ADVISORY: ET HANDBOOK NO. 407, 4th EDITION, CHANGE 3

TO: STATE WORKFORCE AGENCIES

FROM: CHERYL ATKINSON
Administrator
Office of Workforce Security

SUBJECT: Tax Performance System Handbook Updates


3. **Background.** TPS is part of the comprehensive UI performance management system “UI Performs,” and ET Handbook No. 407, Edition 4, provides standard instructions for operating TPS in each state. This advisory transmits a number of modifications, clarifications, and replacement pages for the Handbook.

4. **Handbook Modifications Summary.**
   - Chapter II, General Procedures. Instructions have been added to define appropriate source documentation for employers who file electronically.
   - Chapter III, Status Determination. References to employer account inactivation procedures have been updated to comply with ET Handbook 401, Changes 10 and 12.
   - Chapter III, Status Determination. Sampling instructions have been updated to define appropriate source documentation for employers who file electronically.
   - Chapter IV, Cashiering. Instructions have been updated to address electronic fund transfers.

RESCISSIONS
None

EXPIRATION DATE
December 10, 2008
Chapter VII, Field Audit. Sampling instructions have been modified to address audits of employers who report and maintain wage documents electronically and to provide examples of acceptable electronic source documents; instructions have been further defined to describe more fully the audit activities necessary to verify accuracy of employer payroll; instructions have been added to clarify that simple typographical or mathematical errors do not cause case failure, and instructions have been added regarding the review of audits of non-registered or non-reporting employers.

5. **OMB Approval.** ET Handbook No. 407 has been approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1995, (OMB Approval No. 1205-0332, expiration date: January 31, 2009).

6. **Action Required.** Administrators are requested to distribute this advisory and the attached replacement pages to the TPS reviewer(s) and appropriate tax staff. These updates are also available electronically at: http://wdr.doleta.gov/directives/ETA_Handbook.cfm


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<tr>
<th>Remove Pages</th>
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<tbody>
<tr>
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<td>Pg. 9 R 11/07 and 10 R 04/03</td>
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<td>Chapter III</td>
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8. **Inquiries.** Address all inquiries to the appropriate Regional Office.

I. PLANNING FOR REVIEWS

a. Review All TPS Materials

To complete the Program Review, the reviewer must be thoroughly familiar with the TPS review procedures. Knowing the required review steps of Computed Measures, Systems Review, and Acceptance Sampling will allow the reviewer to conduct all necessary activities without undue delays. Understanding the review questions is also essential to building reviewer credibility. If the reviewer is not knowledgeable, respondents may think their time is being wasted and be less cooperative.

The reviewer should thoroughly examine the materials in this handbook and other TPS background materials before contacting the state UI tax staff regarding the review. *If there are any questions, please call the Regional TPS staff for clarification.*

b. Ensure that Records are Retained

Upon familiarization with the TPS design, the reviewer must ensure that the state is retaining the necessary records from the specific tax functions to such a degree as to allow all Acceptance Sample questions to be answered (e.g., paper copies, imaging, microfiche, back up discs, etc). If employers are registering and reporting electronically, or entering data directly into the state’s automated system, the exact information entered must be recorded by the state, along with an electronic audit trail including the entry’s date and identity of the employer or representative entering the data.

For example, in the Status Determination chapter an Acceptance Sample question asks if, at the time of the TPS review, evidence exists the account had been correctly set up. In this instance, to properly answer the question, the state must have retained sufficient documentation for the reviewer to make that determination, whether examining the registration form or a printout of an electronic data screen which captured the original information entered by the employer. Another question asks if the employer provided all the information that is material to the Inactivated/Terminated Determination. For the reviewer to properly answer this question, documentation authorizing the termination must exist. Such documentation may be found in the form of a letter for the termination from the employer, or a report from state field staff indicating the business is closed, or on a computer listing of accounts terminated after the required quarters have lapsed with no reported wages.
It is the responsibility of the TPS reviewer to become knowledgeable about the information requested in the Acceptance Samples and ensure if the state is not currently retaining the information that arrangements are made to do so. In each chapter's Acceptance Sample instructions, information is provided that will also assist the reviewer in clarifying what work product must be retained by the state.

