F I N A N C E
NEW ● YORK
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

DEPARTMENT OF FINANCE

AUDIT DIVISION

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4/7/08

STATEMENT OF AUDIT PROCEDURE

**COMPUTER ASSISTED STATISTICAL
SAMPLE FIELD AUDITS**

I. BACKGROUND

Audits of large taxpayers require a great deal of field time because of the number of records that must be examined. Statisticians have developed methods of "sampling" (examining) a small portion of these records to establish whether the records accurately reflect a taxpayer's actual business activity. Using statistical sampling techniques in field audits can reduce the time needed to complete most large examinations.

In addition, most taxpayers maintain computerized records. These records may be analyzed using time-saving computer programs.

In order to take advantage of both computerized records and statistical sampling, the Audit Division has developed procedures for computer-assisted and statistical sample field audits ("CASSFA"). A CASSFA is generally applied to one or more components of a taxpayer's return that may result in a change in tax liability.

II. SCOPE

This Statement of Audit Procedure will advise auditors how to identify a field audit case that is suitable for CASSFA. This Statement of Audit Procedure will also explain how to conduct such an audit.

III. PROCEDURE

A. An auditor will work with his or her supervisor to identify possible **CASSFAs.**

B. **STATISTICAL SAMPLE AUDITS** – Once it has been determined that the company's records are suitable for statistical sample audit (an audit of all records by random sample of items throughout the audit period) the taxpayer will be asked to sign a form consenting to a statistical audit

sampling method (see Exhibit A). This form must be completed by the taxpayer prior to the commencement of the statistical sample audit.[1]

The Audit Division has prepared a description explaining the methodology used in a statistical sample audit (see Exhibit B). This shall be given to taxpayers along with the consent form. Any taxpayer with accurate and complete records has the right to refuse a statistical sample audit. If the taxpayer does not consent to a statistical sample audit, the auditor may be required to review all of the documentation of the taxpayer.

C.   **COMPUTER ASSISTED AUDITS** – Once a potential CASSFA is identified, the taxpayer will be asked to complete the computer audit feasibility questionnaire (see Exhibit C). The Quality Management Support Group (QMSG) will review the completed form to determine if the company's computer records are suitable for computer analysis. If the taxpayer's records are inadequate, or if the taxpayer's computer records cannot be converted to a format that can be read with the Department's equipment, the Department may not conduct an audit using the CASSFA method.

Auditors doing a **computer assisted audit** will ask the taxpayer to provide the computer records for all or some of the periods being audited, as determined by the auditor. QMSG is responsible for performing the data conversion and analyzing the records.

D.   **USE OF BOTH METHODS IN ONE AUDIT** - In some cases, a statistical sample audit of the "hard copy" documents that form the basis of a taxpayer's computerized records may be deemed necessary. In that case, both a computer assisted audit and a statistical sample audit may be conducted. The statistical sample audit of the paper records will be used to verify that the taxpayer's computerized records, which were based on the paper records, are accurate.

E.   In all cases, the Department may discontinue a computer-assisted audit if it determines that the data on the computer files are not complete or are otherwise inadequate.

F.   The auditor will review the computer-assisted audit and/or the statistical sample audit results and use the results, in combination with other data found during the course of the audit, to determine any changes in the examined component of the taxpayer's return. Any change may result in a change in tax liability.

G.   All other review necessary to substantiate the remaining segments of the audit will be performed according to existing audit procedures.

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[1]   It is not required that a consent form be signed prior to performing a CASSFA by a taxpayer who has not filed a return.

Statement of Audit Procedure
CONSENT TO STATISTICAL AUDIT SAMPLING METHOD

Company Name: _____
(hereinafter the "Company")

EIN/SSN: _____ **Reg. #:**_____ **Case #:_____**

The Commissioner of Finance and undersigned Company Representative agree as follows:

1. The computer files related to the following issues and supporting invoices for the _____ Tax for the period(s) _____ through _____ are available for audit:

   _____

2. The Commissioner of Finance enters into this agreement on the assumption that the Company's books and records related to the issues described in paragraph 1, including computer files, are complete and adequate. If the Department of Finance determines that the books and records, including computer files, are not complete and adequate, the Department of Finance retains the right to withdraw from this agreement.

3. The computer files described in paragraph 1 are to be audited using the statistical sampling audit method to select records for examination. The Company understands that a random sample (or several random samples drawn from different groupings) of the data and records will be analyzed and used to project additional tax liability or refund. The size of the sample(s) will be determined by generally accepted, standard methods that produce statistically valid results. A Department of Finance representative explained to the signatory (or the signatory's designee) for the Company under audit the statistical sampling audit method and how it will be used to project audit adjustments. The signatory understands the basis of the statistical sample audit method to be used.

4. This agreement allows the Department of Finance to use the statistical sampling method to project audit adjustments. The signatory understands that this consent precludes the protest of the use of this methodology, and that, specifically, the company waives its right to have each document related to the files describe in paragraph 1 reviewed. This agreement does not, however, preclude the protest of the audit results on grounds such as the taxability of certain transactions or the proper application of the statistical sample methodology. This form is not intended as, nor should it be construed to be, a consent to audit findings.

