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LIMITATIONS OF THE AUDIT MANUAL

Manuals serve a useful purpose but they cannot provide an answer to every problem that will be encountered. All taxing jurisdictions will be confronted with new businesses that will require new ways of thinking. A good example is the evolution of the internet and its various components – from the connection fees and advertising charges, to the point of ordering a product and having it delivered to an Arizona residence.

Unusual problems will be encountered that have not been addressed in this manual or by other staff members. This manual cannot be a substitute for experience, training in accounting and auditing, or good judgment and supervision. In many situations, the auditor will need to use his or her education and research skills, and consult with other audit team members to develop an opinion on how an item should be handled.

FOREWORD

The auditor serves the interests of the taxpayer and all taxing jurisdictions. Compliance with the Arizona Revised Statutes (“ARS”) and ordinances of the Model City Tax Code (“MCTC”) are expected. The taxpayer should always be treated with the utmost respect, a high degree of professionalism, and be well advised of its rights, exclusions, and exemptions within the law. Taxation is not a punitive one-way road for the taxpayer. Rather, it is a two-way road, with mutual rights and courtesies for both the taxpayer and jurisdiction representatives.

All auditors have the duty to enforce compliance with the law, and taxpayers expect equity in the administration of those same laws. The auditor is encouraged to step into the role of the business owner and provide the same flexibility the auditor would seek if the tables were turned.

TPT AUDIT SECTION GOALS

There are three all-encompassing goals of the TPT Audit Section. The primary and foremost goal is that of taxpayer education. When taxpayers are informed, the taxing jurisdictions realize many benefits including an increase in voluntary compliance, public involvement with government, and a sustained revenue stream. The jurisdictions pride themselves on the delivery of outstanding customer service, and the willingness to go the extra mile to provide the type of service citizens and taxpayers expect.
The secondary goal applies to the technical competence of the individual auditor, in that the auditor is expected to determine the correct measure of tax. This is the core concept of auditing. Audits will be assigned to auditors based on ability and experience. The assignments will be placed in the auditor’s inventory as shown within their audit plan.

The third goal is to ensure the taxpayer has remitted the proper amount of tax during the audit period. If the audit results in an over payment of tax, the taxpayer shall receive a refund.

**SUPERIOR AND DISTINCTIVE SERVICE**

Every audit is performed by an auditor who has the responsibility for delivering superior and distinctive service, and the full decision making authority to fulfill this responsibility. Auditor autonomy maximizes creative and individualized service. Taxpayers appreciate this approach because it favors innovation, and allows for expeditious and effective problem solving. The auditor is involved in every aspect of the audit, from the initial planning to the ultimate completion. This approach recognizes that each taxpayer is unique; and therefore, each audit must be tailored to maximize its effectiveness.

The quality of service provided by the TPT Audit Section and taxing jurisdictions depends on the quality of its employees. Management recognizes the importance of selecting outstanding individuals, training them thoroughly, and giving them increasing responsibility based on accomplishments and demonstrated potential for further progress. All audits are reviewed and approved by supervisors or authorized senior personnel to ensure quality and accuracy.

**AUDIT OBJECTIVES**

Objectives can be divided into two major groupings, qualitative and quantitative. The qualitative objectives include following General Accepted Accounting Principles ("GAAP") and Generally Accepted Auditing Standards ("GAAS").

Quantitative objectives should have impartial characteristics. As such, quantitative objectives may tend to be limited and narrow in relation to the overall goals and policies of the audit program. Quantitative objectives can be classified as either staff or management oriented.
**APPROACH TO AUDITING**

The auditor must approach an audit with the goal of establishing a true tax liability on an equitable and impartial basis. The auditor should obtain a copy of the General Audit Program developed by the TPT Audit Section.

Every taxpayer has the right to be reviewed on the same basis as other taxpayers engaged in the same (or similar) type of business. Although the circumstances may vary from audit to audit, the fundamental ideas and principles which underlie the law must be applied in a uniform and consistent manner.

The auditor must not be influenced by the following factors:

1. How much additional tax might result from an audit
2. The audit may result in a refund
3. How influential the taxpayer may or may not be
4. The taxpayer’s apparent inclination to accept or protest an assessment

In all cases, the auditor must afford the taxpayer the opportunity to disagree with the findings and present additional information that may help clarify the point in dispute. If after analyzing all information the auditor is confident the determination is valid, sufficiently documented, and supported in the audit work papers, the audit should be submitted.

In respect to the amount of time devoted to conducting an audit, this is largely a question of judgment on the part of the auditor. The following points may aid the auditor when considering the justification of time:

1. The number of transactions to be audited
2. The different types of transactions
3. The business classification
4. The materiality (significance) and impact on the liability
5. The overall complexity of the business
6. The clarity of the taxpayer's books and records

In short, the amount of time that is required in establishing an accurate liability will vary widely, depending on the above factors.
PROFESSIONAL STATUS

Accounting is a constructive process. It starts with original document sources and follows the accounting process where the data is recorded, classified, summarized, analyzed, and ends with the production of financial or other statements.

Auditing is a critical review process, which generally follows the opposite direction of the accounting process. Auditing starts where accounting ends (i.e. begins with the financial statements and finishes with the original document sources). However, the direction of auditing can vary, as the auditor may start a particular verification and follow the same direction as the accounting process.

In a restrictive sense, auditing refers to specialized procedures recognized as essential in acquiring sufficient information necessary to make a specified determination, or to permit the expression of an informed opinion. In our unique audit environment, the focus is on whether or not the taxpayer remitted the proper amount of tax.

Auditors for the taxing jurisdictions are engaged in professional assignments. They are called upon to exercise their highest skills and most impartial judgments throughout the performance of their official duties. To assure that audit methods and techniques are appropriate for the specific assignment, sound professional judgment must be exercised in making tests that are representative in scope and character. By doing so, the auditor can be confident that the results are indicative of the actual business operations during the period covered by the audit. Under all circumstances, tax auditors are expected to conduct themselves in a professional manner.

The Auditing Standards Board (“ASB”), a division of the American Institute of Certified Public Accountants (“AICPA”), sets the professional standards by which audits should be performed. Generally Accepted Auditing Standard (“GAAS”), AU Section 150 provides the measure of audit quality and the objectives to be achieved in the audit. Auditing procedures differ from auditing standards. Auditing procedures are the acts that the auditor performs during the course of an audit to comply with auditing standards (AICPA, 2013).

1. General Standards
   a. The audit is to be performed by a person or persons having adequate technical
training and proficiency as an auditor.

b. In all matters relating to the assignment, independence in mental attitude is to be maintained by the auditor or auditors.

c. Due professional care is to be exercised in the performance of the audit and the preparation of the report.

2. Standards of Field Work

The general quality criteria for the actual conduct of the audit, including the proper design and execution of the auditing procedures.

a. The work is to be adequately planned and assistants, if any, are to be properly supervised.

b. There is to be a proper study and evaluation of the existing internal controls as a basis for reliance thereon, and for the determination of the resulting extent of the tests to which auditing procedures are to be restricted.

c. Sufficient evidential matter is to be obtained through inspection, observation, inquiry, and confirmation to afford a reasonable basis for an opinion regarding the financial statements under audit.