At a minimum, documentation must be recorded and maintained until the TPS Annual Report has been reviewed and approved by the Regional Office. The records can be retained in their original hard copy form, on microfiche or any other means that provides sufficient detail or the state must maintain an audit trail which permits the reviewer to follow the flow of the work in complete enough detail so as to allow the Acceptance Sample to be answered in full.

c. Schedule and Conduct Introductory Meetings

The next step of the TPS review is to meet with the UI Director and the Tax Chief to ensure management support for scheduling and conducting the review. In addition, the state administrator who will deal with the reviewer in terms of TPS findings and recommendations must be identified.

A meeting should be scheduled with all appropriate personnel including unit supervisors and IT staff to discuss the review, to request necessary materials, procedures, charts, etc. and to ensure that data processing staff are informed of their involvement in the creation of sampling universes and the processing of computed measures.

At both administrative and tax staff meetings the TPS reviewer must explain the purpose and content of the TPS review. It should be explained that the primary purpose of the review is to produce information for the state to use to improve the quality of their revenue operation; and that the secondary purpose is to make a formal judgment about whether reasonable assurance of quality exists in each of the functional areas.
5. Is there a built-in edit or manual review to assure that the correct initial rate is assigned to new employers?

Yes ___ No ___

If yes, describe

6. Is there a built-in edit or manual review to assure that correct initial rates are assigned to successor employers according to the state law and written policy?

Yes ___ No ___

If yes, describe

VS: (Questions 5 and 6)
7. Is the information from Status Determinations and other material changes to the employer records verified for accuracy (e.g., Is information on the employer record compared to source documents to assure accurate posting of Status Determinations, address changes, etc.)?

Yes ___ No ___

VS: (Question 7 ________________________________ )

8. Does the state have a quarterly procedure to inactivate employer accounts if the employers have not reported wages for eight consecutive quarters (or less than eight if state procedures require less), or have filed a “no wage” report?

Yes ___ No ___

VS: (Question 8 ________________________________ )

*a. If yes, is the procedure automated?

Yes ___ No ___
ACCEPTANCE SAMPLE INSTRUCTIONS

Sampling Procedures

If the System is automated, the Reviewer must work closely with the IT unit to ensure a thorough understanding of what, when and how the samples should be selected.

Appendix A describes what action needs to be taken for sampling in both manual and automated systems.

Reviewing Samples

Assemble the following information for each of the New Status Determinations selected for review:

1. Status information in the employer account record.

2. The original source of information and any other documentation from the state's records. Documentation can consist of a registration form, field auditor's report notations to the file explaining the source, etc. If the employer registered electronically, or entered data directly into the state's automated system, the electronic data screen containing the original registration information entered by the employer (or employer’s representative) can be used as the source document. If the original source of information is not available, the answer to question 3a must be “no”.

Compare all source documents with the information on the employer's account record, and answer the questions on the Acceptance Sample Questionnaire.
ACCEPTANCE SAMPLE INSTRUCTIONS

Reviewing Samples

1. **Accuracy of Initial Liability Decision** - includes questions to evaluate if a correct initial decision based on minimum information was made. (TPS refers to actual rather than temporary or "pending" accounts). Some states have procedures which allow an initial liability decision to be made based on partial information (i.e., a partially completed contribution return with no other information). These states should follow up after the initial liability decision to ensure that information to make an accurate Status Determination has been obtained. If insufficient time has lapsed for the information to have been received, the review may end with question 3. The time period needed to obtain information is as set by state procedures, but not longer than 3 months, to avoid a situation where a blocked claim could result. States which do not have such a procedure are directed to proceed to question 3.

2. **Accuracy of New Employer Determination at Time of Review** - includes questions to evaluate if a correct, decision, liability date and initial rate have been assigned. Initial rate means the first rate assigned to the account. I.e., if liability began five years ago, the rate assigned for the first year of liability would be the “initial rate”.
ACCEPTANCE SAMPLE INSTRUCTIONS

**Sampling Procedures**

The following steps must be taken to establish the universe and select the sample accounts:

1. Identify all Successor Status Determinations made during the calendar year selected for the review.

2. Select 60 sample cases after identifying the universe.

**NOTE:** Sometimes an account is selected in the successor sample which was set up based on less than complete information. If it is discovered when the state follows its investigative procedures that the account should have been a "new" employer, continue to review it with this questionnaire and consider the case acceptable.
If the system is automated, the reviewer must work closely with the IT unit to ensure a thorough understanding of what, when and how the samples should be selected.

