

DEPARTMENT OF TREASURY

STATE TREASURER

AUDIT STANDARDS FOR FIELD AUDITS

(By authority conferred on the Department of Treasury by sections 3 and 21 of 1941 PA 122, MCL 205.3 and MCL 205.21.)

R 205.2001 Definitions.

Rule 1. As used in these rules:

(a) “Audit sampling” means the application of an audit procedure to less than 100% of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class.

(b) “Audit workpapers” mean workpapers created by the auditor. The auditor shall retain the audit workpapers and may only share them with the audited person or his or her or its authorized representative to the extent disclosure is allowed by statute. The workpapers provide support for the auditor’s opinion as to the proper tax owed for a tax period.

(i) Workpapers include information about the procedures followed, the tests performed, the information obtained, including identification of the documents or accounts that constitute the evidence pertinent to the auditor’s review and conclusions about an audited person’s tax liability. The workpapers may include samples of the documents or accounts that support the auditor’s conclusions.

(c) “Field audit” means the examination of the books and records of a person to determine the proper tax liability for a tax period. A field audit includes an examination of the audited person’s books and records to test if they are sufficient to accurately determine the tax liability for a tax period. All of the following apply:

(i) The books and records of a person are sufficient if they allow transactions to be traced back to the source or forward to a final total. For example, bank deposit slips, receipt books, credit card charge slips, cash register tapes, canceled checks, credit card sales slips, invoices, bills of lading, and shipping documents are source documents.

(ii) Sales transactions must identify the item sold. Sales records include, but are not limited to sales slips, receipts, invoices, cash register tapes or other original sales documents.

(iii) Documents prepared for internal use by the audited person are not source documents for purposes of tracing a final total to a transaction if the documents do not provide detail at the transaction level and if the documents were created in a process for which the auditor cannot obtain reasonable assurance that the transactions were accurately reproduced from the original documents.

(d) “Indirect audit procedures” means the determination of the tax liability through an analysis of the audited person’s business activities using information from a range of sources beyond the person’s declaration and formal books and records.

(e) A “review” generally requires the examination of only one or two documents but in some instances may require a review of other related documents to substantiate an item that was reported, or that should have been reported on a tax return or claim form. A review is not a field audit. The audit standards for field audits, rule 2 through rule 11 of these rules, do not apply to reviews.

(i) Generally, department employees who conduct reviews are not required to meet the minimum educational standards for auditors outlined by the Michigan civil service commission but they must meet the minimum educational requirements that are commensurate with the scope and expertise necessary to conduct a review.

(ii) Department employees who conduct reviews do not visit the taxpayer’s place of business.

(iii) Reviews do not require an understanding of the entity or the entity’s internal controls. Reviews do not require an assessment of audit risk and do not involve sampling.

(iv) Department employees who conduct reviews are subject to the standards for the treatment of the public set forth in the taxpayer bill of rights rules, R 205.1001 through R 205.1013, the ethical conduct standards set forth in the state ethics act, 1973 PA 196, MCL 15.341 through 15.348, as well as civil service commission rules and regulations. Employees are also subject to the department policies and procedures set forth in the treasury employee handbook regarding confidential information, employee conduct, training and development. Employees are also subject to the policies and procedures set forth in the taxpayer rights handbook regarding conduct, including but not limited to conflicts of interest, confidentiality, fairness and impartiality, and courtesy and consideration.

(v) The results of the review may be reported to the taxpayer or claimant through a letter, a notice of refund adjustment or a notice of intent to assess.

History: 2015 AACCS.

Editor's Note: An obvious error in R 205.2001 was corrected at the request of the promulgating agency, pursuant to Section 56 of 1969 PA 306, as amended by 2000 PA 262, MCL 24.256. The rule containing the error was published in *Michigan Register*, 2015 MR 9. The memorandum requesting the correction was published in *Michigan Register*, 2015 MR 9.

R 205.2002 Technical training; competence for field audits.

Rule 2. (1) Auditors must meet the minimum educational requirements outlined by the Michigan civil service commission in the applicable civil service job specification.

(2) Auditors must possess the professional competence needed to adequately address the field audit objectives and perform the field audit.

(3) Auditors must have adequate technical training and proficiency to perform a field audit. Auditors must satisfactorily complete relevant departmental training prior to conducting an audit.

