LEGISLATIVE POST AUDIT REPORT

WEST VIRGINIA STATE TAX DEPARTMENT

For the Period: July 1, 2011 - June 30, 2012

AUDIT SUMMARY

- Failure to Utilize Payment Plan Enforcement Methods
- Failure to Follow Payment Plan Agreement
- Failure to Levy Joint Debtors for Tax Debt
- Lack of Management Oversight
- Lack of Signed Agreements and Supporting Documentation
- Levies Not Initiated Within a Reasonable Timeframe
- Liens Not Initiated Within the Prescribed Timeframe
- Lack of Internal Control over Write offs and Waivers
- Failure to Assess Additions to Tax
- Violation of 24 Hour Rule

WEST VIRGINIA LEGISLATIVE AUDITOR

POST AUDIT DIVISION

Aaron Allred - Legislative Auditor
Denny Rhodes - Director

Building 1, Room W-329
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305
Phone: (304) 347-4880

LEGISLATIVE POST AUDITS SUBCOMMITTEE

Senate
President Jeff Kessler, Chairman
Roman Prezioso
Mike Hall

House
Speaker Tim Miley, Chairman
Harry Keith White
Tim Armstead

WEST VIRGINIA LEGISLATIVE AUDITOR
LEGISLATIVE POST AUDIT DIVISION

Aaron Allred
Legislative Auditor

Denny Rhodes
Director

Londa Sabatino, CPA, CICA
William Spencer, CPA
Audit Managers

Mike Jones
Melissa Childress, CPA
Micah Vines, CPA
Senior Auditors

Bret Jones
Cindy Williams
Amanda Copeland
Elizabeth Kinsey
Jake Osborn
Leah Harvey
Staff Auditors

Legislative Post Audit Division
Building 1, Room W-329
1900 Kanawha Blvd., East
Charleston, WV 25305-0610
(304) 347-4880

Post audit reports are available on-line at
www.legis.state.wv.us/Joint/postaudit/reports.cfm.

For more information about the Legislative Post Audit Division, please visit our website at
www.legis.state.wv.us/Joint/postaudit/postaudit.cfm.

WEST VIRGINIA LEGISLATURE

Joint Committee on Government and Finance

Denny Rhodes, Director
Legislative Post Audit Division
Building 1, Room W- 329
1900 Kanawha Blvd. East
Charleston, WV 25305-0610

Area Code: (304)
Phone: 347-4880
Fax: 347-4889

The Joint Committee on Government and Finance:

In compliance with the provisions of the W.Va. Code, Chapter 4, Article 2, as amended, we conducted a post audit of the West Virginia State Tax Department (Tax Department) for the period of July 1, 2011 through June 30, 2012.

The audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). The audit disclosed certain findings, which are detailed in this report. Findings deemed inconsequential to the financial operations of the agency were discussed with management. The Tax Department management has responded to the audit findings; we have included the responses at the end of the report.

Respectfully submitted,

Denny Rhodes

Denny Rhodes, Director
Legislative Post Audit Division

TABLE OF CONTENTS

INTRODUCTION

POST AUDIT AUTHORITY

The audit was conducted pursuant to §4-2, as amended, of the W.Va. Code, which requires the Legislative Auditor to "make post audits of the revenues and funds of the spending units of the state government, at least once every two years, if practicable, to report any misapplication of state funds or erroneous, extravagant or unlawful expenditures by any spending unit, to ascertain facts and to make recommendations to the Legislature concerning post audit findings, the revenues and expenditures of the State and of the organization and functions of the State and its spending units."

The Post Audit Division of the Office of the Legislative Auditor is organized under the Legislative Branch of the State and the audits are reported to the Legislative Post Audits Subcommittee. Therefore, the Division has historically been organizationally independent when audits are performed on an agency, Board, or program of the Executive Branch of the State.

This communication is intended solely for the information and use of the Post Audits Subcommittee, the members of the W.Va. Legislature, and management of the Tax Department. Once presented to the Post Audits Subcommittee this report is a matter of public record and its distribution is not limited. The reports are designed to assist the Post Audits Subcommittee in exercising its legislative oversight function and to provide constructive recommendations for improving State operations.

BACKGROUND[1]

Created under Chapter 11, Article 1 of the W.Va. Code, the Tax Department administers, collects and enforces various state taxes, administers business registration and other licensing functions in the state, appraises industrial and natural resource properties throughout the state, supervises work of county assessors, prepares tentative ad valorem property tax assessments for all public utilities operating within the state for the Board of Public Works, and regulates and issues licenses for charitable bingo and charitable raffle operations in the state.

The Tax Department maintains seven offices located across the state of W.Va. assisting individual taxpayers and businesses. These locations include Beckley, Charleston, Huntington, Martinsburg, Parkersburg, Clarksburg, and Wheeling.

EXIT CONFERENCE

The report was discussed with management of the Tax Department on June 12, 2014. All findings and recommendations were reviewed and discussed as well as any items deemed inconsequential. Management's response has been included at the end of the report in Appendix B.

[1] Background information obtained from the West Virginia Blue Book 2012.

SCOPE

We conducted the post audit, which is a performance audit, in accordance with the standards applicable to performance audits contained in GAGAS. Those standards require that auditors plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. We believe the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives. An audit includes examining, on a test basis, evidence about the Tax Department's compliance with those requirements referred to above and performing such other procedures, as we considered necessary in the circumstances. The audit does not provide a legal determination of the Tax Department's compliance with those requirements.

The audit scope included a review of applicable internal control policies and procedures review of tax assessment and collection procedures; and fund collection and deposit procedures; compliance with W.Va. Code, W.Va. State Treasurer's office cash receipts handbook, IRS publications, best business practices and the Tax Department policies and procedures applicable for the period of July 1, 2011 through June 30, 2012. The audit was a performance audit conducted in accordance with the standards applicable to performance audits contained in GAGAS.

the Tax Department management is responsible to accurately and efficiently collect all monies due the state as mandated under W.Va. Code Chapter 11 as well as apply all applicable fines, penalties, fees, interest, additions to tax, and violations in accordance with W.Va. Code, the Code of State Rules, their own internal policies, and as a result of their own audits. To achieve this the Tax Department must create and maintain policies and procedures to ensure all monies due the State are being collected. Additionally, it is the duty of the Tax Department to accurately track and account for all monies remitted and outstanding debt owed the State.

The Tax Department management is also responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding assets, compliance with applicable laws, rules, and regulations are achieved. Due to inherent limitations in internal control, errors and fraud may nevertheless occur and not be detected.

The scope over internal controls involved only assessing controls significant to the audit objectives. To conclude on the adequacy of internal controls regarding the Tax Department as a whole was not a specific objective of the audit. Projections of any evaluations to future periods are subject to the risk that conditions may change or compliance with policies and procedures may change. Any significant internal control weaknesses discovered were reported in the findings.

This report includes findings regarding significant instances of noncompliance with applicable laws, rules and regulations as related to the objectives. Instances of noncompliance deemed insignificant to warrant inclusion in the report, but still merited the attention of the Tax Department management, was communicated in a letter to the Tax Department management.

OVERALL SUFFICIENCY OF EVIDENCE

The auditors determined the overall sufficiency and appropriateness of evidence to provide a reasonable basis to persuade a knowledgeable person the findings and conclusions, within the context of the audit objectives are supported by sufficient evidence and resulted in reasonable findings. The manager evaluated the evidence, testing, using original source documents, information documented in the GenTax[2] system, and using auditor judgment. The manager reviewed all audit documentation throughout the audit and at the end of audit and concluded the evidence supports our objectives.

All testimonial evidence obtained by the audit team was evaluated for objectivity, credibility, and reliability and was obtained under conditions in which the employee was able to speak freely without intimidation. The employees had direct knowledge of their working area and there was no evidence employees were biased. The sufficiency and appropriateness of computer processed information was assessed regardless of whether the information was provided to the auditors or was independently extracted by using an Internal Control Questionnaire, assessing the reliability and integrity of data, performing analytical reconciliations, and testing the supporting documentation.

The auditors performed and documented an overall assessment of the collective evidence used to support findings and conclusions, including the results of any specific assessments conducted to conclude on the validity and reliability of specific evidence, according to Section 6.69 of the Yellow Book, by documenting internal controls, and performing tests with an appropriate sample size.

The overall evidence obtained was relevant to the objectives and findings. All evidence supported the findings, giving validity in having a reasonable basis for measuring what was being evaluated. The overall evidence was reliable when tested and can be verified and supported. In establishing the appropriateness of the evidence as a whole, the auditors tested reliability by obtaining supporting documentation, used statistical and non-statistical testing, used original documents when testing, used the GenTax system when testing, verified the credibility of testimonial evidence, evaluated analytical review, assessed risk through Internal Control Questionnaires, and used auditor judgment on the overall evidence

When assessing the sufficiency and appropriateness of evidence, the auditors evaluated the expected significance of evidence to the audit objectives, findings, and conclusions, available corroborating evidence, and the level of audit risk as described in Section 6.71 of the Yellow Book, by using professional judgment and statistical sampling to determine a sufficient quantity for the testing and to determine the type of evidence needed based on the audit objectives.

The auditors did not identify any limitations or uncertainties in evidence that were significant to the audit findings and conclusions.

[2] A completely integrated tax processing software package for agencies implementing multiple taxes.

SPENDING UNIT CONTACTS

West Virginia State Tax Department

Craig A. Griffith ……………………………..Tax Commissioner (Beginning of Audit Period to January 31, 2013)

Charles O. Lorensen ………………………………Acting Tax Commissioner (February 1, 2013 to May 14, 2013)

Mark W. Matkovich ……………………………….Acting Tax Commissioner (May 15, 2013 to January15, 2014)

Mark W. Matkovich.. Tax Commissioner (January 16, 2014 to present)

Kristin Mounts ……………………………………..Deputy Tax Commissioner (September 30, 2013 to present)

Jeff Oakes......................................Acting Deputy Tax Commissioner (July 1, 2011 to September 30, 2013)

Mark Morton ………………………………………………………General Counsel and Director of Legal Division

Cynthia Dunbar ……………………………………………………………………………………………Internal Auditor

Dana Angell …...……………………………………………………………………………………...Director of Auditing

Jeff Oakes ……………Director of Compliance and Taxpayer Services (September 30, 2013 to April 30, 2014)

Michael Coutz ……….Acting Director of Compliance and Taxpayer Services (July 1, 2011 to May 31, 2013)

Thomas Moore ………………………………………………………………Director of Criminal Investigations

Thomas Moore ....Acting Director of Compliance and Taxpayer Services (May 12, 2014 to present)

Stephanie Tichenor ……………………………………………………………… Director of Information Technology

Steve Wroblewski ….……………………………Acting Director of Operations (January 1, 2013 to present)

Patricia Haddy ……………...............................Director of Operations (July 1, 2011 to December 31, 2012)

Roger Cox ………………………………………………………………………………………….Director of Research

Jill Whited ……………………………………………………………………………………..Director of Revenue Processing

Tonja Oakes ………………………….Director of Tax Account Administration (August 1, 2009 to April 1, 2014)

Matt Irby………………………………..Acting Director of Tax Account Administration(April 2, 2014 to present)

OBJECTIVES and CONCLUSIONS

OBJECTIVE 1

Did the Tax Department have policies and procedures in place to ensure they were collecting all monies due the State?

