient performance of the ITS and the integrity of the information generated by the system.

Respectfully submitted,

Deborah K. Nichols
District of Columbia Auditor

APPENDICES

Number of Returns Processed by Tax Type and Tax Year (Post-ITS Implementation)



Number of Returns Processed by Tax Type and Tax Year

	TY 2000	*TY 2001*	*TY 2002*	*TY 2003*	*Totals (by Tax Type)*
Individual	9,477	17,070	246,076	247,784	520,407
Fiduciary	2	369	4,526	5,259	10,156
Partner	-	-	1	-	1
Corporate Franchise	8,260	16,069	17,093	16,592	58,014
Unincorporated Franchise	2,106	3,779	5,499	4,804	16,188
Withholding	25,827	105,490	79,690	155,593	366,600
Sales and Use	14,168	39,875	31,399	35,913	121,355
Personal Property	1,836	9,290	12,827	11,606	35,559
Special Event	-	-	-	8	8
Motor Fuel	-	-	-	65	65
					-
TOTAL (by Tax Year)	**61,676**	**191,942**	**397,111**	**477,624**	**1,128,353**

Source: Information provided by staff at the Office of Tax and Revenue

APPENDIX II

Interest on Individual IncomeTaxpayer Refunds[1]

(Based on an Eligibility Period Before the 91st Day After the Due Date of Return)

Item	Transaction #	Date Received from Taxpayer	Refund Amount (Per Tax Return)	Required Interest Eligibility Date	Interest Eligibility Date (Per ITS)	Interest Period (Per ITS)	Date Paid	Interest Paid to Taxpayer	Tax Owed (Per OTR)	Total Amount Paid to Taxpayer
1	9100003984269	10/12/02	103,235.00	01/14/03	07/14/02	07/14/02 - 12/13/02	12/17/02	3,035.03	121,468.00	124,503.03
2	9100003964416	10/15/02	102,127.00	01/14/03	01/13/03	01/13/03 - 11/14/03	11/18/03	5,120.33	102,127.00	107,247.33
3	9100004135674	04/15/02	100,000.00	07/15/02	07/14/02	07/14/02 - 12/27/02	01/02/03	2,728.76	100,000.00	102,728.76
4	9100003964919	10/14/02	100,000.00	01/14/03	01/12/03	01/02/03 - 05/30/03	06/03/03	2,003.14	88,303.00	90,306.14
5	9100003979520	10/14/02	78,914.00	01/14/03	07/14/03	07/14/03 - 11/02/03	11/13/03	1,537.81	78,614.00	80,151.81
6	9100003903714	10/10/02	64,800.00	01/14/03	01/08/03	01/08/03 - 09/16/03	09/22/03	2,673.66	64,800.00	67,473.66
7	9100003971928	10/14/02	53,248.00	01/14/03	01/12/03	01/12/03 - 11/14/03	11/18/03	2,678.44	53,248.00	55,926.44
8	9100003875460	04/15/02	50,056.00	07/15/02	04/15/02	04/15/02 - 11/07/02	11/09/02	1,695.04	50,056.00	51,751.04
9	9100004624607	04/15/02	56,159.00	07/15/02	07/14/02	07/14/02 - 04/04/03	04/03/03	1,966.97	45,325.00	47,291.97
10	9100006421421	10/18/02	29,307.00	01/17/03	02/05/03	02/05/03 - 11/13/03	11/18/03	1,353.83	29,309.00	30,662.83
11	9100007633330	04/15/02	15,960.00	07/15/02	11/06/02	11/06/02 - 03/29/04	03/31/04	1,334.73	15,960.00	17,294.73
12	9100006326053	09/24/03	-	01/14/03	12/22/02	12/22/02 - 11/03/03	11/05/03	5,111.94	98,410.48	103,522.42
13	9100006399194	09/22/03	60,520.00	01/14/04	07/14/03	07/14/03 - 10/24/03	10/28/03	1,014.74	60,520.00	61,534.74
14	9100005828320	05/27/03	-	11/14/03	08/25/03	08/25/03 - 10/30/03	11/03/03	589.20	54,307.91	54,897.11
15	9100006484358	10/10/03	44,188.00	01/09/04	07/14/03	07/14/03 - 11/25/03	11/28/03	973.34	44,188.00	45,161.34
16	9100005419050	04/11/03	41,182.00	07/15/03	07/14/03	07/14/03 - 10/22/03	10/24/03	676.96	41,182.00	41,858.96
17	9100006425994	10/10/03	34,699.00	01/09/04	07/14/03	07/14/03 - 10/22/03	10/24/03	570.39	34,699.00	35,269.39
18	9100008464308	04/13/03	15,958.00	07/15/03	07/14/03	07/14/03 - 06/14/04	06/16/04	880.26	15,959.00	16,839.26
19	9100005328542	04/15/03	16,167.00	07/15/03	07/14/03	07/14/03 - 07/23/04	07/28/04	995.10	16,167.00	17,162.10
20	9100008486884	04/15/04	168,203.00	07/15/04	07/14/04	07/14/04 - 07/23/04	07/28/04	247.89	168,015.79	168,263.68
21	9100008440472	04/14/04	132,686.00	07/15/04	07/14/04	07/14/04 - 07/28/04	08/02/04	303.81	132,376.00	132,679.81
22	9100008474577	04/15/04	57,138.00	07/15/04	07/14/04	07/14/04 - 07/28/04	08/02/04	123.99	54,024.45	54,148.44
23	9100008125458	04/14/04	11,189.00	07/15/04	07/14/04	07/14/04 - 08/20/04	08/24/04	183.73	30,292.00	30,475.73
			$ 1,335,736.00					$ 37,799.09	$ 1,499,351.63	$ 1,537,150.72