Appendix A describes what action needs to be taken for sampling in both manual and automated systems.

Assemble the following information for each of the successor Status Determinations selected for review:

1. Status information in the employer account record.

2. The original source of information and any other documentation from state’s records. Documentation can consist of a registration form, successor and or predecessor application form, field auditor’s report, notations to the file explaining the source, etc. If the employer reported electronically, or entered data directly into the state’s automated system, the electronic data screen containing the original successorship information entered by the employer (or employer’s representative) can be used as the source document. If the original source of information is not available, the answer to question 3a must be “no”.

Compare all source documents with the information on the employer’s account record.

Using this information, answer the questions in the Acceptance Sample Questionnaire.

**NOTE:** If the account has been terminated by the time of the TPS review, the Successor Employer Status Determination, rate assignment and posting should be the basis for answering the questions.
ACCEPTANCE SAMPLE INSTRUCTIONS

Reviewing Samples

Assemble the following information for each of the Inactivated or Terminated Determinations selected for review:

1. Status information in the employer account record.

2. The original source of information and any other documentation from the state's records. Documentation can consist of a letter or Status change form from an employer, a list or an automated code which indicates that state law or policy permits the inactivation or termination of accounts after a certain number of quarters in which no wages were reported, etc.

If the employer provided inactivation information electronically, or entered data directly into the state's automated system, the electronic data screen containing the original inactivation information entered by the employer (or employer's representative) can be used as the source document. If the original source of information is not available, the answer to question 3a must be "no".

Compare all source documents with the information in the employer's account record.

Using this information, answer the questions on the Acceptance Sample Questionnaire.

NOTE: If the account has been reactivated by the time of the TPS review, the Terminated Employer Status Determination, and posting should be the basis for answering the questions.
ACCEPTANCE SAMPLE INSTRUCTIONS

Drawing Conclusions

All the questions are evaluative, except 1, the first part of 2, and 4b. Posting of “Other” information.

A "No" answer to either of these questions indicates that the Status Determination was not accurate. This means that the case is not considered acceptable.

If the completed review of 60 cases includes three or more unacceptable cases, then the reviewer must conclude that accuracy in the Status Inactivated/Terminated function was not confirmed.

For all unacceptable cases, the reviewer must provide an explanation on the Acceptance Sample Explanation Sheet for each unacceptable case.

Documentation

All source documentation (gathered to review samples) must be kept until the completion and Regional Office approval of the Annual Report. Either hard copy documentation or (in some highly automated systems) the ability to recreate the identical information used in the review must be maintained.
ESTIMATION SAMPLE INSTRUCTIONS

Sampling Procedures cont.

j. Divide the difference by the projected number of payments, and multiply the result by 100. Round to the nearest, one decimal place and enter on the space in Part I of the Summary Sheet for % of Deviation. This information should be taken into account for estimating contribution payments for the next Deposit Timeliness sample.

EXAMPLE:
Projected number of payments = 15,000
Actual number of payments = 18,000
Difference = 18,000 - 15,000 = 3,000
Percent Deviation = 3,000/15,000 = 1/5 or .20
.20 * 100 = 20%

STEP 11. Calculating Electronic Fund Transfers (EFTs).
(If no EFTS are received, go to Drawing Conclusions).

All EFTs from employers for contributions (do NOT include penalty and interest payments) received during the quarter, will be counted as being deposited timely. The following formula should be used by states that receive both paper payments and EFTs to determine overall timeliness of deposit.

\[ P = (w \times 100) + [(1-w)\times p] \]

where w is the proportion of funds deposited electronically and p is the percentage of the paper payments received by the agency or sent to the lockbox that were deposited within 3 banking days (line 8 from Summary Recap).
ESTIMATION SAMPLE INSTRUCTIONS
Sampling Procedures cont.