CONCLUSION

There are inadequate policies and procedures to ensure the collection of all monies due the State. In addition, the Tax Department does not consistently enforce existing procedures to ensure all monies due the state are collected. The unaudited amount of outstanding debt as of 12/16/13 per the Tax Department was approximately $715,693,175. The total outstanding debt the Tax Department has deemed collectible was approximately $298,283,873 encompassing 139,037 tax accounts[3] not including debt less than 180 days, or greater than 10 years, debt under bankruptcy, deemed uncollectible by the Tax Department, covered by the Office of Tax Appeals, suspected tax fraud, and unverified or suspended legacy debt.

There are inadequately documented policies in place for the following: the oversight of the levy process, the execution of levies for joint tax returns, the timeframe and initiation of levies, follow-up on the enforcement of legal actions in the 10-Day Notice Letter, and the payment plan terms and conditions.

The lack of internal control policies in the compliance and legal divisions allow the same user to request and approve multiple transaction types. The same employee is able to request and approve write offs regardless of amount, and waivers of less than $5,000. The internal control policies also allow supervisors to request and approve waivers without additional approval.

There is a lack of enforcement of existing policies and procedures in the following areas: the approval process for payment plans exceeding 12 months, supporting documentation for payment plan agreements, extensions to Corporate Income Tax (CIT) filers, and the Lien function in GenTax

The Tax Department has policies and procedures in place contradictory to contractual agreements and W.Va. Code. W.Va. Code §11-21-74(g) requires an annual reconciliation be filed by employers; the Tax Department has a policy to waive the annual reconciliation for employers who file through the Mytaxes website. The Tax Department is not following the terms of the payment plan agreement by not placing a priority on the collection of monies due the state. The Tax Department management has provided insufficient oversight and direction, leading to a failure to utilize enforcement methods and a failure to default payment plans in a timely manner according to the payment plan agreement.

[3] For a breakdown by tax type see the delinquent debt table in Appendix A on page 27.

RELEVANT FINDINGS

Finding #	Item	Instances	Amount
Finding 1	Failure to Utilize Payment Plan Enforcement Methods	145	$6,840,086
Finding 2	Failure to Follow Payment Plan Agreement	133	$5,074,599
Finding 3	Failure to Levy Joint Debtors for Tax Debt	59	$1,305,823
Finding 4	Lack of Management Oversight	157	$ 8,877,301
Finding 5	Lack of Supporting Documentation	202	$11,693,568
Finding 6	Levies Not Initiated Within a Reasonable Timeframe	14	$109,879
Finding 7	Liens Not Initiated Within the Prescribed Timeframe	39	$1,210,503
Finding 8	Lack of Internal Control over Write offs and Waivers	31	$476,085
Finding 9	Failure to Assess Additions to Tax	9	-
	Totals	789	$35,587,844

OBJECTIVE 2

Were all remitted funds deposited into a State Account/Fund?

CONCLUSION

All remitted funds were deposited into a State Account/Fund.

OBJECTIVE 3

Were all funds promptly deposited into a State Account/Fund?

CONCLUSION

Not all funds were deposited into a State Account/Fund promptly. Monies received in the Tax Department satellite offices were not promptly deposited into a State Account/Fund. All other monies collected were promptly deposited.

RELEVANT FINDINGS

Finding 10 Violation of 24 Hour Rule

OBJECTIVE 4

Were all funds adequately tracked and accounted for?

CONCLUSION

All funds were adequately tracked and accounted for by the Tax Department.

OBJECTIVE 5

Did the agency follow W.Va. State Code in assessing all state taxes mandated under W.Va. Code Chapter 11?

CONCLUSION

The Tax Department assessed all state taxes mandated under W.Va. Code Chapter 11.

OBJECTIVE 6

Did the Tax Department apply fines, penalties, fees, interest, additions to tax, and violations consistently in accordance with W.Va. State Code, the Code of State Rules, their own internal policies, and as a result of their own audits?

CONCLUSION

The Tax Department did not apply fines, penalties, fees, interest, additions to tax, and violations consistently in accordance with W.Va. State Code and their own internal policies.

The Tax Department is not complying with the terms of the payment plan agreement by not placing liens and levies on taxpayers who default. When an in full, on time payment is not made the Tax Department does not automatically default a payment plan as required by the payment plan agreement. The Tax Department also does not immediately default taxpayers and notify the taxpayer of the default via a default letter. Both liens and levies are not initiated in a reasonable timeframe. Levies are not being executed on both debtors of joint debt.

CIT taxpayers were given erroneous filing extensions and not assessed additions to tax. For one soft drink excise (SDR) tax account, a preexisting credit in the system prevented late file penalties from being assessed properly. Due to a system error one account in the Tobacco Products Excise Tax (TPT) had a remove interest and penalties indicator added to the account to prevent the system from incorrectly assessing interest and/or penalties. The Tax Department indicated the account was supposed to be monitored and a manual assessment of interest and penalties should have taken place as needed.

Other instances of noncompliance were noted during the audit. These instances were determined to be inconsequential and did not warrant inclusion in the audit report. Although not included in the report these instances required the attention of the Tax Department management and as such were communicated to the Tax Department management.

RELEVANT FINDINGS

Finding #	Item	Instances	Amount
Finding 1	Failure to Utilize Payment Plan Enforcement Methods	145	$6,840,086
Finding 2	Failure to Follow Payment Plan Agreement	133	$5,074,599
Finding 7	Liens Not Initiated Within the Prescribed Timeframe	39	$1,210,503
Finding 8	Lack of Internal Control over Write offs and Waivers	31	$476,085
Finding 9	Failure to Assess Additions to Tax	9	-
	Totals	357	$13,601,273

FINDINGS and RECOMMENDATIONS

Finding 1 **Failure to Utilize Payment Plan Enforcement Methods**

Condition The Tax Department fails to utilize enforcement methods available for defaulted payment plans. For the sample tested, enforcement methods for 145 payment plans (35.98%)[4] were not utilized as follows:

Item	Instances	Amount
No levy upon agreement default	92	$2,342,957
No lien in place	9	$2,373,573
No lien in place and no levy upon default	44	$2,123,556
Totals:	145	$6,840,086

Criteria **Payment Plan Agreement Terms, section 5, states:**

"The liability is a lien on all property of the taxpayer, and a Notice of a Tax Lien will be recorded as required by law."

Payment Plan Agreement Terms, section 12, states:

"Upon DEFAULT, the State may give the taxpayer notice of any default of the terms and conditions of this agreement by first class mail at the above address. If the default is not cured within ten (10) days after notice, the unpaid balance shall be due and payable immediately. The State may then, without further notice, collect the unpaid balance by any lawful means, including distraint or levy upon any property or rights to property of the taxpayer. In consideration of this agreement, the taxpayer gives up any rights he may have to a notice of intent to levy, and to a hearing prior to levy. The taxpayer further consents to any search and seizure of any property or entry into property of the taxpayer necessary to make such levy."

The Tax Department documented Payment Plan Procedure states:

"If the payment plan is defaulted on, the account will continue through the other enforcement methods such as wage or bank levies and the full amount of the tax will be due immediately."

[4] The population of 7,820 items totaled approximately $40,077,363. A random probability sample of 403 items totaling approximately $18,356,412 was tested.

Cause The Tax Department is not placing liens and levies on taxpayers account after they have defaulted on the payment plan because internal procedures deviate from the terms of the agreement.

Effect The Tax Department is the collection arm of the W.Va. State government and as such, emphasis should be placed on collecting the debts owed the State. By not using all collection methods available, the Tax Department is decreasing the possibility of collecting the outstanding tax debt and is unable to force compliance with the payment plan agreement.

Based on a statistical projection of the results over the population of payment plan transactions, we are 95% confident, if our sample holds true to the entire population, the total payment plan transactions not utilizing payment plan enforcement methods is between 2,089 and 3,424 out of 7,820 for fiscal year 12.

Recommendation We recommend the Tax Department comply with the Terms and Conditions of the Payment Plan Agreement by setting up the GenTax system and internal policies to reflect the Payment Plan Agreement Terms and immediately default payment plans that do not adhere to the terms and fully pursue all collection methods to the fullest extent available.

Spending Unit Response See Appendix B on page 49.

Auditor's Comments to the Spending Unit Response See Appendix C on page 55.

Finding 2 **Failure to Follow Payment Plan Agreement**

Condition

The Tax Department does not follow the terms of payment plan agreements. For the sample tested, terms for 133 payment plans (33.00%)[5] were not followed as detailed by the schedule below:

Item	Instances	Amount
Defaulted in GenTax and no default letter	98	$3,079,509
Not defaulted in GenTax and no default letter	30	$1,546,769
Not defaulted in GenTax and default letter sent	5	$448,321
Totals:	133	$5,074,599

Criteria

Payment Plan Agreement Terms sections 11 and 12, state:

"The taxpayer shall be in DEFAULT if the taxpayer (a) fails to pay the full amount of any payment when due; (b) fails to timely file any state tax return or fails to timely pay any state tax, becoming due during the term of this agreement; (c) makes any payment with a check that is dishonored or not paid for any reason; (d) becomes insolvent or becomes a debtor in bankruptcy; (e) fails to comply with any other provision of this agreement."

"Upon DEFAULT, the State may give the taxpayer notice of any default of the terms and conditions of this agreement by first class mail at the above address. If the default is not cured within ten (10) days after notice, the unpaid balance shall be due and payable immediately. The State may then, without further notice, collect the unpaid balance by any lawful means, including distraint or levy upon any property or rights to property of the taxpayer. In consideration of this agreement, the taxpayer gives up any rights he may have to a notice of intent to levy, and to a hearing prior to levy. The taxpayer further consents to any search and seizure of any property or entry into property of the taxpayer necessary to make such levy."

Cause

the Tax Department is not following the terms of legal payment plan agreements because their internal procedures for collection of tax liabilities are contradictory to the payment plan agreement. The Tax Department stated, "The only condition that creates an automated default work item is a missed payment or filed but not paid current return." the Tax Department internal policy does not encompass all terms of the payment plan.

Effect

Not following the terms of the agreement devalues the payment plan option that is available to taxpayers since taxpayers not meeting the terms of the agreement are receiving the same benefit as the taxpayers that are meeting the terms of the agreement. Business taxpayers that do not meet the terms of the agreement and are not defaulted as required are given a competitive advantage over businesses in good standing. Failure to follow the payment plan agreement also results in a lapse of collection of the outstanding tax debt.

[5] The population of 7,820 items totaled approximately $40,077,363. A random probability sample of 403 items totaling approximately $18,356,412 was tested.

If the payment plan agreement is defaulted due to late file or late pay of current taxes owed, taxpayers are not forced to comply with the payment plan agreement. Instead they can create a new payment plan to include both the original delinquent debt and the current debt. While payment plans are in progress all other collection methods are put on hold. Starting a new payment plan allows the taxpayer to continually add to a debt that may never be satisfied, and further delay the State receiving the amount owed.

Based on a statistical projection of the results over the population of payment plan transactions, we are 95% confident, if our sample holds true to the entire population, the total payment plan transactions not following the terms of the agreement is between 1,916 and 3,225 transactions out of 7,820 for fiscal year 12.

Recommendation

We recommend the Tax Department comply with the Terms and Conditions of Payment Plans by placing the taxpayers' payment plan in default within GenTax and mail a default letter upon default informing the taxpayer of the unpaid balance. We also recommend the Tax Department configure the GenTax system to automatically generate and mail default letters, when a taxpayer defaults on a payment plan.

Spending Unit Response

See Appendix B on page 49.

Finding 3 **Failure to Levy Joint Debtors for Tax Debt**

Condition

The Tax Department does not attempt to execute levies on both the primary and secondary taxpayer when the outstanding tax debt is the result of a joint tax return.