3. Reporting Standards

Reporting standards provide guidance for the ultimate objective of auditing the audit report.

a. The report shall state whether the financial statements are presented in accordance with Generally Accepted Accounting Principles.

b. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.

c. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

d. The report shall contain either an expression of opinion regarding the financial statements taken as a whole, or a statement as to why an opinion cannot be expressed. In all cases where an auditor’s name is associated with financial statements, the report should contain a clear-cut indication of the character of the
auditor’s work, and the degree of responsibility the auditor is taking.

The only standards that do not directly apply to tax audits are 3(a) and 3(b) due to the nature of tax audits, but all other standards should be taken into consideration during the performance of tax audits.

**EVIDENTIAL MATTER**

In auditing, evidential matter consists of underlying accounting data and corroborating information available to the auditor.

1. Underlying Accounting data consists of:
   a. Book of original entry
   b. General and subsidiary ledgers
   c. Related accounting manuals
   d. Informal and memorandum records, such as worksheets, computations, and reconciliations

2. Corroborating information consists of:
   a. Documents such as checks, invoices, contracts, etc.
   b. Confirmations and other written representations
   c. Information from inquiry, observation, inspections, and physical examination
   d. Other information obtained or developed by the auditor

**MATERIALITY**

Certain accounting assumptions, accepted principles, and modifying conventions are also applicable to tax audits. The important accounting concept used throughout auditing is materiality.

An attempt must be made to arrive at an accurate determination of the tax liability with the least amount of time expended. These two opposing conditions obviously require that some compromises in auditing technique be made. The auditor must take into account how an item of income or deduction will influence the total tax liability for the audit period. Some of the more common factors auditors’ uses in making materiality judgments are explained below.

1. **Absolute Size** - The dollar amount of one specific error may be important irrespective of any other considerations
2. **Relative Size** - The relation of potential error to a relevant base is often used

3. **Nature of the Item or Issue** - An important qualitative factor is the descriptive nature of the item or issue. Some errors are generally more important than others are and some tax issues are more clearly defined than others are.

4. **Circumstances** - The matters that relate to the audit and particular issue which could impact on the auditor’s judgment of materiality.

5. **Cumulative Effects** - Auditors must evaluate the sum of known or potential errors. The absolute size of one error may not be material, but the sum of several errors may be material.

The concept of materiality is used by auditors in three ways:

1. **Guide to Planning the Audit Program** - directing attention and audit work to the important, uncertain, or error-prone items and issues


3. **Guide for Making Decisions Regarding Compliance with the Arizona Revised Statutes and Model City Tax Code** - such as deciding whether the taxpayer made a material misstatement on the tax returns or whether the matter can be considered immaterial and disregarded

**SUMMARY OF AUDIT WORK**

An audit must be adequately planned to meet the overall audit objective and to determine the methods of achieving it in an efficient manner. The plan should be based on an understanding of the taxpayer’s business, its information system and control environments, and the nature of its transactions. The plan should be documented as part of the work papers and should be revised as needed. The auditor should understand, evaluate and obtain evidence of the effective operation of any control when determining the nature, extent, and timing of other audit procedures.

The auditor should obtain sufficient competent information to provide a reasonable basis for the audit results. This evidence should be properly documented in the work papers and should include a record of the planning and supervision of the audit, the evidence relied upon, and the reasons underlying any significant decisions made during the audit. The audit report or
determination letter should provide a clear expression of the conclusions reached per the ARS and MCTC sections that relate to the tax imposed and the period covered by the audit. The following paragraphs address some of the key standards in more detail.

The auditor is required to maintain independence when performing a professional engagement. The auditor shall not audit a business in which the auditor has a conflict of interest, such as a financial or personal relationship. Use of common sense can help maintain the role of independence.

The auditor is to possess integrity and objectivity in performing the professional assignment. The auditor should not knowingly misrepresent facts. When engaged in an assignment, the auditor shall not subordinate his or her judgment to others, but will render judgments within the confines of the laws, rulings, and procedures. Ideally, different auditors will come up with a similar result if objectivity is properly maintained.

The auditor shall not undertake any engagement, which cannot be reasonably expected to be completed with professional competence. Until the auditor has the required experience working with a particular type of business, an experienced auditor or a supervisor should accompany the auditor. Although several audit tools are available to assist the auditor, experience is gained only by performing the actual tasks.

The auditor shall not disclose any confidential information obtained in the course of an audit to the public, except with the written consent of the taxpayer in the form of the General Disclosure/Representation Authorization Form (“AZ 285”). The auditor should not discuss any confidential matter or even mention taxpayer’s names in a public setting where confidentiality could be at risk. Any knowledge gained through the audit examination should remain confidential. This includes discussing issues with family members and employees outside of the TPT Audit Section. When performing audit work with an agent or representative of the taxpayer, such as outside accountants or attorneys, a properly executed AZ 285 form is required before confidential information may be discussed with such representatives. Without an AZ 285 form, information can be accepted but not discussed.

The auditor shall not induce offers of services or employment from taxpayers or accounting firms while on a professional engagement. In addition, unsolicited offers of employment
should be refused if proposed on a professional assignment.

The auditor shall not commit an act discreditable to the taxing jurisdictions. Such an act may result in disciplinary action up to and including termination. All auditors are expected to maintain professionalism.

The auditor shall not seek to obtain personal clients by solicitation while on a professional assignment for the taxing jurisdictions. The auditor may perform individual professional services if prior written approval has been received by their supervisor, and that such services do not conflict with those performed while representing the taxing jurisdictions. If approved, the auditor must observe all standards of conduct and ethics pertinent to those personal services provided.

**PUBLIC RELATIONS**

Each auditor is responsible for developing positive public relations. What the public thinks of an organization depends largely on contacts made by the employees of the organization.

Consistent with the purpose of tax auditing, it is unnecessary for the auditor to imply that the audit objective is to find errors in the taxpayer’s reporting. The taxpayer should be assured that the auditor’s function is to determine whether the amount of tax has been reported correctly. The auditor should emphasize taxpayer education and should explain that auditors are not evaluated based on taxes assessed or collected. Care should also be taken to inform the taxpayer of their rights and privileges in connection with such determinations. The auditor should administer the tax laws fairly and uniformly, with minimum disruption to the taxpayer’s business affairs.

The auditor must keep in mind the aspects of public relations involved in any tax audit and demonstrate the following qualities:

1. The auditor should attempt to establish a good rapport with the taxpayer.
2. The auditor should uphold an objective attitude, while maintaining a professional interpersonal relationship with the taxpayer. To the extent possible, the auditor should:
   a. Maintain an arms-length relationship with the taxpayer.
   b. Never argue with or be condescending to a taxpayer.
   c. Avoid humorous remarks, since they are frequently misinterpreted.
d. Avoid political or religious discussions.

e. Do not use remarks or engage in conduct, which could be interpreted, as sexual harassment.

