



DEPARTMENT OF FINANCE

AUDIT DIVISION

AP/AU - 14

4/5/90

STATEMENT OF AUDIT PROCEDURE

DOCUMENTING AN AUDIT

I. BACKGROUND

This Statement of Audit Procedure guides the field auditor in assembling the documentation for a completed field audit. It is intended to apply to all taxes, with appropriate modifications as necessary to each. While the same care must be exercised in all cases, it is particularly important to observe the requirements that follow for cases which conclude with a determination to which the taxpayer has not consented. Such cases, when a taxpayer protests the notice of determination, are handled by the Department's Office of Legal Affairs.

While failure to observe these procedures does not affect the validity of a determination, they are intended particularly to facilitate the disposition of contested cases. The Office of Legal Affairs must rely on the information gathered and the documentation produced by the auditor prior to referral of the matter to Legal Affairs. Thus, timely and complete documentation during the course of the audit becomes crucial in contested cases.

For purposes of uniform reference, the following terms are used to denote the sections and contents of an audit file:

Audit Package: This contains documents which support the audit adjustments. Its contents include a separate file for each audit year or for the entire audit period, as required for the relevant tax, each file containing the Workpapers relevant to that year or years. Other contents include the federal tax return and an index of the package.

Administrative Package: This contains most correspondence and other documentation not found in the Audit Package. Its contents should include: the Auditor's Report and Comments; the Audit Summary Sheet; powers-of-attorney; Statement of Audit Adjustments; Consent and Waiver or Consent to Audit Adjustments; waivers of the statute of limitations; Summary Workpaper; payment reconciliation; Contact Sheet; all written correspondence with taxpayer (including Information Document Requests); any supporting documents (e.g., Commercial Rent printouts, partnership agreement, lease, etc.); and a checklist or index of the package.

Litigation Package: This contains all material prepared in support of a possible dispute of the asserted tax liability and is not disclosable to the taxpayer or taxpayer's representative. Such material would include any advice or opinions of counsel, analysis of the taxpayer's and the Department's respective positions on any issue, the Audit Recommendation, and the Exit Conference Memorandum.

II. PROCEDURE

1. Case File

Except for minor variations as may be dictated by administrative necessities relevant to each tax, the case file for an audit should be organized and labeled in accordance with the uniform system provided in the Background, above. This will facilitate review of the audit.

2. Auditor's Report and Comments

The Auditor's Report and Comments (referred to as the "Comments") is a valuable part of the audit documentation. Therefore, Comments should be maintained meticulously by the auditor throughout the course of the audit.

Generally speaking, the more complete and accurate the Comments, the better equipped the Department's attorney will be to effect the timely resolution of a dispute either by informal agreement or by litigation. The purpose of the Comments is to show how the auditor arrived at the final determination of tax liability. Comments should begin with a description of the taxpayer's business, including affiliates and partners and taxpayer's federal, state, and city filing status. The Comments will also mention any prior audits of the taxpayer and the federal and state adjustments. The auditor should give a brief description of taxpayer's treatment of items on the return as filed. The auditor will describe the issues found on audit, following the format of the return and schedules, and will discuss any adjustments as they are made, giving the Department's final treatment of each adjustment. Comments should be grouped by year and should quantify each issue by approximate percentage of the total adjustment.

When completed, the Comments are to be placed at the beginning of the Administrative Package.

3. Documents

(a) **Document Requests.** If a taxpayer fails or refuses to supply a document or record, the proof of requests for such items can be extremely helpful in later discussions or litigation. The

auditor's care in maintaining a complete and accurate record of such requests is, therefore, important to the case documentation.

The auditor should request the documents needed on the Information Document Request, at the beginning of the audit or as needed during the audit. However, while written requests for documents are recommended, a later request for an additional or particular document from a cooperative taxpayer may be made orally. In this instance, the auditor will establish with the taxpayer the date by which the document will be provided. The auditor should record his or her oral request on the Contact Sheet, noting the date of the request, the name of taxpayer's representative, the document requested, and the mutually-agreed date by which the document is to be supplied. The auditor will call the taxpayer promptly if the document is not supplied by the agreed date and will send a written confirmation of the conversation and a renewed request for the document. If a meeting is held with the taxpayer to discuss problems in obtaining documentation, the auditor will enter the meeting in the Contact Sheet, noting the date, the attendees, and the content of any discussion agreement, or dispute.