(4) Departmental training must be conducted by employees who have previously demonstrated competence in the area in which training is being provided. Training includes instruction in all of the following:

(a) The tax under audit.

- (b) Sampling methods employed in the audit.
- (c) Software and other technology used in the audit.
- (5) Auditors must have appropriate technical knowledge. Appropriate technical knowledge contemplates all of the following:
 - (a) The ability and resources to conduct necessary research.
 - (b) Access to consult with knowledgeable individuals as necessary.
 - (c) Sufficient experience to evaluate the need for additional research or consultation with others.

History: 2015 AACCS.

Editor's Note: An obvious error in R 205.2001 was corrected at the request of the promulgating agency, pursuant to Section 56 of 1969 PA 306, as amended by 2000 PA 262, MCL 24.256. The rule containing the error was published in *Michigan Register*, 2015 MR 9. The memorandum requesting the correction was published in *Michigan Register*, 2015 MR 9.

R 205.2003 Objectivity, independence.

Rule 3. (1) Independence is a state of mind that permits the performance of a field audit without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

(2) Objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair the auditor's objectivity.

(i) Relationships that may appear to impair objectivity include a direct or a material indirect interest in a taxpayer by the auditor or a family member of the auditor.

(3) An auditor's independence and objectivity are not impaired by the selection of a taxpayer for audit by the department because the taxpayer or the taxpayer's industry has been identified through audit selection criteria as at risk for noncompliance with tax laws.

(4) If an auditor believes that a conflict of interest may exist in relation to an audit, he or she shall inform the audit supervisor. The audit supervisor will assist the auditor in determining the best course of action.

(5) The department will provide periodic training to promote awareness about the necessity for independence and objectivity in carrying out the duties of an auditor.

History: 2015 AACCS.

R 205.2004 Due professional care for field audits.

Rule 4. (1) Auditors must exercise due professional care in the performance of the field-audit and the preparation of the audit report. Due professional care requires auditors to plan and perform the audit observing field audit standards. Field audit standards include all of the following:

(a) Adequately planning the audit and supervising assistants.

(b) Obtaining a sufficient understanding of the audited person and internal controls that are significant within the audit objectives.

(c) Obtaining sufficient evidence to support the auditor's findings and conclusions.

(2) Auditors should possess the skills commonly possessed by other auditors and exercise those skills with reasonable care and diligence.

(3) The lead auditor shall assign tasks and supervise assistants.

(a) Auditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining.

(b) The lead auditor shall know the relevant auditing standards and be knowledgeable of the person being audited.

(4) Throughout the field audit, auditors shall exercise professional skepticism when evaluating the competency and sufficiency of the evidence. Professional skepticism requires the auditor to have a questioning mind and the ability to make a critical assessment of the evidence.

(5) Auditors shall diligently, in good faith and with integrity, gather evidence for objective evaluation.

(6) When evaluating the quality of information provided by the audited person, auditors shall recognize that the information should not be accepted without some basis for reliance. Auditors should seek to verify the accuracy of the audited person's assertions.

(7) Failure of the audited person to provide requested evidence shall not reflect on the due professional care of the auditor.

History: 2015 AACCS.

R 205.2005 Reasonable assurance for field audits.

Rule 5. (1) Auditors shall obtain sufficient and appropriate evidence to provide reasonable assurance that the findings of the field audit have reasonably determined the tax liability of the audited person.

(2) Auditors shall use professional judgment regarding the areas to be tested and the nature, timing, and extent of the testing to be performed.

(3) Auditors shall use professional judgment in interpreting the results and evaluating the audit evidence.

(4) Reasonable assurance is not absolute assurance. Absolute assurance is not attainable because of the nature of audit evidence and the fact that auditors must rely on evidence that is persuasive rather than convincing.

(5) Reasonable assurance does not apply to an audit if the audited person does not have sufficient records or does not permit access to records. The auditor may then rely on the best available information to determine estimated tax due.

History: 2015 AACCS.

R 205.2006 Planning and supervision of field audits.

Rule 6. (1) To the extent possible, the field audit plan should be discussed with the audited person or the person's authorized representative prior to the commencement of fieldwork.

(2) Auditors should plan audit procedures to obtain the quality and quantity of evidence necessary to accurately determine the tax liability.

(a) The specific procedures employed and the evidence gathered will vary depending upon the audited person's record-keeping system, amounts reported, risk of misstatement of the tax liability, and other circumstances.