Source: The Auditor's review of sampled taxpayer refund transactions as recorded in ITS.

[1] *See* D. C. Code § 47-4202(c): "The overpayment [interest] rate is 6% per year simple interest."

APPENDIX III

Interest on Corporate FranchiseTaxpayer Refunds[1]

(Based on an Eligibility Period Before the 91st Day After the Tax Return Was Filed)

Item	Transaction #	Date Received from Taxpayer	Refund Amount (Per Tax Return)	Required Interest Eligibility Date	Interest Eligibility Date (Per ITS)	Interest Period (Per ITS)	Date Paid	Interest Paid to Taxpayer	Tax Owed (Per OTR)	Total Amount Paid to Taxpayer
1	9100002947253	04/18/02	727,887.00	07/18/02	07/14/02	07/14/02 - 08/12/02	08/14/02	3,469.92	727,887.00	731,356.92
2	9100004059707	11/13/02	43,246.00	02/12/03	02/11/03	02/11/03 - 10/14/03	10/16/03	1,741.68	43,246.00	44,987.68
3	9100003978940	10/24/02	36,574.00	01/23/03	01/22/03	01/22/03 - 11/10/03	11/13/03	1,755.55	36,574.00	38,329.55
4	9100006164951	08/18/03	56,100.00	11/17/03	07/14/03	07/14/03 - 10/28/03	10/30/03	977.52	56,100.00	57,077.52
5	9100006094596	08/19/03	17,508.00	11/18/03	07/14/03	07/14/03 - 04/23/04	04/27/04	816.45	17,508.00	18,324.45
			$ 881,315.00					$ 8,761.12	$ 881,315.00	$ 890,076.12

Source: The Auditor's review of sampled taxpayer refund transactions as recorded in ITS.

[1] *See* D. C. Code § 47-4202(c): "The overpayment [interest] rate is 6% per year simple interest."

AGENCY COMMENTS

AGENCY COMMENTS

On May 5, 2006, the Office of the District of Columbia Auditor submitted this report in draft for review and comment to the Office of the Chief Technology Officer (OCTO), the Office of the Chief Financial Officer (OCFO), and the following offices within the OCFO cluster: (a) the Office of Integrity and Oversight (OIO), (b) the Office of Tax and Revenue (OTR), and (c) the Office of Finance and Treasury (OFT).

