

Arizona Department of Revenue Sunset Factors

CONCLUSION: The Arizona Department of Revenue (Department) is responsible for administering various taxes, including transaction privilege, use, and severance taxes; corporate income, individual income, and withholding taxes; and luxury tax. It also administers unclaimed property (i.e., abandoned or inactive accounts or assets) and the State property tax laws through the 15 county assessors. We found that the Department did not comply with some conflict-of-interest requirements, had not ensured that it collected and reported all State income taxes, and should begin planning for the eventual replacement of its primary information technology (IT) system. Additionally, the Department supports 3 commissions and 1 committee, and we found that 1 of the commissions did not adhere to all open meeting law requirements. Finally, the Department should document the complaint-resolution processes for its Taxpayer Assistance Office and Criminal Investigation Unit (CI Unit) and track the CI Unit's complaint-resolution timeliness. Our report also provides information about the Native American Veterans Income Tax Settlement Fund (NASF).

Department did not comply with some conflict-of-interest requirements

Arizona law requires employees of public agencies and public officers to avoid conflicts of interest that might influence or affect their official conduct and outlines several requirements for doing so. Although the Department used an appropriate conflict-of-interest disclosure form that it required new staff to complete, it lacked a special disclosure file required by law, did not require contractors or commission/committee members to disclose conflicts, did not require annual disclosures, and lacked conflict-of-interest policies and procedures. These deficiencies increased the risk of Department employees and public officers not disclosing substantial interests.

After we spoke to the Department about these deficiencies, it developed and implemented a new conflict-of-interest disclosure process that went into effect in February 2019 and addressed each of the deficiencies we noted.

Recommendation

The Department should continue to implement and comply with its new conflict-of-interest disclosure process.

Other Department actions needed

As reported in the Sunset Factors, we identified additional areas where the Department should improve. These include the following:

Fix income-tax-processing issues—The Department is solely responsible for collecting and reporting all State income taxes and should have adequate procedures and systems for doing so. However, the Department's IT system lacks the functionality to perform automatic system checks and reconciliations, and the Department has not performed manual compensating review procedures to ensure all income taxes are collected and reported. As a result, there is an increased risk that the State may (1) not collect all income tax revenue that is due and (2) report inaccurate income tax revenue in its financial statements. We have reported this issue in the State's single audit reports since at least fiscal year 2009.

Recommendation

The Department should address its IT system's limitations or immediately implement alternative review procedures to ensure it collects and reports all State income taxes.

Plan for its primary IT system's end-of-life cycle—The Department relies on its Business Reengineering Integrated Tax System (BRITS) to administer State taxes and the transaction privilege tax for counties, cities, and towns. Prior performance audits of the Department found that BRITS was not adequately designed/implemented in the early 2000s,

has required thousands of system improvements since implementation, and is cumbersome to use. The Department also lacks several IT capabilities used in other states to administer taxes and, instead, relies on workarounds, vendors, and manual, time-consuming processes to perform various functions that are less efficient and more susceptible to error.

Prior Department leadership indicated that BRITS was nearing the end of its useful life and requested funding to conduct a feasibility study for replacing it. However, Department leadership changed and decided to focus on improving existing Department processes before requesting funding to implement a new IT system. Still, best practices recommend continual planning for a system's full life cycle, and organizations should continually plan for the future of their IT systems.

Recommendation

The Department should plan for BRITS' ongoing maintenance and eventual replacement and document these plans.

Ensure its public bodies adhere to all open meeting law provisions—We tested the Department's compliance with open meeting law requirements and found that 1 commission did not provide agendas at least 24 hours in advance for 2 of its meetings and did not provide meeting minutes for 1 of these meetings within the required 3 business days.

Recommendation

The Department should ensure that the commissions and committee it supports adhere to all provisions of the State's open meeting law.

Document complaint-resolution processes and track complaint-resolution timeliness—The Department's Taxpayer Assistance Office, which assists customers in various ways, and CI Unit, which investigates complaints alleging tax fraud and other types of tax-related criminal activity, have not documented their complaint-resolution processes in written policies and procedures. In addition, although the CI Unit had a goal to review and determine the outcome of complaints within 3 business days, it did not track its complaint-resolution timeliness.

Recommendations

The Department should:

- Document its Taxpayer Assistance Office's and CI Unit's complaint-resolution processes in written policies and procedures.
- Track the timeliness of its CI Unit's complaint-resolution process.

Department administers NASF

The Department is responsible for administering the NASF, a temporary program it operates with assistance from the Arizona Department of Veterans Services (ADVS). The Legislature established the NASF to reimburse Native American veterans who were on active duty in the U.S. military and erroneously had Arizona State income tax withheld from military pay between 1977 and 2005. The program was established as of May 2016 and will accept claims through December 31, 2019. The Legislature appropriated \$2 million dollars to the NASF, and any monies not claimed as of June 30, 2021, will revert to the State General Fund.

State law requires claimants to provide specific documentation in order to prove eligibility for a refund. Claimants apply with the ADVS, and both the ADVS and Department process these claims. Per law, each agency has specific time frames for processing claims. We reviewed 4 claims from fiscal year 2019 and found that both agencies processed these claims well within the required time frames.

As of May 15, 2019, the Department had received and processed a total of 243 claims. According to the Department, it approved or partially approved 123 of these claims and denied 120 claims because either the taxpayer had already received a refund or the taxpayer's withholding could not be verified by the U.S. Department of Defense, Department records, or a W-2 provided by the claimant. As of that same date, the Department reported that it had spent more than \$337,300 from the NASF for both approved refunds and administrative costs.