A key ingredient of public relations is communications. The following guidelines help establish good communications:

1. Listen with understanding
2. Ask questions designed to uncover taxpayer needs and concerns
3. Share meaningful information
4. Explain reasons for policies
5. Ask taxpayer to take another look at the problem
6. Refrain from forcing the taxpayer to accept the auditor’s position on an issue – let them make their own decision, regardless of the outcome

**GENERAL TPT INFORMATION**

TPT is imposed directly on the person conducting taxable activities within the State of Arizona. A true sales tax imposes the tax on the actual consumers rather than the business activity. Therefore, under the transaction privilege tax, the seller remains liable for the tax, whether or not the seller passes the tax on to the customer or consumer. There will be situations where the customer claims to be exempt, but the taxpayer remains liable for the tax until the exemption is substantiated.

Taxable business activities have been placed into more than twenty different categories or classifications. The sections pertaining to each classification include statements concerning the basic nature of the businesses included within that classification and a general statement of taxability. Each section will define any exemptions or deductions applying to that category of business. For those classifications for which it is required, regulations are provided to offer additional clarification regarding the applicability of the tax in unusual circumstances or situations.

Each classification is independent of the others. Therefore, the laws and regulations, which govern business activities in one classification, do not necessarily apply to businesses in other classifications.
USE TAX

Most taxing jurisdictions also impose a use tax on items that are purchased, leased, or rented without paying a privilege or sales tax. These items may become subject to use tax when they are used, stored or consumed within a taxing jurisdiction.

STATUTE OF LIMITATIONS

Every person conducting business in the State of Arizona is required to maintain appropriate records as are necessary to determine the tax for which the taxpayer is liable. Such books, invoices, and other records are to be available for examination by the taxing jurisdictions during normal operating hours of the taxpayer. Any books and records of the taxpayer, which are to be open for examination, shall be kept for a minimum of forty-eight (48) months (ARS 42-1104 / MCTC Section 550). If the auditor encounters delays, which are caused by the taxpayer, a waiver of limitation form should be proposed to the taxpayer to allow them more time to obtain additional information. The waiver needs to be signed by the taxpayer prior to the expiration date of the first month of the audit period. If a taxpayer has underreported by 25% or more, the audit period may be extended to six years (A.R.S. §42-1104.B.2 / MCTC Section 550). If the audit is extended an additional two years as noted above, each reporting period stands on its own. Therefore, for every reporting period within the extended 2-year window the auditor must review each return to determine if the period has been underreported by 25% or more. If not, the period must be excluded from the audit.

If a person is doing business in a taxable activity and has no license, the four-year limitation does not apply and there is no limitation. If no waiver of limitation form can be obtained, the auditor should consult their supervisor for direction.

TAX RATES

The privilege tax is applied at a combined (State, County and City) tax rate as indicated in the tax tables.

AUDIT ASSIGNMENT

Audits will be assigned through the Arizona Department of Revenue. If a business is approved for an audit, the Department will enter the account into the audit database. A request will be sent to all formerly self-reporting cities to provide all relevant reporting
histories. These histories will be combined with the Department’s reporting histories and indexed into an Automatic Tax Calculator (“ATC”) file. This file will be electronically forwarded to the auditor performing the audit.

**AUDIT PLAN**

Once a business is selected for audit, the taxpayer information is entered into the Department of Revenue Audit database and ATC file. The auditor should begin to plan the audit as soon as it is assigned. Information gathered by initial research, taxpayer interview, general questionnaire, and general review of the books is used to formulate the plan.

**GENERAL SCOPE OF AUDIT—Historical Information & Analytical Review**

Before beginning an audit, the auditor should become familiar with the business operations in order to determine what areas of taxability may exist. This will permit the auditor to get an idea of the overall scope of the audit.

In making a general analysis of the business, the auditor should determine:

1. Records needed
2. Relative importance of the different areas to be checked
3. Different approaches that can be used in establishing the tax liability

The auditor may also find it useful to question the taxpayer or the taxpayer's representative to acquire a general overview of the business.

The auditor will inquire about the person responsible for preparing the transaction privilege tax documents, from what source the auditor can obtain the reported figures, and exactly how the preparation is done.

**PRE-AUDIT WORK**

The auditor should review:

1. The taxpayer’s license application
2. Any correspondence in the taxpayer’s file
3. The taxpayer’s tax payment history
4. The tax code
5. Related audit classification guidelines and audit programs
6. Any prior audits or audits of similar entities
7. Building permits, recorded documents, improved real property sales history

To ensure that the audit progresses as originally planned, an audit program should always be followed. When this information is gathered, the auditor will have finished the first stage of the audit. If no other items need to be addressed, the auditor will send the “Notice of Intent to Audit” letter. At times, it is difficult to schedule audits, and for this reason, it is good to have several audits in process at one time to reduce the auditor down time.

**TAXPAYER’S COOPERATION**

If the auditor experiences difficulty in obtaining the necessary records during the course of the audit, the auditor should give the taxpayer reasonable time to produce the required records. If, after a reasonable time, the documentation has not been obtained, the auditor should refer the account to the supervisor. The supervisor may then attempt to procure information from the taxpayer, through either telephone or personal contact. If a taxpayer fails or refuses to furnish any information requested in writing by the auditor, a written request may be sent to the taxpayer by certified mail under the authority of A.R.S §42-1125(C) and Section 555 of the Model City Tax Code. If the request is not successful, a subpoena may be completed and served on the taxpayer. Prior to the issuance of a subpoena, approval must be granted from the Department of Revenue.

In cases where the taxpayer appears to have a legitimate reason for delaying the audit for an extended period, the auditor must have the taxpayer sign a waiver covering the period of audit.

**SETTING INITIAL AUDIT APPOINTMENT**

The auditor will contact the taxpayer for an appointment to begin the audit. An appointment confirmation letter showing date, time, and records to be examined shall be sent. If the auditor cannot obtain a firm commitment from the taxpayer after reasonable attempts have been made, the auditor will consult with his or her supervisor to determine the next steps.

**OPENING INTERVIEW**

Once the auditor arrives at the taxpayer’s location, the auditor should provide a business card and explain the audit process. The auditor should ask if someone will be representing the taxpayer, and determine if such person is able to furnish the records and information needed,
and be able to discuss the auditor’s findings at the appropriate time. The Standard Interview Questionnaire should be used during the opening interview.

The auditor should also become acquainted with the taxpayer’s accounting system, tax worksheets, and internal controls. Such information will allow the auditor to select the proper sources for verifications, as well as to make judgments regarding the types of tests to be conducted during the audit.

After conducting an opening interview, the auditor should know how the related transactions are processed, recorded, and summarized in order to select the best approach and technique in conducting the detailed tests to support the various recorded amounts.

The taxpayer should be able to guide the auditor through the monthly tax return process and point out the key documents relied upon to prepare the tax returns. It is important to ask about the source of various reported items and gain an understanding of how the various transactions flow through the accounting system.