For the sample tested, 59 of the 62 levies involving joint returns (95.16%),[6] totaling approximately $1,305,823 lacked execution of a levy on both taxpayers. Both the primary and secondary filers of joint returns were not included on bank levies. Also, both the primary and secondary filers of joint returns were not issued separate wage levies in an attempt to collect the tax debt.

Criteria

W.Va. Code §11-10-7(e) (2), as amended, states in part:

"(2) **Joint income tax return.** -- In the case of a joint income tax return filed by a husband and wife, such notice of assessment may be a single notice…."

W.Va. Code §11-21-55(c), as amended, states in part:

"c) **Joint declaration of husband and wife.** -- A husband and wife may make a joint declaration of estimated tax as if they were one taxpayer, in which case the liability with respect to the estimated tax shall be joint and several."

Cause

Due to a lack of policies and procedures governing the execution of levies for joint tax returns, the Tax Department is not including the primary and secondary filers of joint returns on the levies executed for joint debt.

Effect

Since a bank levy was not executed on both taxpayers for a joint return, the bank levy may not allow the state to receive enough assets to satisfy the debt. By not issuing a wage levy on both taxpayers the ability to collect the outstanding tax debt is hindered.

Based on a statistical projection of the results over the population of levy transactions, we are 95% confident, if our sample holds true to the entire population, the total levy transactions which may not have wage and/or bank levies issued for both joint debtors is between 1,016 and 1,650 transactions out of 2,754 for fiscal year 12.

Recommendation

We recommend the Tax Department comply with W.Va. Codes §11-10-7(e)(2) and §11-21-55(c) as stated above by placing bank levies that involve a joint tax return on both taxpayers, and issue wage levies for both taxpayers to increase the likelihood the Tax Department is able to satisfy the debt owed to the State.

Spending Unit Response

See Appendix B on page 49.

[6] The population of 2,754 items totaled approximately $4,293,328.05. A random probability sample of 119 items totaling approximately $854,636.87 was tested. Only 62 items involved joint returns.

Finding 4 **Lack of Management Oversight**

Condition The Tax Department management does not adequately administer the payment plan approval process when the requested plan is longer than 12 months in length. For the sample tested, the lack of oversight for 157 payment plans (38.96%)[7] was as follows:

Item	Instances	Amount
Lack of Manager Approval +	105	$5,154,559
Lack of Director. or Asst. Dir. Approval *	52	$3,722,742
Totals:	157	$8,877,301

+Payment Plans between 13 and 48 months
*Payment Plans exceeding 48 months

Criteria **Compliance and Division Policy & Procedures 2009 ed., page 121, states in part:**

"Payment Agreements in excess of 12 Months –

…..All payment agreements exceeding 12 months but not exceeding 48 months must be reviewed and signed by a manager. Any payment agreement where the requested terms exceed 48 months must be reviewed by the Assistant Director prior to the execution."

Cause The Tax Department management is not setting the appropriate tone at the top and providing appropriate oversight to ensure employees are following the approval process for payment plans in excess of 12 months.

Effect There is an increased risk unapproved payment plans can be entered into between the Tax Department and a taxpayer. Inadequate approval processes and an overall lack of management oversight increase the risk of fraud, and inadvertent errors which could remain unnoticed.

Based on a statistical projection of the results over the population of payment plan transactions, we are 95% confident, if our sample holds true to the entire population, the total payment plan transactions not following the terms of agreement are between 527 and 1,072 transactions out of 7,820 for fiscal year 12.

Recommendation We recommend the Tax Department comply with Compliance and Division Policy & Procedures 2009 ed. as stated above by enforcing their policy that all payment plans exceeding 12 months have formal documented approval from either a manager or the Director/Assistant Director as required.

Spending Unit Response See Appendix B on page 49.

[7] The population of 7,820 items totaled approximately $40,077,363. A random probability sample of 403 items totaling approximately $18,356,412 was tested.

Finding 5 **Lack of Signed Agreements and Supporting Documentation**

Condition The Tax Department does not maintain adequate documentation supporting payment plans and/or have signed agreements for all payment plans. For the sample tested, the lack of supporting documentation and/or signed agreements for 202 payment plans (50.12%)[8] is as follows:

Item	Instances	Amount
No signed payment plan agreement	98	$5,286,400
No completed 433A or 433B	74	$4,506,285
No signed agreement and no completed 433 A/B	30	$1,900,883
Totals:	202	$11,693,568

Criteria **W.Va. Code §5A-8-9 (b), as amended, states in part:**

"The head of each agency shall….

(b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities."

Payment Plan Agreement Terms, states in part:

"I, the undersigned taxpayer, agree to pay the amount indicated on this Payment Plan Agreement. I have read and fully understand the Terms and Conditions listed above of the Agreement. I understand if I default on any of these terms, the West Virginia State Tax Department can, without further notice, collect the unpaid balance by any lawful means, including distraint or levy upon any property or rights to property of the taxpayer."

Compliance and Division Policy & Procedures 2009 ed., page 121, states in part:

"Any taxpayer requesting payment plan agreement terms exceeding 12 months will be required to submit sufficient financial information to justify the extended terms. The taxpayer must complete form 433-A ….or 433-B…"

Cause Large workloads for case managers, no processes in place to monitor the payment plan agreement process, and a lack of enforcement of policies by supervisors all contributed to the lack of documentation.

[8] The population of 7,820 items totaled approximately $40,077,363. A random probability sample of 403 items totaling approximately $18,356,412 was tested.

Effect The lack of a signed and completed payment plan agreement prevents the Tax Department from having proper legal documentation needed to pursue collection of outstanding tax debt in the event of a defaulted payment plan. Without the documentation of the 433-A/B forms possible abuse or favoritism could be permitted in the granting of extended payment plans, and supervisors and Directors cannot make an informed decision in granting payment plans.

Based on a statistical projection of the results over the population of payment plan transactions, we are 95% confident, if our sample holds true to the entire population, the total payment plan transactions not following the terms of agreement is between 2,675 and 4,039 transactions out of 7,820 for fiscal year 12.

Recommendation We recommend the Tax Department comply with W.Va. Code §5A-8-9 (b), the Terms and Conditions of Payment Plans, and Compliance and Division Policy & Procedures 2009 ed., as stated above by requiring all taxpayers complete and sign all payment plans and 433-A/B forms. We also recommend taxpayers that do not sign and return a payment plan agreement be subject to further collection efforts immediately. We further recommend the Tax Department include the payment plan number on the signature page of the agreement to assist in providing proper supporting documentation.

Spending Unit Response See Appendix B on page 49.

Finding 6 **Levies Not Initiated Within a Reasonable Timeframe**

Condition The Tax Department is not initiating levies within a reasonable timeframe[9]. For the sample tested, levies transactions not initiated within a reasonable timeframe totaled approximately $109,879 in unpaid tax liabilities and encompassed 14 transactions (11.76%).[10]

Highest Number of Unreasonable Days Until Levy	553
Lowest Number of Unreasonable Days Until Levy	77
Average Number of Unreasonable Days Until Levy	157

Criteria **W.Va. Code §11-10-5, as amended, states in part:**

"The tax commissioner shall administer and enforce each tax…"

W.Va. Code §11-10-5e, as amended, states in part:

"Any service of notice addressed by United States Postal Service regular mail is presumed to be accepted upon mailing unless proven otherwise by the taxpayer."

The 10-Day Compliance Letter states in part:

"You are requested to remit the entire amount due within 10 days of receipt of this letter.

Your failure to comply can result in one or more of the following legal actions: revocation of your Business Registration Certificate, an injunction preventing you from engaging in business, levy of personal property, garnishment of wages or foreclosure of our tax lien."

The Payment Plan terms and conditions section 12 states in part:

"Upon default, the State may give the taxpayer notice of any default (...). If the default is not cured with ten days after notice, the unpaid balance shall be due and payable immediately. The State may then, without further notice, collect the unpaid balance by any lawful means, including distraint or levy upon any property or rights to property of the taxpayer."

Cause A lack of written procedures outlining the timeframe of the initiation of levies, as well as a lack of follow-up on and enforcement of the legal actions in the 10-Day Notice Letter and the Payment Plan terms and conditions caused levies to not be initiated within a reasonable timeframe.

[9] We believe a reasonable timeframe is 60 days following the expiration of the 10 day notice, or 60 days following the last attempted bank levy.
[10] The population of 2,754 items totaled approximately $4,293,328.05. A random probability sample of 119 items totaling approximately $854,636.87 was tested.

Effect Not initiating levies in a reasonable timeframe reduces the effectiveness of the Tax Department in the collection of taxes due the State, and increases the likelihood the Tax Department will not receive enough assets to satisfy the tax debt.

Based on a statistical projection of the results over the population of waiver transactions, we are 95% confident, if our sample holds true to the entire population, the total levy transactions not initiated in a reasonable timeframe is between 119 and 557 transactions out of 2,754 for fiscal year 12.

Recommendation We recommend the Tax Department comply with W.Va. Code §11-10-5, W.Va. Code §11-10-5e by establishing procedures setting forth the timeframe for enforcing the legal actions as listed in the 10-Day Notice letter, and in section 12 of the Payment Plan agreement. We believe a reasonable timeframe to be within 60 days following the expiration of the 10 day notice, 60 days following the last attempted bank levy, or 10 days following a payment plan default.

Spending Unit Response See Appendix B on page 49.

Auditor's Comments to the Spending Unit Response See Appendix C on page 55.

Finding 7	**Liens Not Initiated Within the Prescribed Timeframe**

Condition

The Tax Department does not initiate liens within the timeframes established by their own procedures. For the sample tested, lien transactions not initiated within 90 days totaled approximately $1,210,503, and encompassed 39 transactions (15.23%).[11]

Highest Number of Days Until Lien	154
Lowest Number of Days Until Lien	119
Average Number of Days Until Lien	122

Criteria

W.Va. Code §11-10-5, as amended, states in part:

"The tax commissioner shall administer and enforce each tax…"

The Tax Department Documented and Signed off Lien Procedures dated 2/6/13 states:

"If full payment or an appeal is not received within 90 days of the Notice of Assessment (NOFA) (….) a lien is automatically placed on the taxpayer's property in the county in which the taxpayer resides or does business."

Cause

The lien function is set up within GenTax to perform the lien function on the next available billing cycle after the occurrence of two, 30 day billing cycles, and after at least 90 total days.

Effect

Not initiating liens in a reasonable timeframe reduces the effectiveness of the Tax Department in the collection of taxes due the State, and increases the likelihood the Tax Department will not recover the full tax debt.

Based on a statistical projection of the results over the population of lien transactions, we are 95% confident, if our sample holds true to the entire population, the total lien transactions not initiated within 90 days is between 2,567 and 6,125 transactions out of 19,300 for fiscal year 12.

Recommendation

We recommend the Tax Department comply with W.Va. Code §11-10-5 and the documented and signed procedures, as stated above, and initiate liens within 90 days.

Spending Unit Response

See Appendix B on page 49.

[11] The population of 19,300 items totaled approximately $76,181,401. A random probability sample of 256 items totaled approximately $20,811,939.

Finding 8 **Lack of Internal Control over Write offs and Waivers**

Condition For the sample tested, the Tax Department allowed 31 write off and waiver transactions to be entered and approved by the same person without additional approval.

Item	Instances	Amount
Waivers-No Supervisor Approval[12]	18	$214,237
Write offs- Requested & Approved by Employee[13]	6	$258,500
Waivers-Requested & Approved by Supervisor[12]	7	$3,348
Totals:	31	$476,085

Criteria **COSO Internal Control- Integrated Framework May 2013, Control Activities states in part:**

"Control activities are the actions established through policies and procedures that help ensure that management's directives to mitigate risks to the achievement of objectives are carried out. (…) They may be preventative or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews. Segregation of duties is typically built into the selection and development of control activities."