EXAMPLE: If 10 percent of dollars are deposited electronically and 92 percent of dollars received as paper payments are deposited within 3 banking days, the weighted combined estimate is:

\[ P = (0.1 \times 100) + (0.9 \times 92) \]

\[ P = 10 + 82.8 = 92.8 \text{ percent} \]

If the percent of EFT dollars is expected to be 50% or greater, the sample size and value to pass will change. Reference the Sampling Table under Drawing Conclusions.

NOTE: While the percent of paper payments deposited in a timely manner is based on the Estimation Sample, the percent of contributions received via EFT should be based on actual EFT payments for the quarter.

Drawing Conclusions

To draw conclusions about timeliness, do the following.

Identify the size of the sample from Part II, line 2, column D of the Summary Coding sheet (Total Items).

Refer to the following Sampling Table to determine the value to pass.

TIMELINESS STANDARD: 90% or more dollars deposited within 3 days or less.
If the percentage of the total dollar amount deposited within 3 banking days (line 8 of Summary Sheet), is equal to or greater than the value to pass percentage, then the reviewer will conclude that 90% of the dollar amount of employer contribution payments have been deposited timely.

If the percentage of the total dollar amount deposited within 3 banking days is less than the "value-to-pass" percentage, then the reviewer must conclude that timely deposit of employer contribution payments cannot be confirmed.

The value to pass figure is lower than the 90% timeliness standard in order to lessen the probability of "Type I Error”. Type I Error is the appearance of failure when in fact, the sample passes.

**SAMPLING TABLE**

<table>
<thead>
<tr>
<th># of Sample Items</th>
<th>Value to Pass</th>
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<tbody>
<tr>
<td>375 - 405</td>
<td>87.5%</td>
</tr>
<tr>
<td>406 - 441</td>
<td>87.6%</td>
</tr>
<tr>
<td>442 - 481</td>
<td>87.7%</td>
</tr>
<tr>
<td>482 - 527</td>
<td>87.8%</td>
</tr>
<tr>
<td>528 - 579</td>
<td>87.9%</td>
</tr>
<tr>
<td>580 - 640</td>
<td>88.0%</td>
</tr>
</tbody>
</table>
ESTIMATION SAMPLE INSTRUCTIONS

Drawing Conclusions, cont.

**EFT SAMPLING TABLE**

<table>
<thead>
<tr>
<th>% EFT</th>
<th>Sample Size</th>
<th>Value to Pass</th>
</tr>
</thead>
<tbody>
<tr>
<td>50 – 54.9</td>
<td>400</td>
<td>77.4</td>
</tr>
<tr>
<td>55 – 59.9</td>
<td>400</td>
<td>75.1</td>
</tr>
<tr>
<td>60 – 64.9</td>
<td>400</td>
<td>72.2</td>
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<tr>
<td>65 – 69.9</td>
<td>300</td>
<td>68.1</td>
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<tr>
<td>70 – 74.9</td>
<td>300</td>
<td>63.2</td>
</tr>
<tr>
<td>75 – 79.9</td>
<td>200</td>
<td>55.6</td>
</tr>
<tr>
<td>80 – 84.9</td>
<td>200</td>
<td>45.5</td>
</tr>
<tr>
<td>85 – 89.9</td>
<td>200</td>
<td>29.1</td>
</tr>
<tr>
<td>90 - 100</td>
<td>0</td>
<td>N/A</td>
</tr>
</tbody>
</table>

If the state receives no EFTs, then this conclusion will be based solely on the outcome of the Estimation Sample. If EFTs are accepted by the agency, the conclusion will be based on a combination of the Estimation Sample results and the EFTs received by the agency. (See Step 11).

For all untimely deposits, the reviewer must provide an explanation on the Acceptance Sample Explanation Sheet.

*Documentation*

All documentation gathered to review samples (which does not include checks) must be kept until review completion and Regional Office approval of the Annual Report. Hard copy documentation should be maintained, unless the state is able to recreate the identical information used in the review.
ACCEPTANCE SAMPLE RATIONALE

The following questions assess the quality of completed Field Audits. For each question, a score and a rationale are given. The "Documentation" section presents examples of acceptable documentation to confirm that a particular audit activity has been performed. Work papers can range from checklists of actions taken and documents reviewed to a narrative by the auditor. The total score for a case of acceptable quality is 80.