The best way to accomplish the preliminary audit for each tax category depends on the auditor’s discretion. Some auditors prefer to first obtain general information about the operational methods and the accounting system, and then get more specific details of the audit trail. Other auditors find that obtaining all the necessary information at the beginning is better. Auditors must use their best discretion and adapt to the amount of information available, without being overwhelmed if the information supplied by the taxpayer is voluminous

**INTERNAL CONTROL**

The auditor should make a proper study (compliance test) of internal controls to verify the degree of reliance on such controls, and to determine need for substantive testing based on the results. Tax audits are not focused on the entire internal control structure. The tax auditor’s concern with internal control is focused on determining:

1. Was the tax law interpreted correctly?
2. Do the tax reporting procedures result in an accurate determination of tax?

General compliance testing procedures produce evidence of whether control techniques are being performed and applied by company employees. Tax auditing compliance tests produce evidence of whether the taxpayer’s knowledge of the tax code is sufficient and
reporting procedures are accurate. In contrast to compliance testing which produces evidence regarding the taxpayer’s control of taxes, substantive testing will produce evidence regarding the dollar measurement of inaccurate tax reporting controls.

**LIMITATIONS OF INTERNAL CONTROL**

Compliance tests should reveal any limitations of internal (tax) control, which could result in:

1. Misunderstandings of the tax laws, rulings, licensing requirements, and reporting procedures
2. Mistakes of judgment involving arbitrary and/or contrary interpretation of the tax laws and administrative rulings
3. Carelessness with regard to tax control and reporting procedures
4. Fraud or intentional disregard of the tax laws and administrative rulings

**INTERNAL CONTROL EVALUATION**

In addition, the auditor can utilize transaction sampling to determine tax compliance. Two types of transaction sampling techniques are Acceptance Sampling and Discovery Sampling.

1. **Acceptance Sampling**
   
   When the acceptance-sampling plan is used, a sample is taken or drawn. If no more than a certain number of errors are found, the universe examined is considered acceptable. If more than that number is found, the universe is rejected as unacceptable. This plan is more useful for the control of errors.

2. **Discovery (Exploratory) Sampling**
   
   When using this plan, the auditor tries to disclose the existence of evasion of regulations, avoidance of the internal control system or other critical departures. If further action is warranted based on the results of this sampling, the auditor may execute an estimation sampling plan (variable sampling).

   The evaluation of internal control and transaction sampling should confirm, either in whole or in part, the taxpayer’s correct tax interpretation and accurate reporting, or misinterpretation and noncompliance. Any errors in tax interpretation should result in substantive testing to determine the dollar measurement of noncompliance.
SAMPLING FOR AUDITING - GENERAL INFORMATION

In general, the use of sampling methods for testing is necessary due to two elements:

1. The time spent to conduct the audit
2. The total cost of performing the audit.

The concept of a sampling audit (test basis audit) is the opposite of a detail audit as far as the use of original sources for verification purposes.

The ideal starting point in an audit is to review the tax worksheets and final data sources (including any intermediate data sources such as the general journal, auxiliary journals), because the data is summarized or condensed. This approach represents a relatively easy method to verify how totals in the intermediate and final sources were calculated, and to verify aspects and details that may be found only in the original documents, as the auditor will eventually have to verify the original documents as well.

CLASSIFICATION OF SOURCES FOR TAX AUDITS

For audit purposes, sources for data may be classified as follows:

1. Original Source Documents
   These sources include any original documents that initiate accounting entries and reflect an original transaction. Examples include, sales invoices, cash sales tickets, cash register tapes, purchase orders, purchase invoices, original contracts, canceled checks, etc.
   When reference is made to a test or sampling, these are the document sources used.

2. Intermediate Document Sources
   These sources are found in the middle of the accounting process, after the original documents have been recorded. Examples include general journal, auxiliary journals, daily summaries of sales, collections, etc.

3. Final Document Sources
   These sources represent the final product of the accounting process and are represented by financial statements and tax returns.

4. Other Sources
   These sources are third party in nature and exist outside of the taxpayer’s accounting process. Examples include vendors, customers, governmental agencies, publications,
GENERAL AUDITING PROCEDURES

The following sections briefly describe the books, records, and detail that the auditor will normally encounter in performing an audit. All or a portion of these records may be relied upon in performing the audit, and they may be used in either compliance or substantive testing.

1. Examination of the General Ledger
   The general ledger accounts must be examined for debits and credits, which may represent unreported taxable transactions. For example, sales of merchandise at cost may have been credited to the purchase or inventory accounts; sales of by-products may have been credited directly to profit and loss, surplus or expense accounts; sales of furniture, equipment and other capital assets may have been credited to equipment, depreciation or other accounts. Debits to general ledger equipment and supply accounts may represent unreported purchases subject to use tax. Additionally, accrued tax liabilities may indicate the taxpayer has accrued use tax but failed to remit the same.

2. Examination of the General Journal
   Transactions not disclosed by examination of other records may be disclosed by examination of the general journal. The auditor should examine journal entries, specifically noting those, which may indicate unreported taxable transactions. Documents should be examined to determine whether the entry represents an unreported taxable transaction. Examples include correspondence, contracts, invoices, etc.

3. Examination of the Cash Receipts Records
   The cash receipts records should be examined to determine that receipts from cash transactions have been credited to the proper sales or revenue accounts. Care should be exercised not to duplicate taxable transactions disclosed in the examination of other records.

4. Examination of the Accounts Receivable Ledger
   Accounts receivable entries from the owners, partners, officers, or employees of the
company should be examined for evidence of taxable transactions not otherwise recorded in the sales or revenue accounts. All drawing accounts and employees’ advance accounts should be examined.

5. **Examination of the Purchase Journal**

Entries may be made in the purchase journal for sales at cost or for returned merchandise. Inventory withdrawals, which should have been reflected in the inventory accounts, may appear as credits in the purchase journal. These postings should be scrutinized for taxable transactions.

6. **Schedule of Sales or Revenue**

In some cases, it is more practical to trace the reported figures to the sales or revenue journal or general ledger by period. If frequent differences are found, it would be advisable to schedule total sales or revenue. If there are only a few isolated differences, the periods where the differences occur should be scheduled. A detailed schedule of total sales may be advisable when the recorded figures can be used for tying several items such as total sales and several deductions. Amounts may be scheduled from the sales journal if the segregation between taxable and nontaxable sales is not discernable in the general ledger. Where sales are scheduled from the sales journal or other detailed sources, the scheduled figures should be reconciled with the general ledger.

7. **Examination of Sales or Revenue Invoices**

Sales or revenue invoices usually represent the original record of a transaction after an order execution (purchase order) has been provided. It is a necessary part of the audit procedure to examine a representative number of these invoices to determine how the transactions are recorded and on what basis the tax was accrued. The following is an itemization of the various functions involved in the examination of this original detail:

   a. **Postings**

   A review of postings is the first step necessary to verify the accuracy of the books of original entry. The sales or revenue invoice is vouched directly to the sales or revenue journal for accuracy of posting relative to amount and classification in the journal.
b. **Tax**

Invoices subject to taxation often have the tax stated separately. If so, the amount of tax should be recalculated to verify the correct amount of tax was charged.

c. **Deductions**

At the time the invoice is being reviewed for posting accuracy, etc., it should also be reviewed for evidence of exemption. For example, if the sale is being claimed exempt as a sale for resale, the resale certificate could be examined at that time.

d. **Form of the invoice**

The auditor should examine the form of the invoice and check to see if charges are segregated or shown as a lump sum. The importance of segregation will vary by a particular tax category. For example, under the retail classification, labor charges are deductible only if segregated on all books, records and customer billings or invoices.