.

Cause There is an inadequate separation of duties within the compliance and legal divisions which allow the same user to request and approve write-off and waiver transactions. This is due to a lack of employees to adequately segregate duties and inadequate internal control policies in place to prevent supervisors from requesting and approving waivers below the $5,000 threshold which require approval of the Director.

Effect There is an increased risk unauthorized write-off and waiver transactions could be made and not detected. Inadequate segregation of duties increases the risk of fraud, and inadvertent errors which could remain unnoticed.

Based on a statistical projection of the results over the populations of write-off and waiver transactions, we are 95% confident, if our sample holds true to each population in its entirety, the total write-off transactions lacking internal controls is between 299 and 680 transactions out of 703 for fiscal year 12, and the total waiver transactions lacking internal controls is between 775 and 1,998 transactions out of 3,958 for fiscal year 12.

[12] The population of 3,958 items totaled approximately $5,807,089. A random probability sample of 117 items totaling approximately $2,002,332 was tested.

[13] The population of 703 items totaled approximately $11,891,551. A random probability sample of 24 items totaling approximately $7,197,768 was tested.

Recommendation We recommend the Tax Department develop internal controls as described above including segregation of duties for requesting and approving write offs and waivers, and develop additional internal controls governing the oversight of write offs and waivers requested by supervisors.

Spending Unit Response See Appendix B on page 49.

Finding 9 **Failure to Assess Additions to Tax**

Condition

The Tax Department failed to assess additions to tax for nine tax returns received after the due date.

For the sample tested, seven Corporate Income Tax (CIT) transactions (11.67%)[14] were granted an erroneous extension and were not assessed interest and penalties for returns received after the original due date. One Soft Drinks Excise Tax (SDR) return (1.41%)[15] and one Tobacco Products Tax (TPT) return (1.43%),[16] were not assessed interest and penalties for the returns received after the original due date.

Criteria

W.Va. Code §11-10-18(a) (1) Additions to tax, as amended, states in part:

"(a) ***Failure to file tax return or pay tax due***. –

(1) In the case of failure to file a required return of any tax administered under this article on or before the date prescribed for filing such return (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return five percent of the amount of such tax if the failure is for not more than one month, an additional five percent for each additional month or fraction thereof during which such failure continues, not exceeding twenty-five percent in the aggregate*: Provided,* That this addition to tax shall be imposed only on the net amount of tax due;"

W.Va. Code §11-24-18. Extensions of time, as amended, states in part:

"**General.** -- The tax commissioner may grant a reasonable extension of time for payment of tax or estimated tax (or any installment), or for filing any return, declaration, statement, or other document required pursuant to this article, on such terms and conditions as he may require."

W.Va. Corporate Net Income Instructions 2012, pg. 3 Extension of Time to File:

"An extension of time to file a federal return is automatically accepted by West Virginia as an extension of time to file the West Virginia return. A copy of the federal extension form must be attached to the West Virginia return when filed and the extended due date must be entered on top of the return. **Returns filed after the due date, without supporting documents and extended due date entered on the top of the return, will be processed as late filed and interest and penalties will be assessed." (Emphasis added)**

Cause

Due to user error the Tax Department granted erroneous filing extensions to CIT taxpayers who did not meet the requirements for an extension. The SDR return

[14] The population was 8,768 items. A non-probability sample of 60 items was chosen. Every 146th item was tested.
[15] The population was 3,215 transactions. A random probability sample of 71 was tested.
[16] The population was 1,782 transactions. A random probability sample of 70 was tested.

indicated a tax due on the return which was satisfied by a preexisting account credit. This credit prevented the addition of late file penalties. The TPT account had a “remove the penalties and interest” indicator added to the account which prevented the system from automatically assessing interest and/or penalties. A Tax Department agent was responsible for assessing these penalties manually and this return was overlooked.

Effect

By granting erroneous extensions**,** the Tax Department cannot assess penalties and interest to tax returns filed after the due date. This harms the State by not receiving the full financial benefit it was due. Taxpayers able to file after the deadline without any ramifications have no financial incentive to ensure compliance with the tax laws of this State. Not assessing penalties on late filed returns removes incentives for taxpayers to file the returns on time. Late filed returns may cause delays in the processing and collecting tax due the state or the taxpayer.

Based on a statistical projection of the results over the populations of SDR and TPT transactions, we are 95 percent confident, if our sample holds true to each population in its entirety, the total SDR transactions not assessed additions to tax is between two and 242 out of 3,215 for fiscal year 12, and the total TPT transactions not assessed additions to tax is between one and 135 work items out of 1,782 for fiscal year 12.

Recommendation

We recommend the Tax Department comply with W.Va. Code §11-10-18 (a) (1), W.Va. Code §11-24-18, and W.Va. Corporate Net Income Instructions 2012, pg.3 Extension of Time to File, as stated above, by enforcing the parameters for the proper extension of the filing deadline and imposing additions to tax for any return received after the filing deadline without a proper extension.

Spending Unit Response

See Appendix B on page 49.

Finding 10	**Violation of 24 Hour Rule**
Condition	Regional and satellite offices of the Tax Department do not deposit revenues received within 24 hours. A cash count in the Huntington and Beckley regional offices revealed checks were being mailed to the Charleston office on Monday, Wednesday and Friday.[17]
Criteria	**W.Va. Code §12-2-2, as amended, states in part:** "(a) All officials and employees of the state authorized by statute to accept moneys due the State of West Virginia … **shall deposit within twenty-four hours with the State Treasurer all moneys received or collected** by them for or on behalf of the state for any purpose whatsoever." (**Emphasis Added**)
Cause	Due to the accounting process, checks received by the Tax Department regional offices must be mailed to the Charleston office for processing into the GenTax system, delaying the deposit of the funds.
Effect	There is an increased risk of financial instruments being damaged, destroyed, lost or stolen when not promptly deposited.
Recommendation	We recommend the Tax Department comply with W.Va. Code §12-2-2 as amended during the 2013 legislative session. The recent amendment of W.Va. Code §12-2-2 allows for the granting of an exemptions if the accounting process prevents the ability to complete deposits of funds within 24 hours. We recommend the Tax Department seek an exemption for the check depositing process for only the regional and district offices modifying the deadline for the deposit of checks received at those locations to 48 hours, or request a legislative amendment to the code recognizing the unique situation of the Tax Department.
Spending Unit Response	See Appendix B on page 49.
Auditor's Comments to the Spending Unit Response	See Appendix C on page 56.

[17] Due to the comingling of all revenues received by the satellite offices upon receipt at the Main office the dollar amount was unable to be determined.

APPENDIX A- SUPPLEMENTAL INFORMATION

DELINQUENT DEBT[18]

Unaudited data obtained from the Tax Department as of 12/16/13

Tax Type	Delinquent Tax Debt[19]	Number of Delinquent Accounts	Average Delinquent Tax Debt per Account[19]
Personal Income Tax	$104,701,058	50,189	$2,086
Sales Tax	$83,929,903	41,112	$2,041
Withholding Tax	$40,166,958	20,963	$1,916
Combined Sales & Use Tax	$39,918,189	20,130	$1,983
Coal Severance Tax	$6,909,935	79	$87,468
Corp. Income & Franchise Tax	$5,596,112	1,597	$3,504
Health Care Broad Base	$4,617,717	288	$16,034
Use Tax	$3,957,567	1,399	$2,829
Pass Through Entity Tax	$2,296,830	1,337	$1,718
WC Additional Severance Tax	$1,015,801	276	$3,680
Coal Reclamation Tax	$732,533	104	$7,044
Tobacco Products Tax	$714,008	131	$5,450
Motor Carrier Tax	$707,735	412	$1,718
Motor Fuel Backup	$507,842	41	$12,386
Timber Severance Tax	$481,629	35	$13,761
International Fuel Tax	$420,218	298	$1,410
Severance Tax	$300,829	140	$2,149
Waste Coal Severance Tax	$290,038	4	$72,510
Motor Fuel Importer	$242,905	84	$2,892
Local Wine & Liquor Tax	$198,038	152	$1,303
Motor Fuel Transporter Tax	$181,350	68	$2,667
Direct Pay Tax	$140,542	20	$7,027
Fiduciary Tax	$121,608	37	$3,287
Health Care Severance Tax	$86,319	15	$5,755
Non Resident Composite Tax	$18,231	26	$701
Corporate License Tax	$15,104	55	$275
DE OHIO Highlands	$6,702	13	$516
Business Registration Tax	$4,482	25	$179
Soft Drink Excise Tax	$2,232	2	$1,116
Motor Fuel Exporter	$978	2	$489
Business Occupational Tax	$382	1	$3,812
Motor Fuel Supplier	$100	2	$50
Total	**$298,283,873**	**139,037**	**$2,145**

[18] The unaudited data does not include debt less than 180 days, or greater than 10 years. Debt under bankruptcy, deemed uncollectible, covered by Office of Tax Appeals, suspected fraud, and unverified or suspended legacy debt was not included. Total debt listed in GenTax was $715,693,174.

[19] Amounts rounded to the nearest dollar.

FUND LISTING

GENERAL REVENUE ACCOUNTS

The Tax Department maintained the following accounts:

Fund Number	Fund Name
0470	Tax Division Fund[20]

SPECIAL REVENUE ACCOUNTS

The Tax Department maintained the following special revenue accounts. These accounts represent specific funds from specific activities as required by law or administrative regulations. These funds were deposited with the State Treasurer in the following special revenue accounts:

Fund Number	Fund Name
7050	Additional Tax-Administration Fund
7052	Oil & Gas County Revenue Fund Administration
7053	County Tax Fund
7054	Inheritance Tax-Administration Fund
7057	Surface Mining Reclamation Fund
7059	Transient Vendor Fund
7064	Sales of Tax Maps Fund
7066	Tax Collection Agency Clearing Fund
7068	Administration of Seized Wells Fund
7071	Cemetery Company Registration Fund
7072	Medicaid State Share Administration Fund
7073	Special Audit & Investigative Unit Fund
7075	International Fuel Tax Agreement Clearing Fund
7077	Solid Waste Fee Clearing Fund
7079	Telemarketer Registration Fund
7083	Motor Fuel General Tax Administration Fund
7084	Tax Amnesty Fund
7086	Special District Excise Tax Administration Fund
7087	Wine Tax Administration Fund[20]
7088	Tax Offset Fee Administration Fund
7090	GenTax Clearing Account
7092	Redcd Cigarette Ignition Propensity Standard & Fire Prev Act Fund
7093	Municipal Fines & Fees Collection Fund
7094	Tax Dept Municipal Sales & Use Tax Fund

[20] Appropriated fund.

Additional Tax-Administration Fund
Revenue from coal severance tax for administration of program, not to exceed $35,000 annually.

Oil & Gas County Revenue Fund Administration
Severance tax for the administration of the oil and gas severance tax.

County Tax Fund
County commission funds to pay costs of central assessment computer system.

Inheritance Tax-Administration Fund
Fiduciary fees used to defray costs of administering estate tax.

Surface Mining Reclamation Fund
Three cents & two cents per ton tax on coal transfers to West Virginia Department of Environmental Protection (DEP) funds 3321 & 3324, respectively, to carry out reclamation of lands and environmental regulatory programs.

Transient Vendor Fund
Surety bonds to ensure compliance with the law by transient vendors.

Sales of Tax Maps Fund
Receipts of sales from tax maps to defray costs & transfer remaining funds to county assessors.