1. A pre-audit discussion concerning the purpose of the audit must be held with the employer or an identified designated representative. (10 points)

RATIONALE: A preliminary discussion must be held with the employer or an identified designated representative, in which the purpose of the visit and any pre-audit questions are discussed. At a minimum, the owner, a partner, or a corporate officer should be advised in person, by telephone or letter that an audit is to be performed and have the opportunity for a meeting.

DOCUMENTATION: The completed audit must record the name and title of the individual involved in discussion. If the employer designated a representative, record the name and title of the designated representative, and also record the name and title of the employer who designated the representative.

2. An acceptable explanation will be given as to how the auditor verified the existence of the business. (5 points)

RATIONALE: Conducting the audit at the employer's place of business is the best way to verify its existence. Otherwise, the business entity must be verified in accordance with state audit procedures to ensure it is a bona fide operating establishment and not part of a fictitious employer scheme.

DOCUMENTATION: The completed audit must contain documentation of an on site visit, personal knowledge of the business, or other sources of verification in accordance with state audit procedures (e.g., business license, business advertisement in yellow pages).
ACCEPTANCE SAMPLE RATIONALE

3. An acceptable explanation must be given as to how the auditor verified the ownership of the business. (5 points)

RATIONALE: The current status of the business must be verified each time an audit is performed. If there has been a change of which the state was not aware, information on the change must be reported by the auditor in accordance with the state's policies and procedures.

DOCUMENTATION: The completed audit must contain confirmation that the auditor examined documents regarding partnership agreement, articles of incorporation, corporate charter, income tax returns and their findings (the type of income tax returns should be identified - e.g., 1120S - Sub-Chapter S Corp. 1040-Schedule C - Individual Ownership, 1065 - Partnership, 1120 – Corp.), business license, verification with the Secretary of State, or other sources of verification in accordance with state audit procedures.

4. Tests of employer's payroll records must be performed to verify the accuracy and completeness of reported payroll. (25 points)

RATIONALE: To establish that the auditor can rely on payroll data reported to the state, a minimum of four tests are required. To begin, the auditor must confirm reliance on the accuracy and completeness of the employer's payroll system, and this is done through Test “a” which requires verification that amounts paid were properly posted to the employer's payroll records. Then, as further checks on the accuracy of reported wages, Test “b” involves reconciliation of audited total payroll to reported total wages; Test “c” requires computation of total taxable payroll; and Test “d” involves reconciliation of total taxable payroll to reported total taxable wages. (Note that reconciliations may not always be exact due to tolerance levels, rounding and other state-established procedures. In these situations, the reviewer will determine whether state-established procedures have been followed. Minor mathematical or typographical errors discovered by the reviewer, such as errors that do not prevent identification of the employer or of potential UI claimants, should not cause the audit to fail, however, they should be noted in TPS findings.)

These tests will not be possible for employers or employing units that have not reported wages or have not registered. Procedures for auditing such employers are described at the end of Question Four.

DOCUMENTATION: The audit must include documentation which confirms that each test was conducted and supports conclusions drawn from the tests. Any discovered discrepancies greater than state-established tolerance levels between reported and audited payroll must be documented, reconciled and properly adjusted in order to pass Question Four. Such documentation could take the form of an annotated calculator tape, or include copies of records, or consist of work papers, or be notations on a computerized audit program.
ACCEPTANCE SAMPLE RATIONALE

Test a. Verification that amounts paid were properly posted to the employer’s payroll records. There are two methods to verify that payroll was properly posted to the employer’s payroll system.

Provide documentation showing that the audit verified the gross payroll by adding all payments of the individual gross wages from source document(s) (e.g., paper or electronic check stubs, cash disbursements journal, check register, etc.) for the quarter and compared that total to the total gross wages reported on the state’s records. Documentation may be in the form of an annotated calculator tape or computer printout showing quarter or year and source documents used. Comparison may be for a single quarter (or more) or annual.

or

Provide documentation showing that the auditor verified at least one employee’s wages for one quarter from evidence of payment through to the employer’s copy of the quarterly contribution and wage report or to the wages posted in state records. If the auditor is supplied with detailed wage information from state records prior to conducting the audit, then the wage data of the individual must be traced through the employer’s payroll system to the state’s records for that quarter.