8. **Examination of Income Tax Returns**

When taxpayer records related to gross receipts do not match gross receipts reported on the Federal Income Tax returns, the differences should be reconciled. If the gross receipts reported on income tax returns are significantly greater than those reported on TPT returns, the differences should be scheduled as additional taxable receipts, unless the taxpayer presents satisfactory proof to the contrary. In making this reconciliation, adjustments resulting from deducting TPT from gross receipts, per the TPT return, should be recognized. Another example would include reporting on a cash basis for income tax purposes, while reporting on an accrual basis for TPT purposes.

**TAX FACTORING/TAX COLLECTED**

When additional gross receipts or disallowed deductions are discovered, and the auditor has verified that no tax was separately charged, the auditor should allow the appropriate factored tax deduction.

**TAXPAYERS WITH POOR TAX ACCOUNTING PROCEDURES**

If weaknesses in the tax accounting procedures make it impossible for the auditor to rely on
those procedures, the auditor should accomplish the audit objectives by other means including:

1. Request the taxpayer to reconstruct records so that either gross receipts or deductions may be allowed based on tests of those records.
2. Tax the gross receipts of the taxpayer or disallow the specific deductions for which the records are inadequate.
3. Perform a detailed audit if the potential tax liability would offset the time and cost restraints. Before a detailed audit is undertaken, the audit supervisor should be consulted.

**TAXPAYERS WITHOUT RECORDS**

The auditor will encounter some cases where the taxpayer has no records of any kind, or perhaps only fragmentary records. The first step is to offer the taxpayer reasonable time to reconstruct their records based on available information. If the taxpayer is unwilling, or refuses to provide any information, a written request may be sent to the taxpayer by certified mail under the authority of ARS §42-1125(C) and Section 555 of the MCTC.

**FIELD WORK**

The evidential matter required by the third standard of fieldwork is obtained through two general types of auditing procedures. Collectively, these procedures are substantive tests and include:

1. **Tests of Transactions and Balances**
   These procedures are designed to obtain evidence as to the validity and propriety of the accounting treatment of transactions and balances. Conversely, the tests may also be used to determine the existence of any unintentional monetary errors or irregularities (deliberate distortions and misrepresentations). The auditor uses tests of transactions and balances to determine the dollar measurement of noncompliance.

2. **Analytical Review Procedures**
   These procedures are designed to verify the reasonableness of relationships among data and identify unusual fluctuations in such data. These procedures include:
   a. A comparison of current financial information with comparable information for corresponding previous periods
b. A comparison of the financial information with anticipated results (i.e., tax forecast);

c. A study of the inter-relationship between elements of financial information that would generally be expected to conform to a predictable pattern based on the entity’s history or experience

d. A comparison between the taxpayer’s financial information and information regarding the industry in which the taxpayer operates

e. A study of the inter-relationships between financial information and relevant non-financial information

AUDIT TECHNIQUES

The techniques below serve as useful guidelines; however, the auditor’s ingenuity and judgment play a crucial role in the audit process. Each audit may present a unique challenge that can be solved only by applying and adapting different techniques and improvising as the situation warrants.

The manner by which the auditor examines accounting evidence is known as an audit technique. There are various audit techniques available to the auditor. The auditor may use one technique instead of another depending on the audit objective. Several audit techniques are listed below:

1. **Analyzing**

   This requires careful consideration of each item. The purpose of analyzing is to separate the whole into meaningful component parts. In tax audits, this technique is used to analyze claimed exemptions or deductions, or to determine the tax impact related to deductions such as bad debts. Another example would be reviewing the miscellaneous income accounts for possible taxable transactions.

2. **Inquiry**

   This technique can be a formal process or a simple oral question. Although inquiry by itself does not directly allow the auditor to obtain sufficient evidence it can, and often does, lead to areas that provide the needed support. The audit questionnaire and checklist provide good guidance in developing inquiries.
3. **Observing**

   This involves more than merely looking. The auditor’s observations are designed to gather audit evidence. In public accounting, this technique is used with the audit of inventories to determine the accuracy of the inventory account. Observation requires preexisting knowledge of the process being observed. By inspecting the taxpayer’s premises, the auditor is likely to observe new capital additions or remodeling work, which could lead to unreported use tax due or spin-off audits of the contractors who were involved in the remodeling work. Additionally, the auditor can review newspaper or magazine articles that may indicate higher sales than reported by the taxpayer, or the intent to sell improved real property, such as a speculative building.

4. **Re-computing**

   This is based on a selective process performed by the auditor on some of the taxpayer’s mathematical calculations. An example of this technique would be the recalculation of tax on a guest folio at a hotel in order to determine if tax was properly charged.

5. **Scanning**

   This technique is used to examine a considerable amount of evidence in order to locate an exception. Scanning may be applied on original documents, as well as on journal entries or ledger postings. The auditor may scan the journal or ledger in order to locate any unusual transactions. Although all entries for a given period are scanned, only those appearing unusual, in either amount or composition, will be given additional attention. The scanning technique is often used when the auditor conducts a discovery sampling using sales invoices. The sampling is conducted to disclose exceptions related to deductions taken, or to identify sales invoices where no tax was charged. The tax auditor may also use this technique on the adjusted journal entries at the end of the taxpayer’s fiscal year.

   Additionally, this procedure may also be used when reviewing the vendor invoices for potential use tax. In this case, the scanning technique saves time, as every vendor file is not reviewed in detail (i.e.: payroll fees, utility bills, or accounting fees are not subject to use tax, so they generally are not reviewed).
6. **Tracing**
   Tracing requires the auditor to follow a transaction through the accounting system. Generally, tracing links an original transaction with all subsequent processing to determine the accuracy of the recording process. This technique is frequently applied in tax auditing to trace the debit entries posted in the fixed asset accounts back to the original purchase invoices. By doing so, the auditor may uncover potential use tax, or verify deductions claimed on the original sales invoices or similar documents.

7. **Vouching**
   Vouching requires that a transaction be supported by adequate evidence or documents. The auditor should examine these documents for their apparent authenticity and validity. An example is the examination of a taxpayer’s resale certificates received from their customers.

8. **Comparison**
   This technique involves various comparisons including those of ratio and trend analysis. The auditor should expect certain relationships to be in existence, as provided by the evidence gathered through comparison.

   In summary, auditing techniques are the means by which the auditor arrives at the most accurate conclusion in the most efficient time. Each examination requires the auditor to exercise originality and ingenuity in determining techniques that will best accomplish the goal.

**DETAIL AUDIT - VS - SAMPLE BASIS AUDIT**

Before the audit is initiated, the auditor must determine the adequacy of the taxpayer’s records. If a detailed audit is not feasible, a block sample or statistical sample may be performed.

To decide if a sample audit should be conducted, a test must first be made using a tentative block sample. A block sample consent form may be executed **only** after the test has been completed and determined to be applicable. The taxing jurisdictions are bound by the results of a properly executed block sample consent agreement. The taxpayer may, at any time, terminate the agreement. If the taxpayer does so, a detailed audit or other appropriate review should be performed.
The auditor must discuss the selection of sample periods with the taxpayer. If a block sample is selected, the taxpayer must sign a Sampling Agreement. The agreement should indicate the sample periods and any other factors that are pertinent. Generally, three or more different months from separate years are used for the test.