(3) The nature, timing, and extent of the direction and supervision of field audits depend on many factors, including the following:

- (a) The size and complexity of the entity.
- (b) The area of the audit.
- (c) The assessed risks of material misstatement of a tax liability.
- (d) The capabilities and competence of the field auditors.

History: 2015 AACS.

R 205.2007 Understanding audited person, including internal controls, and assessment of risk.

Rule 7. (1) Auditors must have an understanding of all of the following as it pertains to the audited person:

(a) Matters relating to the person's business, including its organization, operating characteristics, business lines, and capital structure.

(b) Matters affecting the industry in which the person operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes.

(c) Legal or regulatory matters affecting the person.

(d) Public information about the person.

(e) The relative complexity of the person's operations.

(2) Auditors shall obtain an understanding of the internal controls that are significant within the context of the audit objective. Both of the following apply:

(a) The audit objective is not to conduct an audit of internal control over financial reporting or to express an opinion on the effectiveness of the person's internal control over financial reporting.

(b) Auditors should have an understanding of the internal controls in order to plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance the tax liability is accurately determined.

(3) Auditors shall assess the risk that findings, conclusions, and ultimately the tax liability may be improper or incomplete. The auditor's risk assessment and the determination of the necessary procedures includes consideration of all of the following:

(a) The complexity of the organization, business unit, or process.

(b) The condition of the records.

(c) The cooperation of the audited person.

History: 2015 AACS.

R 205.2008 Field audit evidence and documentation.

Rule 8. (1) Auditors must obtain sufficient and appropriate audit evidence by performing audit procedures to provide a reasonable assurance for the conclusions reached in the audit.

(2) Auditors must prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connections to the audit, to understand from the audit documentation the nature, timing, extent, and results of audit procedures performed; the audit evidence obtained and its source; and the conclusions reached.

History: 2015 AACCS.

R 205.2009 Field audit sampling and sampling projections.

Rule 9. (1) When designing an audit sample, auditors must consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. The auditor may use statistical or nonstatistical sampling. The sampling method shall be determined on a case-by-case basis. The auditor may consider the circumstances of the audit, the type of taxpayer entity, and the taxpayer's internal control system.

(2) Auditors must select items for the sample in such a way that the auditors can reasonably expect the sample to be representative of the relevant population and likely to provide the auditors with a reasonable basis for conclusions about the population.

(3) Auditors must perform audit procedures, appropriate to the purpose, on each item selected.

(4) Auditors must investigate the nature and causes of any deviations or misstatements identified and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit.

(5) Auditors must project the results of audit sampling to the population.

(6) Auditors may use either statistical or non-statistical sampling of the audited person's books and records to provide sufficient evidence to form a conclusion about the correct tax liability. Non-statistical sampling includes judgmental samples, random samples, simple random sampling, systematic sampling, and cluster sampling or any other sampling method that does not involve statistical evaluation.

(7) Whenever 2 or more accounting populations for a particular tax return are combined and examined with the aid of a statistical sample, the sample result can be combined according to the rules for a stratified sample.

(8) When sampling the same accounts for multiple years, the auditor may combine the accounts into 1 population. The result must be projected by a reasonable method that the auditor determines prior to selecting the sampling units.

(9) If an audited person does not have sufficient records or fails to provide records, the auditor shall determine the best information available and base the estimated tax liability on that information.

History: 2015 AACCS.

R 205.2010 Elements of audit report of findings.

Rule 10. The audit report shall disclose all of the following information:

(a) The audit scope, methods, and procedures used, as well as books, records, and papers examined and relied upon to determine any tax deficiency or credit for the tax period or periods involved.

(b) If the evidential matter warrants, a recommendation for penalty and interest, along with the basis for the recommendation, and the statutory authority providing for penalty and interest.

(c) Whether the audited person is in agreement or disagreement with the audit findings. If the audited person disagrees with the findings, indicate the audited person's basis for disagreement if the audited person has communicated a basis for disagreement.

History: 2015 AACCS.

R 205.2011 Confidentiality

Rule 11. Auditors are bound by the same confidentiality rules promulgated under the taxpayer bill of rights rules which are R 205.1001(c), R 205.1003, R 205.1004, R 205.1006 and R 205.1007.

History: 2015 AACCS.