(b) **Copying Original Documentation.** Generally the auditor should make a complete copy of a document, not just a portion of it. Often, a seemingly irrelevant portion of a lease or tax return will be material to the later resolution of a case. Therefore, unless the issue is not material to the case or the audit findings will not be disputed, the auditor should copy the pertinent document in its entirety.

Auditors should exercise judgment in requesting copies of records and documents from a taxpayer. Requests for inessential records create a burden for the taxpayer and undermine the relationship between the auditor and the taxpayer necessary for successful completion of the audit. If a doubt exists as to the advisability of requesting additional documents or copying only a portion of a document, the auditor should confer with his or her Group Chief, Field Manager, or Unit Head. Generally, any doubt existing as to the advisability of copying only a portion of a document should be resolved in favor of copying the entire document.

(c) **Notes.** The auditor should not annotate or make comments on documents (including correspondence from the taxpayer). The auditor should record all relevant remarks in the Comments, making reference, if necessary, to the document (e.g., "paragraph 27, page 10, of the lease shows a building service required by the lease which is normally provided by landlord; we are treating it as rent"). The reader should not need to refer to the cited document in order to understand the auditor's comment.

4. Cross-Referencing of Workpapers

The Workpapers constitute evidence of the scope of the audit work performed. The cross-referencing in the Workpapers is the

audit trail, which memorializes the source documents and records examined during the audit and the computations prepared by the auditor in determining the correct tax liability.

The auditor should cross-reference all Workpapers to the appropriate supporting documents and schedules. If no supporting documentation is available, the auditor should state in a footnote which source documents were examined, e.g., General Ledger, Cash Disbursements Journal, etc. Also, where appropriate, a copy of the initial or title page of the source document cited should be annexed to the relevant Workpaper.

5. Consent to Test-Period Audit Method

If the auditor has obtained the taxpayer's consent to the use of a test period to determine tax liability, the auditor should annex the written consent to the relevant Workpaper and record its receipt in the Comments, giving the date and the signatory's name and official capacity. The auditor should also record in the Comments the test periods used to determine tax liability and the results of each.

6. Inadequate Books and Records

If the taxpayer's books and records are inadequate, the auditor will state in the Comments why the books and records are deemed inadequate and will specify which records were available and which were unavailable or inadequate. If the inadequacy is due to the taxpayer's failure or refusal to supply the requested records, such failure or refusal should be documented either by a record of written requests to the taxpayer (see "Document Requests," 3(a), above) or by a letter from the taxpayer indicating the unavailability of the requested records.

All writings from the taxpayer concerning its inability or refusal to supply the requested records should be noted in the relevant Workpapers and entered in the Comments by date and a summary of contents, including the signatory's name and official capacity, if any. If the taxpayer orally refuses or asserts inability to supply the requested records, the auditor should note the taxpayer's statement in the relevant Workpaper in addition to recording it on the Contact Sheet.

7. Penalties

When penalties are asserted, the auditor should clearly state in the Comments which penalties are being imposed (e.g., failure to file, negligence, understatement of tax due, etc.) and the dollar amount applicable to each. In addition, the auditor will show in the Workpapers how each penalty was calculated, e.g., "Late filing (6 months), 25% of principal.....\$ (amount)."

If a penalty is waived pursuant to an affidavit or other

documentation from taxpayer detailing circumstances warranting a waiver, such documentation should be annexed to the relevant Workpaper and the date and a summary of its contents recorded in the Comments. The Comments will also indicate the name of the Field Manager or Unit Head with whom the auditor conferred in making the decision to waive a penalty and the entry will be initialed by that supervisor.

8. Partial Consent

Any partial consent to a deficiency should contain a statement of the amount contested and outstanding and the audit period involved.

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