Before a statistical sample is used, the Department of Revenue must be consulted.

SAMPLE PERIOD SELECTION

The decision of whether to conduct an expanded sample is based on the results of the preliminary tests. In certain instances, due to the size of the business, it may be necessary to conduct a formal controlled sample as a preliminary test. Some critical points to be considered in the use of sampling include:

1. **Use of a Sample Period**
   a. Units of sale or the dollar amounts of claimed deductions are uniform as to their size and distribution throughout the audit period
   b. Basic characteristics of the business and the methods of reporting remain the same throughout the audit period. Should the basic characteristics of the business change during the audit period, separate samples or tests should be made for each specific period with separate percentages of error for each. this is called a stratified sample)
   c. The sample-audited detail contains sufficient items to make an accurate percentage calculation. If the sample tested has only a few transactions, errors may not lend themselves to a percentage calculation of reasonable accuracy.
   d. The sample period must be representative of the business activity being tested

2. **The Sample Base**
   a. The auditor must establish what is being tested.
   b. The sample base must be representative of the business activity being tested.

   It is important that a firm sample be established so that a percentage of error can be computed and applied. This base is represented as the denominator, with the differences found in the denominator being represented as the numerator. For example, if sales for resale are to be tested for a selected month, all recorded and claimed resales must be examined for that month, with exceptions or disallowed
resales being specifically noted. Alternatively, what is tested may be a combination of various deductions. In this case, the base would be all the deductions recorded and claimed. Other block sample methods are permitted as long as the auditor, supervisor, and taxpayer agree as to the method of sampling to be used.

3. **Size of Sample Period**

The auditor must exercise his or her experience and judgment in determining the size of the sample periods. The following principles should be considered in selecting a sample period:

   a. The size should be adequate to ensure reasonable accuracy.
   b. The auditing time required should not be excessive in relationship to the materiality of the issue.

In general, when auditing a business with good internal controls and a good accounting system, the sample period may be a relatively small portion of the total audit period. However, when auditing a business with little or no internal controls, the sample period should cover a larger proportion of the audit period. If records are available, the periods selected for sampling should be spread over the entire audit period, while ensuring that samples are taken from all years and address any seasonal or other ongoing fluctuations in business activity. The size of each sample period, in addition to the above considerations, will depend on the number of documents to be examined. Usually, the sample periods will consist of complete months or quarters. However, periods of less than a month may be selected if the number of transactions is voluminous, and if daily or weekly control can be established. Statisticians have established that several short samples over the audit period are superior to one long period. For instance, a sample of three scattered months throughout the audit period will give better results than a one-quarter sample.

4. **Elimination of Non-Recurring Items**

In making a test of the taxpayer’s records to determine their accuracy, differences are sometimes found which are unique, either in the dollar amount of the transaction, type of product sold, omission due to an unusual situation or other reason. These should not
be used in computing a percentage of error. These are normally items of considerable size, and the opposition to including them in the percentage of error is quite strong. Before handling these items as non-recurring errors, they should be carefully scrutinized to determine if they meet the requirements to be classified as non-recurring errors. It is suggested that an error of this nature should meet one or more of the following conditions:

a. The amount of the sale or purchase exceeds the amounts of normal sales or purchases and occurs only in rare intervals
b. The sale or purchase was omitted or included due to some unusual circumstance
c. The product sold or purchased is a type not ordinarily sold or purchased in the taxpayer’s normal course of business.
d.

In an instance where a sample item would result in a distorted result, and appears to be extraordinary in nature, it may be considered as non-recurring. However, the fact that no other sales were made to a particular customer would not qualify the transaction as a non-recurring item. Sufficient tests should be conducted in additional periods in order to verify that items of a similar nature did not occur.

5. **Sample Detail**

Some taxpayers file their sales invoices alphabetically on an annual basis, with the sales being posted to the books of original entry chronologically. In this situation the auditor can trace the sales for resale backward from the sales journal, to the invoice, and finally to the resale certificate. This is a time consuming process and may be minimalized by:

a. Spot testing the accuracy of posting as a sale for resale
b. Determining a test base by relating to dollar volume (i.e., a one-month test may be estimated in terms of dollars by dividing total claimed resales by the number of months)
c. Selecting every third, fourth, fifth, or other letter of the alphabet as appropriate to arrive at the desired number of dollars or customer/supplier transactions
d. Scheduling exceptions noted and scheduling invoice amounts for each invoice
examined; thereby establishing a firm base for the calculation and application of a percentage of error.

e. If the auditor is performing the audit soon after the start of the taxpayer’s accounting year, the alphabetical invoice file may provide a reasonable size test period.

6. Application of the Sample Results

The percentage of error obtained in the sample period may be calculated and applied to the entire audit period in the following manner:

If taxable sales of a non-recurring nature are disclosed when auditing on a sample basis, those sales should be excluded from the calculations of a percentage of error. For example, if a claimed resale was found to be taxable and is of a non-recurring nature, all sales of a similar nature should be examined for the entire audit period and the total of such sales deducted from claimed resales in the appropriate reporting periods and shown as a separate amount in the measure of additional tax. The percentage of error developed in the sample periods should then be applied to the adjusted resales claimed for all periods in the audit not covered by the sample (i.e.: sample periods should be considered on an actual basis – the error percentage should be applied to all other periods within the audit). For example:

<table>
<thead>
<tr>
<th>Total claimed resales in sample periods</th>
<th>$10,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>less: Non-recurring taxable sales excluded (exceptions)</td>
<td>$4,000.00</td>
</tr>
<tr>
<td>Adjusted resales</td>
<td>$6,000.00</td>
</tr>
<tr>
<td>Other claimed resales disallowed</td>
<td>$1,200.00</td>
</tr>
<tr>
<td>Percentage of disallowance of adjusted resales ($1,200/$6,000)</td>
<td>20%*</td>
</tr>
</tbody>
</table>

*To be applied to reported resales.

One of the best ways to obtain general knowledge of the tax reporting system is to review the tax worksheets directly with the person responsible for preparation of the worksheets. By doing so, the auditor can ask about exceptions and more readily identify potential omissions when reviewing the taxpayer’s general ledger and supporting journals. A worksheet that fails
to address potential use tax or has not been updated with the addition or deletion of new accounts should trigger the auditor to perform a more in-depth review of these areas.

If a taxpayer has had, an independent audit performed that covered the same period as the jurisdiction’s review period, the auditor can gain more assurance that income amounts and asset balances were properly reflected. These audited amounts can be tied to the audited amounts in most cases. It is also important to review the notes of the financial statements, which may uncover related party transactions, material fixed asset additions, financing arrangements or other significant events, which could affect the privilege tax audit.

It may also be beneficial to review the audits of unrelated businesses that operate in the same industry. These may provide guidelines, issues, and determinations that could be helpful in the privilege and use tax review. For instance, in order to assess use tax, an auditor may need to determine the cost of food provided to managers or owners of a restaurant. A review of similar restaurants may reveal the cost of food percentage used throughout the industry. Another example could include the review of a similar speculative sale, such as an apartment building, to ensure the same types of exclusions in each situation were allowed.

