# STATE OF ARIZONA

*Department of Revenue*
*Office of the Director*
*(602) 716-6090*

*Janet Napolitano*
**Governor**

*Gale Garriott*
**Director**

August 19, 2005

Debbie Davenport, Auditor General
Office of the Auditor General
2910 North 44<sup>th</sup> St.  Suite 410
Phoenix, Arizona 85018

Dear Mrs. Davenport:

The Department of Revenue (Department) has reviewed the August 10, 2005 Audit Division's report of the performance audit and sunset review.  The Department commends and thanks your staff for their understanding and professionalism throughout this performance audit process.

The following comments are provided as the Department's response to the findings and recommendations.

**Finding 1 – Division needs to take additional steps to better manage its limited resources**

**Recommendation 1** – To ensure its resource allocation decisions are based on complete and accurate information, the Division should ensure staff is trained on:

    a)  what data must be entered into ESKORT

    b)  how to enter the data, and

    c)  the importance of ensuring the data is complete.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

As the ESKORT system is implemented, extensive training is being designed to ensure that all users of the system will be properly trained in a timely manner regarding the various systems.  The ESKORT procedure manuals and class handouts are being designed to be very user-friendly to meet all levels of expertise regarding computer input.  We are working closely with members of the ESKORT system design teams to develop in-house trainers that will be "resident experts" so the training of affected personnel and the transition to the

---

new systems will be easy, efficient, and effective. Additional emphasis will be placed on the importance of accurate and complete data input by the ESKORT system users so meaningful management reports can be produced for analytical purposes.

Currently, the Corporate Income Tax Audit and Transaction Privilege Tax Audit field audit units have developed training plans and schedules and are awaiting final configuration of the release in order to update the plans and schedules as needed to provide accurate and timely training. The remaining training for the Audit Division will follow along with the remaining ESKORT implementation.

The Audit Division, in conjunction with the vendor, completed an ESKORT Readiness Plan in May 2005. This plan outlines the high-level timeline for the various awareness and training events that need to occur and is supplemented by a detailed report on the expected hours, broken down by employee and tax type that are expected to be needed. If requested, these documents will be provided.

**Recommendation 2 –** When the Division has complete and accurate data on ESKORT, it should use the data to improve the business plans. Specifically, business plans should include:

a) the number of staff hours available for audits

b) the number of audits to be performed

c) the analysis of audit costs compared to the additional revenue received, and

d) the Division's resource allocation decisions.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

The ESKORT system is only one part of the BRITS project, which is not due to be completed until August 2006. This will delay the Audit Division's complete use of the ESKORT case management and tracking capabilities. The Corporate Income Tax Audit and Transaction Privilege Tax Audit field audit units are scheduled to begin using ESKORT's case management and tracking in mid to late November 2005. The desk audit units in these sections, as well as Individual Income Tax Audit are not scheduled to begin using this ESKORT functionality until full BRITS implementation in August 2006. The ESKORT system will provide all the remaining data elements necessary to facilitate the business plan improvements.

## Finding 2 – Division should further improve its audit selection processes

**Recommendation 1 –** The Division should ensure that all audit units draft rules encompassing key methods for selecting audits through ESKORT.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

The ESKORT audit selection system requires that rules be drafted. These rules are written and programmed into the system to electronically identify potential audit leads. These rules will select audit leads based upon their specific criteria. Value points will then be assigned to each lead and the lead will be designated as high, medium, or low for audit potential. Since the February 2005 implementation, the Transaction Privilege Tax Audit section has created 57 new rules that have been programmed into the system. Individual Income Tax Audit and the desk audit units in Corporate Income Tax and Transaction Privilege Tax Audit sections will be required to implement similar rules. However, the desk audit units will also be able to use the field audit rules for their respective audit type.

**Recommendation 2 –** The Division should ensure that the ESKORT audit selection rules are regularly and appropriately evaluated. This evaluation should ensure that the audit selection rules are selecting audits that help meet the Division's objectives of increasing revenues, compliance rates, and cost-effectiveness.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Since the implementation of the ESKORT audit selection system in February 2005, Corporate Income Tax Audit has modified 4 of its rules and Transaction Privilege Tax Audit section has modified 12. Combining this result with the additional 57 Transaction Privilege Tax Audit Section rules that have been implemented demonstrates the ongoing evaluation that is already taking place.

Additionally, within the ESKORT audit selection system, there is a "rules feedback" mechanism wherein auditors are required to provide feedback regarding the effectiveness of the rule(s) used in identifying taxpayers selected for audit (an audit can't be completed without having the auditor feedback). Training is being designed to ensure that all users of the system will be properly trained in a timely manner regarding the various systems, including the "rules feedback" mechanism. The ESKORT procedure manuals and class handouts are being designed to be very user-friendly to meet all levels of expertise regarding computer input. We are working closely with members of the ESKORT system design teams to develop in-house trainers that are "resident experts" so the training of effected personnel and the transition to the new systems will be easy, efficient, and effective. Emphasis will be placed on the importance of accurate and complete data input by the ESKORT system users, including "rules feedback" so meaningful analysis of the effectiveness of the rules can take place. This will help ensure that the rules are properly designed and functioning to identify the best possible audit leads with the greatest potential for non-compliance. This, in turn, will assist the section with meeting the division's objectives of increasing revenues, improving compliance rates, and functioning cost-effectively.

Thank you for the opportunity to respond to the report.

Sincerely,



Gale Gariott
Director

GG:VP:dbl

cc:     Vince Perez
        File