Written comments to the draft report were received from OCTO's Deputy Chief Technology Officer on May 11, 2006, and from OTR's Deputy Chief Financial Officer on May 22, 2006. Written comments were not received from the OCFO, OIO, or OFT. No substantial changes were made to the final report as a result of the written comments received. All written comments are appended in their entirety to this final report.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer

Sherryl Hobbs Newman
Deputy Chief Financial Officer

Tax and Revenue

May 22, 2006

RECEIVED
MAY 22 2006
OFFICE OF THE DC AUDITOR

Deborah K. Nichols
District of Columbia Auditor
717 14th Street, NW, Suite 900
Washington, DC 20005

Dear Ms. Nichols:

The Office of the Chief Financial Officer (OCFO) is pleased to provide this response to the draft report entitled "Auditor's Performance Review of the Integrated Tax System's Processes Related to the Timeliness of Tax Refunds and Deposit of Tax Payments."

The draft report includes several findings and recommendations to which the Office of Tax and Revenue (OTR) would like to respond, because of our overriding concern with the quality and timeliness of our tax processing systems. In several cases, we are unable to respond as fully as we would like without an opportunity to review the data underlying the findings. In general, many of the recommendations made by the Auditor are in line with processes already implemented within OTR.

Finding 1 – OTR Staff Did Not Use the Appropriate Eligibility Period to Calculate Interest on Taxpayer Refunds

OTR agrees with this finding. OTR has reviewed the programming parameters for calculating interest in the Integrated Tax System (ITS) and found them to be operating correctly. This addresses the majority of the cases sampled by the Auditor in which a system error appeared to be causing a one day difference in the interest calculation period. In cases where an audit case has resulted in human intervention in the setting of the interest calculation date, OTR has established a Quality Assurance process within the audit unit to ensure that calculations are done properly and that the appropriate notes are made in ITS to explain any manual adjustments.

Finding 2 – OTR Personnel Did Not Deposit Payments Received from District Taxpayers within the Timeframe Established in its Internal Policies

OTR disagrees with this finding. Since the implementation of ITS, OTR has had a stated goal of depositing payments within the prompt deposit standard of 48 hours. There are, however, reasons that would explain deviations from this goal, particularly during peak processing times. During the peak income filing season, for example, returns are stamped with an April 15th receipt date, even though some batches of mail received immediately after the tax filing deadline are not opened for several days, due to the massive intake of returns. Without a more thorough review of the sample reviewed by the Auditor, OTR cannot respond with more detail about the variances from our stated goals.

OTR managers in the Returns Processing Administration (RPA) do monitor and track batches to ensure timely deposit of payments, and are held accountable in their annual performance evaluations and in daily/weekly production meetings. Deposits are tracked based on the date stamp on the return to the process date of the deposit. In 2005, prompt deposits reached the $2.1 billion mark, an increase of over half a billion dollars over 2004, thus reducing the need for cash-flow borrowings and providing savings to the District.

Finding 3 – OTR's Process for Imaging Tax Returns and Other Documents was Inefficient and Inconsistently Applied by OTR Staff

OTR disagrees with this finding. The report states that some sampled returns were imaged without a date stamp or with an illegible date stamp. Without additional information on the number of such cases and the processing dates, OTR cannot respond fully as to whether this is an ongoing issue. OTR has established operating procedures which clearly define the requirement and the location specified for the date stamp, and a process for linking scanned documents by batch to the responsible employee. There is a Quality Assurance process established for the imaging operation, and when errors are detected, the entire batch is pulled and the responsible employee is held accountable. The Auditor's recommendations in this area are already in place in OTR.

The report also states that some imaged returns were accompanied by documents that did not match the return. Without specific information about these cases, OTR cannot address whether this is an ongoing or systemic problem. The established Quality Assurance function in the imaging operation is designed to identify and correct such processing errors.

In addition, the report also recommends that W-2s be imaged because it is a core document supporting a tax return. Currently, OTR maintains the W-2s in paper form, along with the entire return, for audit and review purposes. It is unusual for a tax administration to image the W-2. OTR does, however, receive electronic W-2 data from several sources, which is used for various compliance programs. Because of the availability of this electronic record, scanning of the W-2 documents is even less essential to good tax administration. In the current fiscal year, OTR has started a replacement of the front-end imaging system for ITS which will result in significant improvements in throughput and reliability, and it is possible that in the future all supporting documentation will be imaged and, if possible, data captured, to reduce the need to maintain paper records.

