November 13, 1996

Mr. Ronald A. Kapche  
Executive Director  
Texas Workforce Commission  
101 E. 15th Street  
Austin, Texas 78701

Dear Mr. Kapche:

We have recently completed an audit of the Texas Workforce Commission’s (Commission) tax audit function. Our conclusion, based on this work, is that the Commission has effective controls over the tax audit function. The Commission collected over $1 billion in unemployment taxes during the 1995 fiscal year. The average annual assessment for the audit function over the past five years was $4.3 million with an average assessment per dollar of audit cost of $2.83. The Commission has policies and procedures to provide training for auditors, review audit working papers, and identify taxpayers. The majority of employers selected for audit are chosen based on a risk-ranking system.

However, an improvement can be made in the audit selection process which could, as noted in the example below, result in approximately $1.5 million of additional tax assessments. We have previously encouraged the Commission to work with the U.S. Department of Labor to address this long-standing issue by improving the audit selection standards.

The Commission continues to use the federal audit selection standards which limit the effectiveness of the tax audit function. These standards, which state that 2 percent of the taxpayers should be audited, requires the Commission to concentrate on audits of less productive small employers (employers with up to 50 employees) because of limited audit resources. It takes approximately 10 hours to perform these audits and approximately 50 hours to perform the large employer audits (employers with over 100 employees). To audit some large employers, it may take significantly longer than 50 hours.

Over the last five years, the average tax assessment per dollar of audit cost for large employers was $11.42; for small employers it was $1.10. Based on these averages, an additional $10.32 of unemployment tax could be assessed for each dollar of audit resources transferred from the audits of small employers to large employers. For example, if $150,000 in audit resources was transferred to auditing large employers, approximately $1.5 million in additional assessments may be realized.

We recommend that the Commission, with U.S. Department of Labor’s approval, design a plan that will result in more audit resources directed to auditing large employers. The audit selection process should be designed to maximize the return per dollar of audit costs, and at the same time provide a limited amount of audit coverage of small employers.

The Commission’s response is attached.

SAO Report No. 97-017
Audit Objective, Scope, and Methodology

The audit was conducted to satisfy the statutory requirement for a biennial audit of the effectiveness of the Commission’s tax audit function. To do this, we:

- Conducted follow-up work on recommendations from our September 1994 management letter on the tax audit function (SAO Report No. 96-011)
- Collected tax audit performance data, performed trend analysis, and determined whether there were appropriate explanations for significant trends
- Interviewed Commission personnel
- Conducted the audit in accordance with Generally Accepted Government Auditing Standards

We appreciate the cooperation and help of management and staff during this audit.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

cc: Mr. Frank Almaraz, CPA, CIA, Director of Internal Audit
    Mr. Bob Kenyon, Employment and Training Administrator
    United States Department of Labor
Texas Workforce Commission’s Response

We agree with your assessment that additional large employer audits should be conducted and we will share your recommendation with the U.S. Department of Labor. However, the Department of Labor’s recent revised quality audit standards have increased the amount of time spent to complete an audit and reductions in funding during the last three (3) years have forced us to direct resources to delinquent tax collections.

Recognizing the importance of our audit function, we are committed to making improvements to the program including focusing additional resources on the large employer audits. For program year 1997, we plan to increase the number of large employer audits.