**AUDIT DETERMINATIONS**

Upon completion of audit fieldwork, there are three possible determinations:

1. **Assessment**
   
   This concludes there has been an underpayment of taxes. There should be adequate evidence supporting the conclusion with specific ARS and MCTC sections cited.

2. **Credit**
   
   This concludes there has been an overpayment of taxes. There should be adequate evidence supporting the conclusion with the stated reason by the auditor as to how the credit was established.

3. **No Change**
   
   This concludes there have been no overpayments or underpayment of taxes. There should be adequate evidence supporting the conclusion.

Regardless of the audit result, each audit file should be neatly prepared and determined as accurately as possible. Any authorized individual should be able to pick up the audit file and
readily determine the results and the reasons, which support the determination.

The supervisor or senior personnel who review the audit files, and the judges who make determinations of law, can make a more informed judgment on the issues at hand if the relevant facts are presented clearly in the audit file. The auditor should assume that each audit file would be examined by a judge or other external body. The auditor should make every effort to ensure the completed audit could withstand these types of examinations.

**AUDIT CLOSING**

When the audit is complete, the preliminary findings must be sent to the taxpayer. The auditor must attempt to have a closing conference with the taxpayer, either in person or by telephone, depending on the situation. The Preliminary Audit Findings letter should be presented during the closing conference or mailed depending on the circumstances. The letter allows the taxpayer fourteen days to review the results and provide additional information before the audit is finalized. If the taxpayer needs additional time to review the findings, the auditor may grant any reasonable request for an extension.

If the taxpayer has any questions, this is the time to provide an answer. Any warranted adjustments to the determination should also be made at this time.

After the fourteen-day period has expired and all possible adjustments have been made, the Notice of Proposed Assessment is to be issued. The auditor must inform the taxpayer of its protest rights prior to issuing the assessment.

**AUDIT WORK PAPERS**

The audit work papers include all evidence that supports the work performed, methods and procedures followed, assumptions made, and conclusions drawn by the auditor. As this would indicate, the work papers are the connecting link between the taxpayer’s records and the audit findings.

An audit includes the systematic preparation of a series of work papers, in such form and with such context, that the auditor may use them to prepare a report on the activities of the business audited.

Each detailed test may result in the production of additional audit work papers. It is important that the auditor take time to plan the contents of the work papers and the best way
to record information to document the findings appropriately.

FUNCTIONS OF WORK PAPERS

There are two basic functions served by work papers, the first is operational and consists of the following:

1. Support for the Auditor's Determination
   One of the auditing standards concerns the collection of sufficient, competent, and relevant evidence in order to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations. The work papers become the vehicle to establish that the evidence obtained was sufficient.

2. Assist in Preparing the Audit Findings
   In providing support for the report. The work papers facilitate the preparation of the findings. During the audit engagement, many analyses, schedules, and notations are prepared and documented.

3. Assist in Performing the Audit
   Work papers serve as a tool to help in documenting the work performed and aid the auditor in organizing and coordinating all phases of the audit engagement. As the work progresses, the work papers provide a record of the work already completed, and that yet to be done. Verification procedures and analyses are made and retained in the work papers, which are later compared with the other phases of the audit.

4. Assist in Coordinating the Work
   Work papers can help to coordinate the work when a taxpayer may be engaged in different types of businesses. Separate parts of the audit program or different audit programs may be followed for different types of business.

5. Provide a Permanent Record
   It is important that the records developed during the audit be available and accessible. The work papers provide a permanent record of the auditing procedures used and the taxpayer data examined. If questions arise concerning the adequacy or the accuracy of the audit examination, the auditor is able to, by referring to this record, establish what tests and other procedures were employed.
6. **Use as a Guide for Subsequent Examinations**

If a taxpayer has been previously audited. An essential requirement of the pre-audit research is a review of the prior audit’s work papers. The program that was followed and the suggestions or change-in-procedure notes for the next audit will be particularly important for the next auditor. Since parts of the previous audit may be applicable to the current audit, and as some of the work paper formats will be repeated, these documents may be copied and prepared at a more convenient time before the audit begins. Data sources noted on the prior work papers and explanatory comments about unusual accounting system features will guide new or inexperienced auditors on subsequent examinations.

7. **Link Original Transactions to Financial Statements**

As noted previously, much of the auditor’s work consists of tracing a transaction’s trail from its original recording to the final destination in the financial statements. By examining the underlying evidence, the auditor verifies that the transaction actually did take place and was originally recorded in the appropriate manner. The work papers that the auditor prepares will include various summaries of these types of transactions. The analyses of these transactions, and the recording of the same, will provide a link between the original documents and the financial statements.

8. **Provide a Basis for Further Work**

During an audit, certain situations or conditions may come to the attention of the auditor. These usually involve changes in the accounting system that necessitates further investigation. The information accumulated in the audit work papers may prove helpful or even essential in completing this task.

9. **Provide a Basis for Evaluating Personnel**

Work papers provide an important basis for the supervisor’s evaluation of the audit staff. Some of the factors considered in judging the effectiveness of the work papers include completeness, clarity, arrangement, adequate cross-referencing, and the absence of unnecessary information. Work papers provide evidence that the auditor was able to decide what information should be accumulated, how well the auditor
understood the accounting system and flow of documents, and how the auditor was able to assess the situation and conduct adequate testing. Personality, ability to work with client personnel, and other factors are also evaluated, but the work papers provide a tangible starting point for the overall evaluation.

The second overall function of the audit work papers is to establish credibility of the work performed. After completion of the audit, the work papers should clearly show the nature and extent of the work done, the audit procedures followed, assumptions made, and conclusions reached. If differences of opinion exist with the taxpayer, the disposition of these points should be clearly detailed. In addition, the parties should be named and the basis for any issues clearly identified. It is important that the work papers do not contain any unanswered questions, inconsistent statements, or unwarranted or unexplained changes in conclusions. The finished work papers must be complete, clear, consistent, and conclusive.

There are certain aspects of the audit work papers that are both legal and professional in nature; they include:

1. **Confidentiality**
   Whether oral or written, the data should be protected closely by the auditor. In many cases, taxpayer data is also confidential to the taxpayer’s staff. Frequently, analyses are made or questions asked during the audit, which should be restricted to the taxpayer’s authorized representative(s). The auditor should take care that this information is not divulged, either directly or indirectly, to anyone other than the taxpayer’s representative(s). During the course of the auditor’s engagement, many disclosures are made which eventually enter into the work papers. These types of disclosures are also to be considered confidential. Whether the audit is in the planning stage, in process, or has been completed, the work papers should be protected from unauthorized use and disclosure at all times.