Tax Collection Agency Clearing Fund
Collection of delinquent taxes by collection agencies.

Administration of Seized Wells Fund
Taxes remitted to DEP fund 4159 to administer seizures of wells.

Cemetery Company Registration Fund
Registration fees & changes fees to be used by secretary of Tax & Revenue to ensure compliance of preneed cemetery companies.

Medicaid State Share Administration Fund
Transfers from Medicaid state share fund for administration and collection of tax.

Special Audit & Investigative Unit Fund
Charitable bingo, raffle, raffle boards and game fees to support compliance by the Tax Commissioner not to exceed $500,000 annually with all over $75,000 at years end to general revenue fund.

International Fuel Tax Agreement Clearing Fund
International fuel tax to be transferred to State Road Fund after refunds and reconciliation to members of agreement.

Solid Waste Fee Clearing Fund
Fee clearing fund.

Telemarketer Registration Fund
Severance tax, statutory transfers, other collections, fees, licenses, and income for administration of the registration requirements.

Motor Fuel General Tax Administration Fund
The Tax Commissioner is authorized to retain one half of one percent of the tax collected pursuant to the provisions this article to be expensed for the general administration of taxes imposed by this chapter.

Tax Amnesty Fund
Tax & applicable interest collected under the Tax Amnesty Program shall be deposited into the general revenue fund.

Special District Excise Tax Administration Fund
Other collections, fees licenses & income for the administration of Special District Excise Tax.

Wine Tax Administration Fund
Other collections, fees licenses & income for the administration of Special District Excise Tax.

Tax Offset Fee Administration Fund
Other collections, fees, licenses & income to be expended by the Tax Commissioner for the general administration of taxation.

GenTax Clearing Account
GenTax clearing account.

Redcd Cigarette Ignition Propensity Standard & Fire Prev Act Fund
All money as collected under civil penalties under section 6 of this article shall be deposited & divided between the State Fire Marshal & the State Tax Commissioner to support fire safety & prevention programs & the Tax Department enforcement activities.

Municipal Fines & Fees Collection Fund
Severance tax, statutory transfers, other collections, fees, licenses & income and other taxes divided between the State Fire Marshal & the State Tax Commissioner to support fire safety & prevention programs & the Tax Department enforcement activities.

Tax Dept Municipal Sales & Use Tax Fund
The Tax Commissioner may retain from collections a fee not to exceed the lesser of the cost of the service provided or one percent of the amount of taxes imposed pursuant to this article that are collected by the Tax Commissioner during any fiscal year.

METHODOLOGY

METHODOLOGY AND RELEVANT LAWS, POLICIES, OR AGREEMENTS BY OBJECTIVE

OBJECTIVE 1:

Did the Tax Department have policies and procedures in place to ensure they are collecting all monies due the State?

METHODOLOGY:

To achieve the objective all applicable W.Va. Code, Legislative rules, and the Tax Department internal policies and procedures were reviewed. Interviews and walkthroughs were performed to understand how the Tax Department functions and how the relevant policies and procedures were applied to collect monies due the state. Monies due the state include any taxes due, penalties, fees, and interest that have accrued. To obtain sufficient criteria to answer the objective we relied upon W.Va. State Code, Legislative Rules, and the procedures documented by the audit team and signed off by the Tax Department as true and accurate. When applicable, any type of forms or legally binding documents obtained during the audit was used.

To determine if the policies and procedures were in place, a risk analysis was performed to establish the highest areas of risk. After an initial assessment it was determined policies and procedures covering all the Tax Department functions were not documented. For areas deemed moderate or high risk, a test was developed. Tests were designed to determine if procedures were being performed as required by the Tax Department and if debt collection tools were utilized both appropriately and timely in an attempt to collect outstanding debt. Areas tested included: Excise/International Fuel Trade Agreement tax (IFTA), Sales tax, Personal Income Tax (PIT), CIT, Withholding tax (WTH), Levies, Liens, Write Offs, Waivers, and Payment Plans. Areas reviewed but not on a test basis included: Bankruptcy and Delinquent Debt.

<u>Testing Group One</u>

<u>Excise/IFTA Test</u>

The Excise/IFTA test included excise taxes and motor fuel taxes as follows: Tobacco Products Tax (TPT), Soft Drink Excise Tax (SDR), Wine Excise Tax (WNE), Beer Barrel Tax (BBT), Motor Fuel Exporter (MFE), Motor Fuel Importer (MFI), Motor Fuel Supplier (MFS), Motor Fuel Transporter (MFX), Motor Fuel Refunds (MFR), International Fuel Tax (IFT) and Motor Carrier Tax (MCR). Motor Fuel Backup, Telemarketer Tax, Motor Fuel Blender and Motor Fuel Distributor Tax were not included due to low risk and/or an immaterial amount. The population was comprised of 23,684 work items and 14,646 clean returns for a total population of 38,330. The work items were sorted by tax type and separated into groups with similar processes and objectives. Due to the low risk assessed for Clean Returns the clean returns for all tax types were grouped together.

To achieve a 95% confidence level with a five percent precision level when projected over the population, RAT-STATS was used to select the random probability sample size for each individual tax type or for the grouped tax. The RAT-STATS Single Stage Random Numbers function was used to generate random numbers for tax types TPT, SDR, WNE/BBT, MFE/MFI/MFS/MFX/MFR, and IFT/MCR. Due to low risk associated with Clean Returns the population was divided by the desired sample size of 60 resulting in the 244th clean return being selected for testing. For each subsequent sample number the universe was divided by 60 rounded appropriately to the whole number and added to the result of the previous sample number. The numbers generated and calculated were used to identify the items selected for testing in each population. Sample transactions selected were reviewed based on the supporting documentation present and the objectives of each respective test. The probability and non-probability samples resulted in 414 transactions tested. The grouping of tax types, objectives, and resulting sample size for each group are as follows:

<u>TPT- Sample size 70</u>

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Were reports being reconciled correctly to determine if taxes are assessed properly?
- Were applicable discounts being applied properly?
- Were accounts being checked for outstanding tax debt before stamps are issued and/or refusing sale to offenders?
- Were applicable interest, fines, penalties, etc. being applied for late filings?
- If products were determined to have been sold without stamps were collection procedures pursued?

<u>SDR- Sample size 71</u>

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Were reports being reconciled correctly to determine if taxes were assessed properly?
- Were applicable discounts being applied properly?
- Were applicable interest, fines, penalties, etc applied correctly to past due accounts?
- If the returns were not filed on time were delinquency letters mailed out?

<u>WNE BBT- Sample size 69</u>

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Were reports being reconciled correctly to determine if taxes are assessed properly?
- Were letters of good standing issued only for accounts that were in good standing?
- Were applicable penalties being applied to under payments of estimated tax?
- If returns were late or not filed were the taxpayers contacted (by letter or phone)?

<u>MFE MFI MFS MFX MFR- Sample size 72</u>

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Were reports being reconciled correctly to determine if taxes are assessed properly?
- Were applicable discounts being applied properly?
- Were applicable interest, fines, penalties, etc applied correctly to accounts?
- If Returns were late or not filed were the taxpayers contacted (by letter or phone)?

<u>IFT MCR- Sample size 72</u>

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?

- Were account renewal letters mailed out to accounts that were in good standing?
- Were "bad" letters mailed out to taxpayers who filed late or had not remitted taxes?
- Were "bad" indicators properly applied to the accounts (applied by system when letter is generated)?
- Were "bad" indicators removed when appropriate (these are manually removed)?
- Was tax due calculated correctly?
- Was tax owed calculated correctly?
- Were applicable interest, fines, penalties, etc applied to accounts at the correct rate?

<u>Clean Returns Test Objectives- Sample size 60</u>

- Were return work items flagged correctly?
- Did clean returns receive refunds while having outstanding tax debt?

<u>Testing Group Two</u>

To achieve a 95% confidence level with a five percent precision level when projected over the population of work items for the Sales Test, PIT Test, and CIT Test, RAT-STATS was used to select the random probability sample size for each individual tax type or for the grouped tax of each respective test. Due to low risk associated with Clean Returns the population was divided by the desired sample size of 60. The RAT-STATS Single Stage Random Numbers function was used to generate random numbers for each tests work items sample. The numbers generated and calculated were used to identify the items selected for testing in each population. Sample transactions selected were reviewed based on the supporting documentation present and the objectives of each of the following tests.

<u>Sales Test</u>

The sales test included the following tax types: Business Occupation Tax (BOT); District Excise Ohio-Highlands (EOD); Coal Severance Tax (CMS), Severance Tax (SEV); Timber Severance Tax (TIM); Waste Coal Severance Tax (WST); Coal Reclamation Tax (REC); Sales Tax (CST); Combination Sales and Use Tax (SUT); and Local Wine and Liquor Tax (WLT). Cemetery Tax, Solid Waste Management, DE Harrison Charles Point tax, and Use Tax were excluded due to low risk and/or an immaterial dollar amount. The population was comprised of 98,447 work items and 258,861 clean returns resulting in a total population of 357,308. The work items were sorted by tax type and separated into groups with similar processes and objectives. Due to the low risk assessed for Clean Returns the clean returns for all tax types were grouped together.

The non-probability sample for clean returns resulted in every 4,314th clean return being selected for testing. The probability and non-probability samples resulted in 388 transactions tested. The grouping of tax types, objectives, and resulting sample size for each group are as follows:

<u>BOT- Sample size 65</u>

- Were items flagged?
- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Were tax amounts due submitted by the due date?
- Were penalties and/or interest charged to any late returns?

REC- Sample size 65

- Were items flagged?
- Were items flagged correctly?
- Were flagged returns reviewed and corrected?
- Was the amount due paid on time?
- Were interest, fines, penalties, etc, applied to accounts?

EOD-Sample size 55

- Were items flagged?
- Were items flagged correctly?
- Were flagged returns reviewed and corrected?
- Was the amount due paid on time?
- Were applicable interest, fines, penalties, etc applied to accounts?

CMS SEV TIM WST- Sample size 71

- Were items flagged?
- Were items flagged correctly?
- Were flagged returns reviewed and corrected?
- Was the amount due paid on time?
- Were applicable interest, fines, penalties, etc. applied to accounts?
- Did monthly and/or quarterly returns reconcile to the yearly returns?

CST SUT WLT- Sample size 72

- Were items flagged?
- Were items flagged correctly?
- Were flagged returns reviewed and corrected?
- Was the amount due paid on time?
- Were applicable interest, fines, penalties, etc. applied to accounts?
- Were refunds processed before being requested by taxpayers?

Clean Returns Test- Sample size 60

- Were return work items flagged correctly?
- Did clean returns receive refunds while having outstanding tax debt?

Personal Income Tax Test (PIT)

The PIT test included the following tax types: PIT and fiduciary tax (FDY). The population was comprised of 316,698 work items and 625,056 resulting in a total population of 941,754. The work items and clean returns were sorted by tax type and tested separately.

The non-probability sample for clean returns resulted in every 10,283rd PIT clean return and every 134th FDY clean return being selected for testing. The probability and non-probability samples resulted in 263 transactions tested. The tax types, objectives, and resulting sample size for each are as follows:

PIT- Sample size 72

- Were manual returns reviewed?
- Were items flagged?
- Were items flagged correctly according to the review rule stated?
- Were flagged returns reviewed and corrected?
- Did the taxpayer pay the amount due on time?
- Were interest, fines, penalties, etc applied to past due accounts?
- Were non automatic refunds approved?
- Were change letters sent when returns are recomputed?

FDY-Sample size 71

- Were fiduciary returns reviewed to ensure beneficiaries were listed on schedule A?
- Did beneficiaries filing (receiving $ from) FDY returns also file a PIT or NRC?
- If beneficiaries did not file a PIT or NRC did the Tax Department remedy the situation with the taxpayer?

