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STATEMENT OF AUDIT PROCEDURE

DOCUMENTING AN AUDIT

I. BACKGROUND

This Statement of Audit Procedures explains how auditors should assemble information and documents after finishing an audit. It applies, with appropriate modifications, to all tax types.

Following these guidelines is particularly important for contested cases. The Department's attorneys rely on the information and documents provided by auditors if a taxpayer challenges the results of an audit in Conciliations or the NYC Tax Tribunal. A complete audit file will increase the likelihood of a fair resolution.

An audit file is divided into the following sections:

Audit Package: The Audit Package includes documents that support the audit adjustments. It has an index, a separate file containing the workpapers for each audit year (unless one file for the entire audit period is customary for that tax type), and relevant NYC and federal tax returns.

Administrative Package: The Administrative Package contains correspondence and additional documents not found in the Audit Package. It should have a checklist or an index and should include:

- The Auditor's Report and Comments
- The Audit Summary Sheet
- Powers of Attorney
- Statement of Audit Adjustments
- Notices of Proposed Tax Adjustments
- Consent and Waiver or Consent to Audit Adjustments
- Waivers of the Statute of Limitations
- A Summary Workpaper
- A Payment Reconciliation
- Signed copies of all written correspondence with taxpayer (including Information Document Requests)

- Any other supporting documents (e.g.. Commercial Rent printouts, partnership agreement, lease etc.)

Litigation Package: The Litigation Package contains all material prepared in contemplation of a possible dispute of the asserted tax liability. It includes 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. It is not disclosable to any taxpayer or taxpayer's representative.

Recommendation For Follow up Audit: This package contains the tax return for the subsequent period and the recommendation form signed by the auditor, group chief, manager and Assistant Director/Director.

II. PROCEDURE

1. Case File

Except for minor administrative variations for each tax, the case file for an audit should be organized and labeled as outlined above. Uniformity will facilitate review of the audit.

2. Auditor's Report and Comments

The Auditor's Report and Comments (referred to as the "Comments") is very valuable and should be maintained with care throughout the audit.

The purpose of the Comments is to show how auditors arrive at the final determination of tax liability. The more complete and accurate the Comments, the better equipped the Department's attorneys will be resolve disputes quickly and fairly, whether by agreement or by litigation.

Comments should begin with a description of a taxpayer's business, including affiliates and partners and taxpayer's federal, state, and city filing status. The Comments will also mention prior audits and any federal and state adjustments for the period under audit. Auditors should then give a brief description of the treatment of items on the return as filed.

Next, auditors will describe the issues found on audit, following the format of the return and schedules. The Comments should include a detailed discussion of any adjustments made, explaining the Department's final treatment of each item adjusted.

The Comments should include discussion of combination, penalties and recommendation as to a follow up audit. Comments should be grouped by year and should quantify each issue by approximate percentage of the total adjustment. Comments should also include a description of any exit conference held.

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

3. **Documents**

(a) Document Requests. Auditors must carefully maintain a complete and accurate record of all documents and information requested during the course of an audit. If a taxpayer fails or refuses to supply a particular document or record, the Department must be able to show that the document or record was in fact requested. Documenting these requests is a necessary step toward resolving the underlying tax issue, whether informally, or as part of either the conciliation or tax appeals process.

Auditors should use an Information Document Request (“IDR”) to request any documents at the beginning of an audit.

Written requests are always preferable, even during the course of an audit, but follow-up requests for any additional or particular documents from a cooperative taxpayer, may be made orally. Auditors should record all oral requests in the PASS event log, 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.

Auditors will call taxpayers promptly if a 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 the document is not received, follow the procedures as indicated in Paragraph 6. If a meeting is held with a taxpayer to discuss problems in obtaining documentation, auditors will enter the meeting in the PASS event log, noting the date, the attendees, and the content of any discussion agreement, or dispute.

(b) Copying Original Documentation. Generally auditors should make a complete copy of a document, not just part of it. Often, a seemingly irrelevant portion of a lease or tax return will be needed later to resolve the case. Unless it is clear that only a small part of a document is material to the case, auditors should copy the pertinent document in its entirety.

Auditors should exercise judgment in requesting copies of records and documents from a taxpayer. Requests for non-essential records create a burden for the taxpayer and undermine the relationship between auditors and taxpayers necessary for successful completion of an audit.

If auditors are uncertain about whether to request additional documents or copy only a portion of a document, they should speak with the appropriate Group Chief, Field Manager, or Unit Manager.

(c) Notes. Auditors should never annotate or make comments on documents (including tax returns and correspondence from the taxpayer). Instead, auditors should record all relevant remarks in the Comments, making reference 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”). Bear in

mind that auditors' discussion in the Comments should be clear and understandable to a reader, even without viewing the source documents mentioned.

4. **Cross-Referencing of Workpapers**

The Workpapers demonstrate the scope of the audit work performed. Cross-referencing in the Workpapers memorializes how the source documents and records examined during the audit relate to the computations prepared by auditors in determining the correct tax liability.

In addition to the cross-referencing provided in the PASS workpapers templates, auditors should cross-reference all Workpapers to the appropriate supporting documents and schedules in the audit file. If no supporting documentation is available, auditors should state in a footnote or in the Audit Comments 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 Auditors have obtained a taxpayer's consent to the use of a test period to determine tax liability, the written consent must be attached to the relevant Workpaper. Auditors must also record receiving the written consent in the PASS event log and Comments, giving the date and the signatory's name and official capacity. Auditors should then record in the event log the specific test periods used to determine tax liability and the results of each.

6. **Inadequate Books and Records**

If a taxpayer's books and records not adequate, auditors will state in the PASS event log and 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 a taxpayer's failure or refusal to supply the requested records, the 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 a taxpayer indicating the unavailability of the requested records.

All writings from a taxpayer concerning its inability or refusal to supply the requested records should be noted in the relevant Workpapers and entered in the PASS event log and Comments. These notations should include the date and a summary of contents, including the signatory's name and official capacity, if any.

If a taxpayer orally refuses or asserts inability to supply requested records, auditors should confirm with a follow-up-letter. The letter should explain that the auditor believes the taxpayer has stated that they cannot or will not supply the requested records. The letter must give the taxpayer a chance to respond, in writing by a specific date, if the auditor's understanding is not correct. The letter must also state that if there has been a misunderstanding, the taxpayer is expected to indicate, in writing, when the requested records will, in fact, be supplied.

7. **Penalties**

When penalties are asserted, auditors should clearly state in the explanations to the Notice of Proposed Tax Adjustment 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 (5 months),. 25% of principal.....\$ (amount)."

If a penalty is waived pursuant to an affidavit or other document from the taxpayer detailing circumstances that justify a waiver, that document should be attached to the relevant Workpaper. The date and a summary of the document's contents should also be recorded in the Comments and PASS event log . The Comments and event log will also indicate the name of the Field Manager or Unit Manager who was consulted to decide whether to waive a penalty and the entry will be initialed by that supervisor. An entry should also be made in the PASS case file by the Manager who approved the waiver of penalty.

8. **Partial Consent**

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