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GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

ROBERT J. KLEINE
STATE TREASURER

May 29, 2007

MEMORANDUM

TO: Mike Moody, Director
Office of Financial Management
Signature Redacted

FROM: Mark Haas, Chief Deputy Treasurer
Department of Treasury

SUBJECT: Response to the Performance Audit of the Individual Income Tax
Return Processing
Period Covered in Audit: January 1, 2002 – November 30, 2005

The following are our final responses to the recommendations contained in the report of the Auditor General's performance audit of Individual Income Tax Return Processing, Department of Treasury.

Recommendation No. 1: Validity of Income Deductions

We recommend that RPD establish a comprehensive system of automated data comparisons to sufficiently validate the accuracy of certain income tax deductions claimed by taxpayers on their Michigan IIT returns.

We also recommend that RPD use all of the procedures available within its current system of automated data comparisons to validate the reasonableness of income tax deduction amounts claimed by taxpayers on their IIT returns.

Response:

We agree with the recommendations, and we currently utilize data comparison procedures to identify the reasonableness of certain income tax deduction amounts on taxpayers IIT returns. Also, we have initiated a process to expand our procedures to identify and compare certain third-party information to income tax deductions claimed by taxpayers on their IIT returns. We expect to complete our analysis of the results of these additional comparisons by December 31, 2007 and, depending on the results of this project, we will expand the scope of such comparisons using third-party information.

Recommendation No. 2: Delinquent Taxpayers

We recommend that RPD consistently utilize its process to identify taxpayers who fail to file annual returns or who do not remit the appropriate IIT as required by the Income Tax Act.

Response:

We agree with the recommendation and have completed the follow-up on those Michigan residents who did not file an IIT return for 2002. Results will be assessed by May 31, 2007. Decisions will then be made on expanding the process to include subsequent years based on the results of the 2002 tax year. An AGI match will be conducted in 2008 for on tax year to determine the value of expanding the AGI match to subsequent years.

Recommendation No3: Penalties and Interest for Late Returns

We recommend that RPD develop and implement a process that identifies, notifies, and initiates assessment action against certain taxpayers who do not include the required penalties and interest with applicable Michigan IIT returns.

Response:

We agree with the recommendation and, as of January 2007, we have made the changes necessary to have the system automatically assess penalty and interest for tax due on Michigan Income Tax returns filed or paid late.

Recommendation No.4: Refund Interest

We recommend that RPD analyze and implement changes to its manual review process for Michigan IIT refund returns to reduce the processing time and the associated payments of interest.

Response:

We agree that we should reduce the processing time and payment of interest for manually reviewed refund returns. Backlogs have been substantially reduced as of December 31, 2006. We continue to identify system enhancements and make improvements that result in a reduction of the interest due. However, these changes are continually measured against the audit recoveries from the taxpayers and the available resources to implement further system enhancements.

Recommendation No.5: Penalties and Interest for Underpayment of Estimated Tax

We recommend that RPD's processes ensure that certain taxpayers who underpay their estimated tax throughout the year include the required penalties and interest with their annual returns.

We also recommend that RPD adhere to the dollar threshold required by statute in its application of penalties and interest on the amount owed.

Response:

We agree with the recommendation and have made the necessary changes to issue assessments for appropriate penalty and interest to taxpayers who underpay their estimated tax throughout the year. The dollar threshold has been reduced.

Recommendation No. 6: Manually Reviewed Refund Approvals

We recommend that RPD adhere to its refund transaction approval process designed to help ensure the propriety of certain IIT refunds selected for manual review.

We also recommend that RPD enhance its refund transaction approval process to help ensure the propriety of certain refunds selected for manual review.

Response:

We agree with the recommendation and have made changes that do not require system enhancements. Changes requiring system enhancements were included in system change requests during the second quarter of 2007. Action on these system change requests will be prioritized along with other departmental system change requests.

Recommendation No. 7: Limited Review of Returns

We recommend that RPD analyze the dollar effect on IIT revenue to assess when it should implement its limited review procedures on selected IIT returns.

Response:

We have not implemented a limited review of returns since the audit was completed. Any potential impact on revenues will be considered before a limited review of income tax returns is instituted.

Recommendation No. 8: Two-Dimensional (2-D) Bar-Coded Return Management Control

We recommend that RPD revise its data entry process to minimize the ability of its staff to make inappropriate changes to Michigan IIT paper returns encoded with a 2-D bar code

Response:

We agree with the recommendation and have revised the data entry process to minimize the ability of staff to make inappropriate changes to a 2-D bar code, refund return. Instructions have been issued and procedures changed that eliminate Treasury staff keying these changes as well. Additionally, we have requested a system change to generate a report if changes are keyed by Treasury staff.

c: Robert Kleine
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