Finding 4 – Referred to OCTO for Response

This draft report mistakenly assigns certain functions/responsibilities to the Office of Finance and Treasury (OFT), as shown in the chart on page 3; of these, the only functions that are performed by OFT are the printing and mailing of tax refund checks. On page 9, the report states that, OFT is associated with imaging and establishing internal controls for the Check-writing Unit at OCTO. OFT does not image tax returns and the Check-writing Unit is part of OCTO Data Center 2.

Finding 5 – Lack of Segregation of Duties in OTR's Revenue Accounting Administration Could Result in Improprieties in Processing Taxpayer Refunds

OTR disagrees with this finding and believes that the Revenue Accounting Administration (RAA) has appropriate segregation of duties.

RAA handles two distinct refund functions. The first relates to ITS refunds. The Accounting Technician releases refund vouchers in the ITS system. This action begins the final stage of refund processing, the actual production of a refund (check or ACH). The individual refund requests have already been approved prior to voucher assignment. There is no manipulation of the number or amount of the refunds. The Accounting Technician journalizes the refund amounts by tax type directly from a summary report created by ITS and inputs them into SOAR. The Financial Reporting Manager approves the journal entries, which are then released in SOAR by a Systems Accountant.

The second refund function relates to SOAR refunds. These refunds are approved by authorized personnel in the administration requesting the refund. They are then delivered to the Accounting Technician in the RAA for data entry into SOAR, and then given to a Systems Accountant for release in SOAR. This process is reserved for refunds that can not be processed in ITS.

Thank you for this opportunity to provide comments. If you have any additional questions regarding this response, please do not hesitate to contact me at 442-6383.

Sincerely,

Sherryl H. Newman

Sherryl Hobbs Newman
Deputy Chief Financial Officer

cc: Natwar M. Gandhi
Chief Financial Officer

Lasana Mack
Deputy Chief Financial Officer
Office of Finance and Treasury

Sebastian Lorigo
Executive Director
Office of Integrity and Oversight

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF TECHNOLOGY OFFICER

RECEIVED
MAY 12 2006
OFFICE OF THE DC AUDITOR

May 11, 2006

Deborah K. Nichols
District of Columbia Auditor
Office of the District of Columbia Auditor
717 14th Street, N.W., Suite 900
Washington, DC 20005

Dear Ms. Nichols:

On behalf of Chief Technology Officer Suzanne Peck, I am writing to provide the comments of the Office of the Chief Technology Officer (OCTO) on applicable recommendations in your draft report entitled "Auditor's Performance Review of the Integrated Tax System's Processes Related to the Timeliness of Tax Refunds and Deposit of Tax Payments".

OCTO agrees with the recommendations and has already implemented all three. Specifically:

1. **Immediate supervisor of the Check-writing Unit develop and implement comprehensive written policies and procedures for the unit.**

   As of March 25, 2005 the Check-write Unit was eliminated and all Check-write functions were transferred to the Production Control group in OCTO's Data Centers. Production Control has developed and implemented standard operating procedures for the Check-write processes.

2. **Immediate supervisor of the Check-writing Unit train other OCTO staff to perform the Check-writing unit's functions and determine whether adding a staff person in the unit is warranted to ensure proper segregation of duties.**

   All Check-write jobs are now supported by three staff members (in contrast to the two described in the report). Each of the three staff are fully trained on all Check-write processes and rotate responsibility for the various Check-write job streams.

3. **OCTO officials consider the need to have an independent reviewer document the Check-writing Unit's functions and responsibilities.**

The OCTO Production Control team has documented the Check-write process in its entirety. We have evaluated the need for an external reviewer and have concluded that none is necessary.

Sincerely,

Robert Kramer
Deputy Chief Technology Officer

cc: Suzanne J. Peck, Chief Technology Officer
Lawrence I. Perry, Deputy Auditor