2. **Ownership of Work Papers**
   the work papers developed during the course of an audit are the property of the taxing
jurisdiction. The work papers should be kept under strict control at all times in the
taxpayer’s office, while the audit work is in progress, and in the taxing jurisdictions’
offices after the audit is completed. While in the taxpayer’s office or away from the
workplace, the work papers should be placed in a locked file or briefcase. This control is
necessary to prevent unauthorized use. Moreover, the work papers contain information
about the conduct of the audit itself, the scope or methods to be used, and items
selected for testing. This information should not be available to the taxpayer or its
employees, unless first reviewed and approved by the audit supervisor. Lastly, work
papers should be safeguarded because the data they contain may be impossible or
impractical to reproduce.

**WORK PAPER PREPARATIONS**

Verification and investigation procedures are the essence of an audit. Each work paper
should provide summarization and analysis of data and indicate the investigative steps
performed. The following common items should be included in all work papers:

1. Taxpayer Name
2. TPT License Number
3. Subject matter of work paper
4. Date
5. Reference to supporting or summary schedules
6. Auditor’s name

The name of the taxpayer and the subject matter of the work paper should also appear on
each individual work paper footed at the bottom.

**WORK PAPER STANDARDS**

1. **Completeness**

   Maximum usefulness should be the standard for decisions in preparing work papers.
   The auditor’s professional skill is reflected in the work papers the auditor prepares. The
   work papers should be complete, but free of unessential data, and should be carefully
   organized for easy reference.

2. **Accuracy**
Work papers must be accurate and technically correct. Cross-footings and additions of columns (footings) should be proofed and all amounts tied with other work papers when appropriate. All related amounts must tie, unless the difference is inconsequential, in which case it should be noted on the audit work paper with the related reason. The use of proper grammar is also imperative. Therefore, audit notes, chronology of events, and other narratives should be reviewed to ensure they are grammatically correct and have no errors or misspellings, especially company names, officers, employees, and other similar items.

3. Clarity and Understandability

The scope of the examination must be clearly defined by indicating the facts discovered, and the conclusions reached as a result of examining the records. The form and content of each work paper should be constructed so that a person technically competent, but unfamiliar with the work, will readily understand the results. The audit trail and significant stopping points should be clear to the reader. The various schedules and sub-schedules should be arranged to indicate their importance and purpose. Totals should be easily understood and, where applicable, easily traceable to other work papers. The language of comments and other narratives should be accurate yet concise.

4. Legibility and Neatness

The general appearance of the work papers should be neat. The main element contributing to neatness is evidence of orderly preparation. Only one side of the paper should be used since the papers are bound and writing on the backside of the paper may be overlooked or be inconvenient for reference.

5. Relevance and Detail

All items included in the final work papers should have a purpose related to the assignment. No general rule may be stated, but the amount of data to be included in the work papers may include detailed listings of items, photocopies of original documents, an auditor’s initials beside a program item, or a notation indicating that certain supporting documents have been examined. Unnecessary analyses and narrative should not be prepared, but if they exist and are found to be relevant, they
should be retained in the miscellaneous section and noted as not pertinent to the audit.
If the auditor concludes that a certain analysis is required, thought should be given on
how to arrange the data efficiently. Generally, a summary is preferable to a list of
details and an analysis of several related accounts in one schedule is preferable to
duplicated schedules. Preparing memorandums and narratives can be overdone.
Although some preparation is essential, the unnecessary and redundant should be
avoided. Detail material such as adding machine tapes, tab runs, inventory lists, and
other miscellaneous papers should be retained in the work papers only as long as they
serve a purpose. If supplementary information is bulky, but has value in support of the
work papers, it should be referenced and filed separately. Documents that have been
superseded should be removed unless a change is being made subsequent to an
assessment being finalized.

6. **Attention to Design and Layout**

Audit work papers must be designed and prepared so that supervisors and senior
personnel may efficiently and effectively review the work performed. Excel audit
templates are available and provide the necessary elements of all work papers. If
schedules are added they should follow the same format as the templates. The
schedules and analyses should be carefully planned and constructed before and during
the course of the audit.

7. **Other Preparation Standards**

Each work paper should be self-explanatory. No questions, open points, incomplete
notes, or other indications of unfinished work should remain on the work paper. If
items on one work paper tie to those on another work paper, both should be carefully
cross-referenced and referenced in the index. In any event, a separate sheet should be
started for each topic and the sheet (with continuation sheets if necessary) should be
accurately described in the work paper header.

**ESSENTIAL ELEMENTS OF AUDIT NOTES**

Before writing the audit notes, the auditor should carefully consider the content to be used
in the findings. A brief outline enables the auditor to consider all pertinent facts and
conclusions and provides a logical arrangement of the material to be included in the findings.
In addition, an outline demonstrates whether all the necessary elements are present in order to support the findings. The audit notes should fully explain the audit process and conclusions drawn so that any authorized person could pick up the file and understand the issues of the assessment.

Well-prepared audit finding contain the following four basic elements, which should always be considered:

1. **Condition**
   Condition is a statement of what the auditor observed. In the broad sense, “observed” includes not only what the auditor saw, but also what was reviewed through scheduling, analysis, and other techniques. The condition of the various areas can be deemed as either highly efficient or deficient. If there are deficiencies, the condition alerts the reader to examine the degree of review the audit required.

2. **Cause**
   Underlying cause is the reason things have gone awry and the modifications which must be made to prevent recurrence of the adverse condition.

3. **Effect**
   Effect represents the result of the condition the auditor finds and can be either beneficial or undesirable. Effect is the error factor described in terms of assessment value.

4. **Conclusion**
   When the findings have been developed in the manner set out, the conclusion represents the auditor’s summation of the condition, cause, and effect.

**RECORD OF TAXPAYER CONTACTS**

Any contact with the taxpayer must be documented in the Record of Taxpayer Contacts. Taxpayer contacts include phone calls, incoming e-mail, faxes, letters, in-person visits, and any other contact with the Taxpayer, employees, representatives or other related parties. Date, person contacted, contact source, and any relevant detail should be included.
AUDIT COMPLETION

When an audit is completed, the taxpayer shall be furnished with a copy of the results via certified mail. Any additional tax is due within forty-five days after the taxpayer receives the Notice of Proposed Assessment.

Upon receiving a Notice of Assessment, the taxpayer may request an informal conference with the auditor, audit supervisor, and DOR protest unit. The Taxpayer also has the option of appealing the assessment by requesting a formal hearing at the Office of Administrative Hearings. Such request is to contain the objections to the assessment, the amounts in question, and the basis of each objection on the Taxpayer Response Form.
**APPENDIX**

The Following items will be added when policy and/or edits are approved.

1. ATC File Index (Order of File)
2. Intent to Audit Letter
3. Standard Questionnaire
4. Standard Interview Questionnaire
5. Block Sample Agreement
6. Appointment Confirmation Letter
7. Request for Information Form
8. Request for Original Financial Records Form
9. Audit Notes Template
10. Waiver Chronicle Form
11. Record of Taxpayer Contacts Form (Chronology of Events)
12. All AZ 285 Forms and Instructions
13. No Change Letter
15. Amended Audit Documents
16. Taxpayer Response Form (Protest Form)
17. Taxpayer’s Audit Survey
18. Managed Audit Documents
19. Municipal Audit Request Form
20. Municipal Audit Request Approval/Denial Form
21. Quality Assurance Evaluation Form
22. Any other created form or policy from any of the Subcommittees

**REFERENCE**