Authorized Company Representative:

_____   _____   _____   _____
(Signature)   **(Print Name)**   **(Title)**   **(Date)**

For the Commissioner of Finance

_____   _____   _____   _____
(Signature)   **(Print name)**   **(Title)**   **(Date)**

Statement of Audit Procedure
METHODOLOGY FOR COMPUTER-ASSISTED
STATISTICAL SAMPLE AUDITS

The Audit Division of the Department of Finance has developed procedures for the application of statistical sampling techniques for tax audits. The procedures used were developed to achieve more objective and reliable audits. The statistical sampling techniques used employ generally accepted, standard methodologies that produce statistically valid results. Both the taxpayer and the Audit Division may benefit from a computer-assisted statistical sampling audit.

Tax audits are conducted to establish the correct amount of tax liability or overpayment. In the case of large taxpayers with computerized records, this means reviewing numerous (sometimes hundreds of thousands) transactions. Agreement by the taxpayer to a statistical sampling audit permits the review to be made in the most cost-effective and timely manner. Additionally, the reliability of the statistical sampling audit allows the taxpayer and the Audit Division to be comfortable in accepting the audit findings.

Groups of tax transactions subject to audit usually have many transactions in certain ranges (for example, transactions of low dollar amounts), and fewer in other ranges (transactions of high dollar amounts). The Audit Division's computer programs will segregate the transactions into various categories (strata). Certain strata (those of the highest dollar amounts, for example) may be identified for 100% review. For each of the other strata, random samples of transactions are selected by referencing computer-generated random numbers used in the statistical sampling program.

The sample size for each stratum is based on the number of observations necessary for statistical validity. The actual sample size will be larger than the minimum necessary for statistical validity. In most cases, the sample sizes for each audit will be reviewed with the taxpayer.

The results of the statistical sample audit will meet the following Audit Division policy standard:

Based on 95% **Confidence Level,** with a one-sided test, the **Precision** will be no greater than 25% of the total estimate

Confidence Level refers to the reliability of the results of the statistical sample audit. This is generally expressed as a certain percentage, the most common being 90% or 95%. In an auditor states that he or she is 95% confident in a projection of the sample result, the auditor means that he or she would expect 19 samples out of 20 to be within the precision range.

Precision is a statement of how close the sample result should be to the actual result for a given confidence level if every item in the group of transactions were examined. If a sample resulted in an adjustment of $500 (either upward or downward) with a precision of $75 (i.e. $500, plus or minus $75) at a given confidence level, the actual adjustment at a given confidence level would be within $75 of the $500 either above or below. Thus, the adjustment could range from $425 to $575.

The policy of the Audit Division is to make adjustments based on the lower limit of the precision range. For example, if the results indicate a positive adjustment of $500 plus or minus $75, the proposed adjustment would be $425. If the results of the sample indicate a negative adjustment of $500 plus or minus $75, the proposed adjustment would be $425.

Once the review of the transactions selected by the random sampling has been completed, the average of all adjustments found in the sample for that stratum are projected against the total number of items for that stratum. The total upward or downward adjustment for a stratum is computed by summing the individual differences for the transactions reviewed in that stratum, and dividing the sum by the number of transactions reviewed in that stratum. The resulting average difference per transaction is then multiplied by the total number of transactions in that stratum to yield the adjustment for that stratum. The total adjustment for all strata is then calculated by adding the adjustments for each stratum.

Variations in the application of the above procedures may be determined on a case-by case basis.

Exhibit C

Statement of Audit Procedure
COMPUTER AUDIT FEASIBILITY QUESTIONNAIRE

Company Name:_____ EIN/SSN:_____Phone:_____

Address:_____

1. **Are any of your records computerized? YES ☐   NO ☐**
    If YES, complete the remainder of this form.

2. **We own or lease EDP equipment.   YES ☐   NO ☐**
    We use a computer service bureau.   **YES ☐   NO ☐**

3. **Computer records are maintained at the transaction level for the following areas (attach schedule, if necessary:**

    _____

4a. **Computer records are stored on the following media:**

    Tape ___ (specify type: _____)
    Cartridge ___ (specify type:_____)
    Floppy Dist ___(specify type:_____)
    Other ___(specify type:_____)

4b. **Into what other storage medium can you convert the records?** _____

5. **Indicate how records for the following types of files are stored (attach schedule, if necessary):**
    _____

6. Computerized records are retained for _____ years _____ months.

7. **The following type(s) of computer(s) are used to maintain the records mentioned in 3, above.**

    Manufacturer:_____ Model: _____

    Series:_____ Memory size: _____ Operating system:_____

8. **If Electronic Data Interchange (EDI) is used for business transactions, what transactions?**

    _____

9. **Do you maintain a retention agreement with the Internal Revenue Service? YES ☐ NO ☐**

10. **If you have changed your computer system in the last three years, complete the information below for the old system.**

    Manufacturer:_____ Model: _____

    Series:_____ Memory size: _____ Operating system:_____

11. **Computer records from the old system are stored on the following media:**

    Tape: _____ (specify type: _____)   Cartridge: _____ (specify type:_____)

    Other ___ (specify type:_____)

12. **Does each account in the computer records reconcile to the accounts on the tax return (1120) as well as to accounts on the books and records?**

13. **Person to contact for data processing information (e,g, MIS Manager, System Analyst, etc.)**

    _____