Most basic evidence of payment, such as timecards, check stubs, check registers, cancelled checks or copies of automated clearing house (ACH) transactions should be used when available. If such basic evidence is not available, other records may be utilized, but this situation must be documented in the audit report. Other acceptable documents include paper and cash payment vouchers. If the employee is paid by direct deposit, evidence may include employee earnings statements, electronic check stubs, records of direct deposit, or electronic fund transfer tracking numbers.

Records used in the audit that show only net amounts (e.g., cancelled checks, non-detailed check stubs, records of direct deposit, or ACH transactions showing only net amounts) must be reconciled for at least one employee; with supporting evidence of the gross wage amounts paid to the employee such as found in individual payroll or earnings records.

Work paper(s) for each individual traced must contain the identity of the record examined, name, SSN (all or part), amount of pay, and dates of payments.

Test b. Reconciliation of audited total payroll to reported total wages.

Work paper(s) must show that the auditor compared quarterly totals of payroll records for all employees to the total wages on the employer's copy of the UI contribution report, or to the amount posted to the state’s records. Payroll records used for this test could be in the form of individual earnings records, payroll journals or ledgers, payroll summaries, W2s, W3(s), 941s or 940s. For example: Each quarter’s payroll summaries are totaled for the entire year, along with a comparison of the total gross annual payroll to the W2 totals. For an individual’s trace, if W2s are used, the totals for the remaining, untested quarters for the employee traced in Test “a” must be added and reconciled with the employee’s W2.
ACCEPTANCE SAMPLE RATIONALE
The comparison of audited total wages to reported total wages may be annual or by quarter, and must include the entire audit test period. If discrepancies are identified which cannot be explained, the auditor will perform an analysis for each quarter in the audit test period.

Work paper(s) for the reconciliation must include identity of the payroll records examined, calculation of total payroll, and an explanation of variances/differences.

Test c. Computation of total taxable payroll.
Work paper(s) must include identity of the payroll record used in the calculation and also record the calculations to verify the total taxable payroll. This computation may be by quarter or annual, and must include the entire audit test period. Annual records such as W2s that have been validated in Tests “a” and “b” may be used for the computation i.e., the total gross wages from the W2s equal the total of the gross annual wages from the source used in Test “b”.

Test d. Reconciliation of total taxable payroll to reported total taxable wages.
The reconciliation can be performed by comparing the verified total taxable payroll figure arrived at in Test “c” to total taxable wages recorded on the employer’s copy of the UI contribution report, or to the amount posted to the state’s records. The comparison may be by quarter or annual and must include all quarters of the audit test period. If discrepancies are identified which cannot be explained, the auditor will perform an analysis for each quarter in the audit test period.

Work paper(s) for the reconciliation must contain summary calculations and an explanation of variances/differences.

AUDITS OF EMPLOYERS WITH NO REPORTED WAGES
Audits of employers/employing units who have no wages reported or have not registered are acceptable under certain conditions. Approval to conduct such audits must follow guidelines found in Part V, Section 3689 of the ESM, and should contain explanation for the decision to conduct the audit.

In these situations, the auditor must create quarterly tax reports, sometimes using sources such as blocked claims affidavits, lists of gifts, records of cash payments, check stubs, time sheets, payroll deductions taken as expenses on income tax returns, evidence of cash bank withdrawals if employees were paid in cash, evidence of electronic transfers along with any accounting records available such as W2s, 1099 forms, income tax returns, individual payroll or earnings records. To qualify as an “audit”, evidence of the payment of wages must be documented in audit work papers.

The audit must also contain detailed documentation such as calculator tapes or spreadsheet details showing the methodology followed in preparation of the contribution and wage reports or annual adjustment forms. Such documentation must include copies or descriptions of records used by the auditor to determine wage for each employee as well as evidence of the auditor’s computations of total wages, taxable wages, and contributions due.