PIT Clean Returns Test-Sample size 60

- Were PIT work items flagged correctly?
- Did clean returns receive refunds while having outstanding tax debt?

FDY Clean Returns Test- Sample size 60

- Were FDY work items flagged correctly?
- Were FDY returns reviewed?
- For FDY returns not reviewed did beneficiaries file a PIT or an NRC?
- Did clean returns receive refunds while having outstanding tax debt?

Corporate Income and Franchise Test (CIT)

The CIT test included the following tax types CIT, Health Care Broad Base (HCB), and Health Care Severance (HCP). The population was comprised of 17,226 work items and 10,681 clean returns resulting in a total population of 27,907. The work items and clean returns were sorted by tax type and tested separately.

The non-probability sample for clean returns resulted in every 146th CIT, 22nd HCB, and 9th HCP clean return being selected for testing. The probability and non-probability samples resulted in 384 transactions tested. The tax types, objectives, and resulting sample size for each are as follows:

CIT- Sample size 72

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Were change letters sent when returns were recomputed?
- Did corporations make 4 quarterly payments and 1 yearly filing?
- Did the yearly filing reconcile to the 4 quarterly payments?
- If the corporation underpaid was an assessment sent when the monthly billings were sent out?

- If the corporation underpaid or didn't make a quarterly payment was interest and penalties assessed from the date of delinquency?
- Did C corporations file a business franchise tax return with the yearly return?

<u>HCB- Sample size 68</u>

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Did healthcare organizations file 11 monthly payments and an annual return?
- Did the annual return reconcile the 11 previous months and include a final payment to adjust to the correct amount?
- Were refunds requested by the taxpayer in writing or indicated on the tax return?
- If refunds were not requested was the refund credited to the account?
- Were refunds mathematically correct?
- Were refunds between $5,000 and $50,000 approved by the CIT Unit Supervisor?
- Were refunds greater than $50,000 approved by the Director of TAAD and the Deputy Tax Commissioner?

<u>HCP- Sample Size 64</u>

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Did healthcare organizations file 11 monthly payments and an annual return?
- Were interest and penalties assessed correctly for late or missing filings and payments?
- Did the annual return reconcile the 11 previous months and include a final payment to adjust to the correct amount?
- Were refunds requested by the taxpayer in writing or indicated on the tax return?
- If refunds were not requested was the refund credited to the account?
- Were refunds mathematically correct?
- Were refunds between $5,000 and $50,000 approved by the CIT Unit Supervisor?
- Were refunds greater than $50,000 approved by the Director of TAAD and the Deputy Tax Commissioner?

<u>CIT Clean Returns Test- Sample size 60</u>

- Were return work items flagged correctly?
- Were interest and penalties assessed correctly for late or missing filings and payments?
- Did clean returns receive refunds while having outstanding tax debt?

<u>HCB Clean Returns Test- Sample size 60</u>

- Were return work items flagged correctly?
- Was interest and penalties assessed correctly for late or missing filings and payments?
- Did clean returns receive refunds while having outstanding tax debt?

<u>HCP Clean Returns Test- Sample size 60</u>

- Were work items flagged correctly?
- Were interest and penalties assessed correctly for late or missing filings and payments?
- Did clean returns receive refunds while having outstanding tax debt?

Withholdings Test (WTH)

The WTH test included WTH Work Items and WTH Clean Returns. The population was comprised of 53,204 work items and 183,529 clean returns for a total population of 236,733. To achieve a 95% confidence level with a five percent precision level when projected over the population, RAT-STATS was used to select the random probability sample size for work items and clean returns. The RAT-STATS Single Stage Random Numbers function was used to generate random numbers for both the work items and clean returns. The probability and non-probability samples resulted in 144 transactions tested. The objectives and sample sizes for the test of WTH work items and clean returns are as follows:

WTH Work Items Test- Sample size 72

- Were flagged returns reviewed and corrected?
- Were items flagged correctly according to the review rule stated?
- Were desk audits performed on flagged items?
- Were applicable fees being assessed (Interest, penalties, etc?)
- Were spot checks of the annual reconciliations noted and documented in the system?
- Were spot checks reviewed by supervisors if there was a refund due or if there was a question during the spot check?
- Were returns automatically populated by GenTax if a quarterly return was not received from Payroll Service Providers or State Auditor filed accounts?
- If money was determined to be due for the auto populated returns were change notices sent out?
- If the auto populated return accounts with taxes due were not corrected by the 5th of the next month were billing statements sent out?
- If an overpayment was requested by a Taxpayer, was the refund reviewed before the refund was mailed?

WTH Clean Returns Test- Sample size 72

- Were WTH work items flagged correctly?
- Did clean returns receive refunds while having outstanding debt?
- Did clean returns reconcile with the W-2's on file for the annual return?

Testing Group Three

To reduce the bias of choosing strata boundaries in the levies test, liens tests, write-offs test, waivers test, and the payment plans test, each respective population was stratified using the Cumulative Frequency of the Square Root (CSRF)[21] method. Once the strata boundaries were chosen the resulting information for the strata obtained in the CSRF method was inputted into RAT-STATS Variable Sample Size Determination "Stratified" function to determine the sample size for each stratum. To achieve a 95% confidence level with a five percent precision level when projected over the population, RAT-STATS was used to select the random probability sample size. RAT-STATS Single Stage Random Numbers function was used to generate random numbers for each stratum. The numbers generated were used to identify the items selected for testing in each population. Sample transactions selected were reviewed based on the supporting documentation present and the objectives of each of the following tests.

[21] See page 49 for a brief description of the CSRF method.

Levies Test

The Levies test included all levies enacted during the audit period with a total of 2,754 items and a value of approximately $4,293,328. The CSRF method resulted in five strata for the test of levies. The random probability sample resulted in a sample of 119 transactions valued at approximately $854,637 being selected for testing. The levy transactions in each stratum were tested to answer the following objectives:

- For levies that received payments what percentage of the total tax liability was collected?
- Was the lien process being completed before the levy process was initiated?
- Did the Tax Department send a 10 day compliance letter to delinquent taxpayers?
- Did the Tax Department initiate a garnishment/levy after the 10 days had elapsed?
- Were levies initiated within a reasonable timeframe?
- Was a Notice of Levy Letter mailed to the employer or bank and returned to the Tax Department?
- If a garnishment was reduced did the taxpayer submit a 433-A?
- Were garnishment reductions approved by management?
- Were wage levy release letters sent?
- Did the Tax Department levy primary and secondary filers of joint returns for tax debt?

Liens Test

The Liens Test included liens of the following three categories: Liens Placed, which included all liens recorded during the audit period, Liens Released, which included all liens released during the audit period, and Liens Invalid, which included all liens invalidated in the GenTax system during the audit period. The liens placed test incorporated 19,300 transactions totaling approximately $76,181,401. The liens released test incorporated 15,471 transactions totaling approximately $34,963,902. The liens invalid test incorporated eight transactions totaling approximately $2,658,519. The CSRF method resulted in five strata for both the liens placed test and the liens released test. Due to the low number liens invalidated all transactions occurring during the audit period were tested.

Liens Placed

The result of the random probability sample of liens placed was a sample of 256 transactions valued at approximately $20,811,939 was selected for testing. The liens placed transactions in each stratum were tested to answer the following objectives:

- Were liens applied promptly?
- Was the lien applied for the correct amount?
- Was the lien recorded at the courthouse?
- Did the NOFA or NOPTL comply with WV Code §11-10-12(c)?
- Did the Tax Department lien primary and secondary filers of joint returns for tax debt?

Liens Released

The result of the random probability sample was a sample of 42 transactions valued at approximately $10,477,657 was selected for testing. The liens released transactions in each stratum were tested to answer the following objectives:

- Were the liens properly released?
- Were the liens released within the allowable timeframe?

Liens Invalid

Selecting all transactions resulted in a test of eight invalid liens valued at approximately $2,643,019. The liens invalid transactions were tested to answer the following objectives:

- Did the Tax Department maintain sufficient documentation to determine the reason an error was made?
- Was the reason given a sufficient reason to invalidate the lien?
- Were vacate letters sent?

Write Offs Test

The Write offs test included all debt granted a write off during the audit period with a total of 703 items and a value of approximately $11,891,551. The CSRF method resulted in six strata for the test of write-offs. The result of the random probability sample was a sample of 42 transactions valued at approximately $7,197,768 was selected for testing. The write off transactions in each strata were tested to answer the following objectives:

- Were all forced collection methods pursued before an account was classified as a write off?
- Were uncollectible case routing sheets approved by a tax supervisor and the Director or Assistant Director?
- Did any taxpayers with a debt classified as written off receive a tax refund without satisfying the written off debt?
- Could the same person request and approve a write off?

Waivers Test

The Waivers test included all debt granted a waiver during the audit period with a total of 3,958 items and a value of approximately $5,807,089. The CSRF method resulted in five strata for the test of waivers. The result of the random probability sample was a sample of 24 transactions valued at approximately $2,002,332 tested. The waiver transactions in each stratum were tested to answer the following objectives:

- Were only additions to tax being waived?
- Were waivers granted for significantly different amounts than was requested?
- Were waivers below $5,000 approved by tax unit supervisors or regional managers?

- Were waivers above $5,000 approved by the Director or Assistant Director?
- Could the same person request and approve a waiver?
- Did the agency maintain sufficient documentation to support the waiver decision?
- Were waivers only granted for reasonable causes?
- Did taxpayers receive multiple waivers?
- If taxpayers did receive multiple waivers was there a sufficiently documented different reasonable cause for each waiver?

Payment Plans Test

The Payment plans test included all payment plans in which a payment was made during the audit period with a total of 7,820 items and a value of approximately $40,077,363. The result of the random probability sample was a sample of 403 transactions valued at approximately $18,356,412 tested. The payment plan transactions in each stratum were tested to answer the following objectives:

- Did payment plans have a completed and signed payment plan agreement?
- Was proper interest being incurred on the debt?
- Were the payment plans agreed to reasonable?
- Were payment plans in excess of 12 months up to and including 48 months approved by a supervisor?
- Were payment plans in excess of 48 months approved by the Division Director or Assistant Division Director?
- Were payment plans in excess of 12 months providing form 433-A and/or 433-B?
- If the taxpayer had liabilities for personal and business taxes were they handled separately?
- If the payment plan was not adhered to were the accounts defaulted by the system?
- If the taxpayer defaults were payment plan default letters sent seeking payment?
- If the taxpayer defaults on the payment plan was a lien placed on the taxpayer's property?
- Did payment plans not receiving the minimum payment amount by the due date default as required?
- Did the Tax Department attempt to levy the debtor upon default?

Bankruptcy Documentation

Bankruptcy documentation was reviewed for timeliness and completeness to determine if the risk of not completing bankruptcy documentation or not completing bankruptcy filings in a timely manner increased the risk assessed for bankruptcies enough to warrant testing. The bankruptcy review contained all bankruptcies finalized during the audit period. The bankruptcies were stratified by bankruptcy chapter and Chapter 7 bankruptcies were further stratified by those having a status of no claim[22] and all other status. This resulted in a reviewable population of 275 bankruptcies.

[22] Bankruptcies with a status of no claim are bankruptcies with no assets available to the Tax Department to satisfy the debt, and as such, there is no action required by the Tax Department in those cases.

A review rate of 5% was determined by the auditor in charge and the audit manager, resulting in a sample of 14. The number of items chosen per strata was based on the ratio each strata represented of the entire population. Each bankruptcy in its respective strata was sequentially numbered and chosen at random using RAT-STATS random single stage number generator. Three Chapter 7, four Chapter 11, and seven Chapter 13 bankruptcies were reviewed. After review of the sample it was determined that the Bankruptcy documentation represented a low risk. No further work was deemed necessary.

Delinquent Debt

Delinquent debt was analyzed to assess the impact of accruing interest at the daily rate of .00026 (.026%) versus .00026027 (.026027%), to determine if it was necessary to recommend a change to the daily interest rate to the more accurate number, and to manipulate it into a presentable form.

All outstanding tax debt, as of 12/16/13, was obtained including the original tax debt amount, and date of delinquency. The outstanding tax debt was sorted by tax type, totaled, and the number of delinquent accounts counted. The totals for each tax type were summarized on a summary worksheet, which included the number of delinquent accounts for each tax type, and the average amount owed per account was calculated. The outstanding tax debt was then recalculated with the more accurate daily interest rate from the date of original delinquency and compared to the calculated amount for the daily interest rate currently in use. It was determined the difference in the two tax rates was immaterial.

RELEVANT LAWS, POLICIES, OR AGREEMENTS:

W.Va. Code Chapter 11 and W.Va. Code §5A-8-9 (b), as amended

Compliance Division Policies and Procedures 2009 Ed.

Standard Operating Procedure L 32 BR Closed Bankruptcy Cases

The 10-Day Compliance Letter

The Payment Plan terms and conditions section 12

COSO Internal Control- Integrated Framework May 2013

The Tax Department Documented and Signed procedures for the following: Accounts Monitoring Unit, Auditing, Bad Checks, Criminal Investigations Division, CIT, Collection Agency, Desk Audit, Discovery Unit, Excise Tax, GenTax to FIMS Reconciliation, Internal Audit, IT, Legal, Letter of Good Standing, Liens, Morning Job Stream, Offer In Compromise, Payment Plan, PIT, Property Tax, Research & Development, Revenue, Risk Score, Sales Tax, Taxpayer Services, Wage, Levy, and 3rd Party Levies, Waivers, WTH, and Write Offs.

OBJECTIVE 2:

Are all funds deposited into a State Account/Fund that has been remitted?

METHODOLOGY:

To achieve the objective a cash count of four field offices was conducted, and bank reconciliations performed by the Tax Department for July 2011, January 2012, and June 2012 was reviewed. Random deposits from the bank reconciliations were chosen from those months and traced to the West Virginia Financial Management System (WVFIMS).

The process undertaken by the Tax Department to reconcile GenTax to WVFIMS each month was documented and reviewed. The reconciliations performed were analyzed and the process was verified to match WVFIMS. The process in which revenue is received and inputted into the system via both the physical payments received from taxpayers and the electronic payments received via the State Treasurer's Office was documented. Walkthroughs were conducted to confirm the controls and processes in place to ensure the funds are deposited into the State accounts. The auditors witnessed the entire process of receiving funds, allocating them to the correct accounts, transferring the funds from one entity to another entity, and the controls deterring the misallocation or non deposit of funds.

RELEVANT LAWS, POLICIES, OR AGREEMENTS:

W.Va. Code Chapter 11, and W.Va. Code §12-2-2, as amended

Best Business Practices

The Tax Department Cash Count Bank Reconciliation Memo

The Tax Department GenTax to FIMS Recon

The Tax Department Internal Audit Procedures

The Tax Department Revenue Procedure

OBJECTIVE 3:

Are all funds deposited into a State Account/Fund promptly?

METHODOLOGY:

See: Methodology described in Objective Two on page 42.

RELEVANT LAWS, POLICIES, OR AGREEMENTS:

See: Relevant Laws, Policies, or Agreements detailed in Objective Two on page 42.

OBJECTIVE 4:

Are all funds adequately tracked and accounted for?

METHODOLOGY:

See: Methodology described in Objective Two on page 42.

RELEVANT LAWS, POLICIES, OR AGREEMENTS:

Legislative Rule Title 112, Series 3, as amended

See: Relevant Laws, Policies, or Agreements detailed in Objective Two on page 42.

OBJECTIVE 5:

Did the agency follow West Virginia State Code in assessing all state taxes mandated under West Virginia Code Chapter 11?

METHODOLOGY:

To achieve the objective all applicable W.Va. Code, Legislative rules, and the Tax Department internal policies and procedures were reviewed. Interviews and walkthroughs were performed to garner a better understanding of how the Tax Department functions and how the relevant policies and procedures were applied to assessing all state taxes mandated under W.Va. Code Chapter 11. To obtain sufficient criteria to answer the objectives we relied on W.Va. Code, Legislative Rules, and the procedures documented by the audit team and signed off by the Tax Department as true and accurate. When applicable, any types of forms or legally binding documents obtained during the audit were used.

To determine if the Tax Department followed W.Va. Code in assessing all State taxes mandated under W.Va. Code Chapter 11 a risk analysis was performed to establish the highest areas of risk. For areas deemed moderate or high risk, a test was developed. The testing was designed determine if returns were being calculated correctly or if procedures in place to calculate returns correctly; did the Tax Department follow up with late filers or non filers, are there procedures in place to track late or non filing; are tax forms and informational returns being cross checked for the applicable tax types to determine accuracy of the return? Areas tested included: Excise/IFTA, WTH, Sales tax, PIT, CIT, Levies, Liens, Write Offs, Waivers, and Payment Plans.

See: Excise/IFTA Test, WTH Test, Sales Test, PIT Test, CIT Test, Levies Test, Liens Test, Write Offs Test, Waivers Test, and Payment Plans Test methodologies described in Objective 1 beginning on page 31.

RELEVANT LAWS, POLICIES, OR AGREEMENTS:

See: Relevant Laws, Policies, or Agreements detailed in Objective 1 on page 41.

OBJECTIVE 6:

Is the Tax Department applying fines, penalties, fees, interest, additions to tax, and violations consistently in accordance with W.Va. State Code, the Code of State Rules, their own internal policies, and as a result of their own audits?

METHODOLOGY:

To achieve the objective all applicable W.Va. Code, Legislative rules, and the Tax Department internal policies and procedures were reviewed. Interviews and walkthroughs were performed to garner a better understanding of how the Tax Department functions and how the relevant policies and procedures were applied in the application of fines, penalties, fees, interest, additions to tax and violation.

To determine if the Tax Department is applying fines, penalties, fees, interest, additions to tax, and violations consistently, we first performed a risk analysis to establish the highest areas of risk. For any area that was deemed moderate or high risk a test was implemented. After our first initial assessment it was clear that detailed policies and procedures were not in written form. In order to have sufficient criteria to reach our objectives we relied on W.Va. State Code, Legislative Rules, and the procedures performed by our audit team and signed off by the Tax Department as true and accurate; if applicable we also used any type of forms or legally binding documents we found during our audit.

To establish if the Tax Department is applying fines, penalties, fees, interest, additions to tax, and violations consistently we designed testing to discover if procedures were being performed and if debt collection tools were utilized appropriately and timely in an attempt to collect outstanding debt. Areas tested included: Excise/IFTA, Levies, Liens, Write Offs, Waivers, WTH, Sales Tax, PIT, CIT, and Payment Plans.

See: Excise/IFTA Test, WTH Test, Sales Test, PIT Test, CIT Test, Levies Test, Liens Test, Write Offs Test, Waivers Test, and Payment Plans Test methodologies described in Objective 1 beginning on page 31

RELEVANT LAWS, POLICIES, OR AGREEMENTS:

See: Relevant Laws, Policies, or Agreements detailed in Objective 1 on page 41.

Methodology of the Cumulative Square Root Frequency Method (CSRF)

The CSRF Method is a widely accepted method to assign “optimal” strata boundaries. When used appropriately the CSRF method results in more accurate projections by reducing the variation within strata and eliminating inherent bias in “judgmentally” selecting boundaries. In order to establish optimal boundaries for strata, the strata would have to be based on the error amounts; because error amounts are unknown boundaries are stratified using the invoice amounts. CSRF breaks down boundaries into “cells” which are either equal or unequal in width. When performing the unequal width method an extra step is necessary. The unequal width method was used for this audit. The following are the steps used to determine stratum breaks assuming cells of unequal widths.

1. Evaluate the population and remove immaterial transactions, or any items above a dollar range should be examined in more detail.

2. Stratify the remaining items in the population to be sampled into ranges. (The amount is arbitrary and may be adjusted to achieve correct average coefficient variation located in step ten.)

3. Determine the frequency for each dollar range. (Sum the number of transactions in each range.)

4. Calculate the square root of the frequency (number of transactions in each range in step three).

5. Calculate the square root for each range width. The ending of the range minus the beginning of the range and determine the square root. Perform this for each range.

6. For each range multiply the square root of the frequency (step 4) by the square root for each range width (step 5). This gives you the sum of the square root value.

7. Cumulate the values for each range. Achieve this by using the sum of the square root for range 1 as the first number then subsequently add the next range to get a running total.

8. Divide the total cumulative square root value (the value located at the end of the running total) by the number of the strata in the test. This results in the cumulative square root for each stratum.

9. Multiply the cumulative square root for each stratum by the stratum number. Locate the cumulative square root closest to this amount and the corresponding ending range and this gives you the end boundary for your stratum.

10. Calculate the coefficient of variation (standard deviation divided by the mean) for each stratum; then compute the average variation for all the strata. The target range is an average variation under 50 percent. If it is above 50 percent additional strata may need to be added. If the average is far below 50 percent, the number of strata used may be reduced.

APPENDIX B

WEST VIRGINIA STATE TAX DEPARTMENTS RESPONSE TO AUDIT FINDINGS

STATE OF WEST VIRGINIA

Department of Revenue
State Tax Department

Earl Ray Tomblin
Governor

Mark W. Matkovich
State Tax Commissioner

#1 Failure to Utilize Payment Plan Enforcement Methods

Due to the unique facts and circumstances of each taxpayer, Tax explores the reason for default of a payment plan prior to employing enforcement methods. This analysis often results in allowing additional time for taxpayers to "catch up" their payment plan resulting in no immediate enforcement action. Additionally, Tax is often inhibited from taking action in cases where the taxpayer has no sources for levy or lien. Tax will continue to place greater emphasis on appropriate enforcement methods while remaining cognizant of specific taxpayer circumstances.

#2 Failure to Follow Payment Plan Agreement

Employees are instructed on the proper procedures when payment plan agreements are violated. Tax will continue to place greater emphasis on the policies and procedures for payment plans. Tax is currently updating Standard Operating Procedures and training programs to reflect this commitment. Tax is also reviewing the programming of the GenTax system for potential areas of improvement.

#3 Failure to Levy Joint Debtors for Tax Debt

Tax initiates wage garnishments based upon programs designed to identify the debtor's employer. In these cases, it is appropriate to reference only the employee/debtor on the levy document, not both filers of a joint return. For purposes of bank levies, Tax employs a data matching system that associates only the primary debtor on a taxpayers account. Tax agrees with the finding that levy notices and action should include both filers for a joint return. Tax is researching the options for automatic notice and levy to joint filers where appropriate.

#4 Lack of Management Oversight (payment plan approval process)

Employees are instructed on the proper procedures to approve payment plans. Tax will continue to place greater emphasis on the policies and procedures for approval of payment plans. Tax is currently updating Standard Operating Procedures and training programs to reflect this commitment. Tax is also reviewing possibilities for integration of the payment plan approval process into the GenTax system.

#5 Lack of Supporting Documentation (payment plans)

Employees are instructed on the proper procedures regarding support for payment plans. Tax will continue to place greater emphasis on the policies and procedures for documentation of payment plans. Tax is currently updating Standard Operating Procedures and training programs to reflect this commitment. Additionally, Tax is exploring avenues to allow taxpayers to establish a payment plan via the online portal (MyTaxes) which could require agreement with the terms and conditions of the payment plan.

#6 Levies Not Initiated Within a Reasonable Timeframe

Section 11-10-13(e) of the West Virginia Code requires Tax to provide a minimum notice of 10 days to the debtor prior to levy. Tax's "10 Day Compliance Letter", issued to comply with this requirement, states in pertinent part "Your failure to pay your amount **can** result in one or more of the following legal actions: revocation of your Business Registration Certificate, an injunction preventing you from engaging in business, levy of personal property, garnishment of wages or foreclosure of our tax lien."
The letter is mailed to inform the debtor of potential actions that can be undertaken by Tax should the debt not be satisfied. Often, the letter will prompt debtors to pay their liability or execute a payment agreement to satisfy the debt. Just as often, response from the debtor can delay our levy until a later date. In cases where the debtor fails to respond or pay, Tax may choose to levy but is under no statutory requirement to do so within a prescribed amount of time.

#7 Liens Not Initiated Within the Prescribed Timeframe

GenTax is configured to progress debt from assessment to lien on the first available billing cycle after the occurrence of 3, 30 day billing cycles. For purposes of this calculation, short or partial cycles (less than 30 days) are disregarded. Accordingly, liens are not always initiated within 90 calendar days but are initiated within 3 billing cycles.

#8 Lack of Internal Controls over Write offs and Waivers

Tax has already implemented changes in its GenTax system which will lead to increased segregation of duties for the requesting and approval of write-offs and waivers. Additionally, employees are instructed on the proper procedures for approval of both write-offs and waivers. Tax will continue to place greater emphasis on the policies and procedures related to these items.

#9 Failure to Assess Additions to Tax (for late filed returns)

Employees are instructed on the proper procedures for granting an "Extension of Time to File" and the impact of related additions to tax. Additionally, Tax is reviewing the possibility of requiring secondary approval for the waiving of any additions to tax within the GenTax system.

#10 Violation of 24 Hour Rule

Section 12-2-2(a) of the West Virginia Code provides an express **exception** for procedures by which the Department of Revenue accepts monies due the State.
The proviso reads as follows:

> All officials and employees of the state authorized by statute to accept moneys on behalf of the State of West Virginia shall keep a daily itemized record of moneys received for deposit in the State Treasury and shall deposit **within one business day** with the State Treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever. The State Treasurer may grant an exception to the

> one business day rule when circumstances make compliance difficult or expensive. The State Treasurer may review the procedures and methods used by officials and employees authorized to accept moneys due the state and change the procedures and methods if he or she determines it is in the best interest of the state: **Provided, That the state Treasurer may not review or amend the procedures by which the Department of Revenue accepts moneys due the state.**

Emphasis added.

The 24 hour deposits procedure[23] does **not** apply to the Tax Division of the Department of Revenue. We must therefore respond to the recommendation that "STAX comply with West Virginia Code §12-2-2," by stating that the West Virginia Tax Department does in fact comply with those provisions.
We respectfully submit that this finding and recommendation must be withdrawn.

[23] House Bill 2837 (effective July 12, 2013) amended section 12-2-2 to, among other things, change the language in subsection (a), in the first sentence, by substituting "one business day" for "twenty-four hours."

STATE OF WEST VIRGINIA
Department of Revenue
State Tax Department

Earl Ray Tomblin
Governor

Mark W. Matkovich
State Tax Commissioner

June 13, 2014

Mr. Denny Rhodes, Director
Legislative Post Audit Division
Building 1, Room W-329
1900 Kanawha Blvd., East
Charleston, WV 25305-0610

Dear Mr. Rhodes:

Enclosed please find the West Virginia State Tax Department's (Tax) responses to the audit findings for the period of July 1, 2011 to June 30, 2012. As a result of these findings, Tax will continue to develop best practices, improve standard operating procedures and explore system enhancements with the aim of eliminating the causes of these findings.

Tax would also like to provide some insight into the "Delinquent Debt" information included in Appendix A – Supplemental Information. First, Tax would like to clarify that this is debt owed to the State of West Virginia (i.e. accounts receivable) not debt owed by Tax to third parties. Next, Tax would like to emphasize that in relation to total tax collections over the past 10 years, the amount of tax related receivables owed to the State of West Virginia is less than 2%.

Lastly, for the 9 of the past 10 years, annual receivables have remained consistent while collections have improved by an average of 7%. Tax attributes this positive collection trend to the full implementation of the GenTax system which enables discovery efforts to be more focused and productive.

Tax appreciates the opportunity to respond to the audit findings and we look forward to working with the Legislative Post Audit Division in the future.

Sincerely,

Mark W. Matkovich
State Tax Commissioner

TAX COMMISSIONER'S OFFICE
1001 LEE STREET, EAST, P.O. BOX 11771, CHARLESTON, WV 25339-1771
TELEPHONE (304) 558-0751
FAX (304) 558-8999

APPENDIX C

AUDITOR COMMENTS TO THE TAX DEPARTMENT RESPONSE

Generally Accepted Governmental Auditing Standards section 7.37 require the auditors to evaluate the validity of the audited entity's comments, when the audited entity's comments are inconsistent, or in conflict with the findings, conclusions, or recommendations in the report, or when corrective actions do not adequately address the auditors' recommendations.

Below are instances in which the auditors have disagreed with the comments, as well as the reason for the disagreement.

Finding 1 Failure to Utilize Payment Plan Enforcement Methods

The Tax Department has indicated in its response, it places a greater emphasis on assisting the taxpayer instead of collecting the tax debt owed. It is the auditor's position that the payment plan is the method in which taxpayers "catch up", not the Tax Department allowing flexibility in making payments during the payment plan. As the Tax Department indicated in the delinquent debt provided to the auditors there is a finite amount of time before the debt is deemed uncollectible. In the auditor's opinion, it is the duty of the Tax Department to collect the debt in the most efficient and swift method before the debt is no longer collectible. Providing flexibility in a payment plan, which is already providing a service to the taxpayer, is not the most efficient method of collection.

While the auditors applaud the Tax Departments indicated intent of placing a greater emphasis on appropriate enforcement methods it should be noted the difference in the auditor's recommendation of enforcement and the apparent intent of the Tax Department. It is the position of the auditors that based on the parameters of a default as described in the payment plan agreement any payment plan not receiving the full payment required on the due date should be defaulted and all collection efforts pursued.

Further, if payment plans are defaulted as the agreement requires and full collection efforts pursued it is the stance of the auditor that more delinquent tax debt would be recovered. Additional tax debt would be received through the collection efforts, and taxpayers could then agree to a replacement payment plan, and would be more likely to not default on the new payment plan in place.

Finding 6 Levies Not Initiated Within a Reasonable Timeframe

While the auditors agree that the Tax Department is under no statutory requirement to initiate a levy within a prescribed amount of time, it is in the best interest of the State that the agency operates in a businesslike manner as it pertains to seeking payment of outstanding tax debt. Private sector businesses seek payment for their accounts receivables, which is essentially what outstanding tax debt is, in a timeframe well under 60 days. It should be noted in consultation with industry leaders in banking it was determined they operated on a reasonable timeframe of 30 days. To initiate levies within 60 days would only serve to increase the amount of tax debt the department is able to collect.

The section of code referenced by the Tax Department is not of importance when discussing the reasonable timeframe for initiating a levy. The language of the code section indicates the requirements for notification, of which there is not an issue associated with the notification process in this report. It should be noted that during testing the auditors were unable to determine if the other collection efforts listed in the response were undertaken.

Finding 10 Violation of 24 Hour Rule

The language change from 24 hours to one business day is not of relevance to the finding. The audit period was for fiscal year 2012, and as such the language for W.Va. Code§12-2-2 as of the audit period is the correct criteria. As for the claim of the Tax Department of an exemption granted to the department in the code section quoted, it has been determined by a legal opinion issued by the Legislative Services the Tax Department does not have an automatic exemption and that an exemption must be requested from the State Treasurer's Office. Please refer to the opinion below:

The purpose of this memo is to respond to your question whether the State Tax Department must comply with the provision of West Virginia Code §12-2-2 which requires that money received by state agencies be deposited within one business day of their receipt by the agency.

> W. Va. Code §12-2-2(a) provides in relevant part:
>
> All officials and employees of the state authorized by statute to accept moneys on behalf of the State of West Virginia shall keep a daily itemized record of moneys received for deposit in the State Treasury and shall deposit within one business day with the State Treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever. The State Treasurer may grant an exception to the one business day rule when circumstances make compliance difficult or expensive. The State Treasurer may review the procedures and methods used by officials and employees authorized to accept moneys due the state and change the procedures and methods if he or she determines it is in the best interest of the state: Provided, That the State Treasurer may not review or amend the procedures by which the Department of Revenue accepts moneys due the state. . . .

This Code provision places two essential requirements on "all officials and employees": these persons must keep a daily, itemized record of the moneys received and they must deposit those moneys in the State Treasury within one business day. All officials and employees of the State must comply with these requirements. There are no exceptions set out in the Code, but the State Treasurer is authorized to grant exceptions to the one-business-day rule under certain conditions. In the absence of any other exceptions in the Code, the only exceptions are those that are granted by the Treasurer.

The State Tax Department maintains that it is exempt from the one-business-day deposit rule based upon the proviso appearing in the third sentence of this subsection. This proviso says that the "State Treasurer may not review or amend the procedures by which the Department of Revenue accepts moneys due the state." This language does not create an exemption from the deposit requirement. It establishes an exception to the Treasurer's authority to review and amend the procedures for accepting state moneys, but not to the officials' and employees' duty to deposit them promptly. Had the Legislature intended to exempt the State Tax Department from the deposit rule, the exemption would have appeared within the language referencing deposits, not receipts.[24]

[24] Prior to 2013, there were no exceptions to the deposit requirements, but this was amended by the Legislature in the 2013 Regular Session. This was when the second sentence - authorizing the Treasurer to grant exceptions - was inserted into this subsection.

The language of W. Va. Code §12-2-2(a) makes a distinction between procedures for accepting moneys and depositing them. This is shown by the way that the Treasurer's duties and powers are set out within this subsection. When it comes to review and change the procedures for <u>accepting</u> state moneys, the Treasurer has independent and exclusive power, but when it comes to procedures for <u>depositing</u> those state moneys, the Treasurer must propose rules for legislative approval. This is expressed in the following additional portion of W. Va. Code §12-2-2(a):

> "...The State Treasurer shall propose rules for legislative approval, in accordance with the provisions of article three, chapter twenty-nine-a of this code governing the procedure for deposits. The official or employee making deposits with the state Treasurer shall prepare deposit lists in the manner and upon report forms prescribed by the state Treasurer in the state accounting system. ..."

Since the language relating to the Department of Revenue appears in the provision concerning the Treasurer's power to review procedures for accepting moneys, this exception does not apply to the duty to make timely deposits.

Based upon the plain language and the structure of W. Va. Code §12-2-2(a), therefore, it is evident that the one-day-deposit rule applies to ALL officials and employees of the state, including the State Tax Department, unless the State Treasurer grants an exception from this requirement "when circumstances make compliance difficult or expensive." Thus, if the State Tax Department has business reasons to justify a variance from the one business day time limit, the Department should present those circumstances to the Treasurer and request an exception. Barring that, employees and officials of the State Tax Department are required to deposit all state moneys in the Treasury within one business day of accepting those moneys.