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A participant observation study of the resolution of audit engagement challenges in government tax compliance audits

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Abstract

Purpose – The aim of this paper is to extend the prior auditing literature by examining audit engagement challenges arising during government tax compliance audits. The prior auditing literature has examined how audit engagement challenges have been resolved through auditor/auditee negotiations.

Design/methodology/approach – The empirical evidence for the paper was gathered during a participant observation study conducted by the primary researcher over a period of six years while working as an auditor for the Alcohol and Tobacco Tax and Trade Bureau (TTB) of the US Department of Treasury.

Findings – This paper discusses various challenges faced by government auditors and how these challenges were resolved. The path to resolution was not always clearly marked. Resolution depended a great deal on the individual auditor's judgment, interpretation of the Code of Federal Regulations (CFRs), and the willingness of the auditee to change the methods and techniques they use in operating and reporting wine operations. Materiality was determined by compliance with the regulation criteria [CFRs and the US Code (USC)] – any non-compliance was considered to be material. Resolution of many of the challenges resulted in an increased payments of excise taxes or penalties by the auditee entities. In other cases, the audit agency allowed the auditees to agree to change or amend their practices to correct a violation or a lack of compliance with US federal government regulations. As such, while the difference in the role and status of the government tax compliance auditor as compared with the independent external auditor did not necessarily lead to a different set of audit procedures, the pattern of communications between the auditor and the auditee in a government tax compliance audit were quite different from an external audit of financial statements. The government tax compliance environment is often complex, but the auditor may draw on a number of sources of knowledge and communication: CFRs, USC, Generally Accepted Government Auditing Standards, national audit planning, national experts, winery management, local peers, local government supervision, legal counsel and other auditors.

Originality/value – The primary contribution of the paper lies in the fact that little or no prior research in auditing has been conducted using participant observation as a research methodology. The use of participant observation provides new perspectives on the resolution of audit engagement challenges and auditor/auditee communication and negotiation.

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Keywords Participant observation, Audit engagement challenges, Governmental tax compliance auditing, Auditor/client negotiations

Paper type Research paper

1. Introduction

This paper is based on a participant observation study of challenges faced by auditors when engaged in legally mandated audits of federally regulated wineries in the USA. The evidence for the paper was gathered over a six-year period during which the primary researcher was employed as an auditor for the Alcohol and Tobacco Tax and Trade Bureau (TTB) of the US Department of Treasury. Due to restrictions imposed by US Federal law, no identifiable information about the audits can be disclosed, consequently the paper focuses primarily on the nature of the audit challenges and how they were resolved. The paper is organized as follows: Section 2 provides a review of prior literature focusing on auditor/client negotiations and communications. Section 3 provides background regarding government tax compliance audits of wineries in the USA.

2. Review of prior literature

Nelson and Tan (2005) indicate that that the prior auditing literature has approached auditor/client negotiations and communications using either field-based questionnaires or practitioner-based experiments. Field-based questionnaires have provided insight about the process of auditor/client negotiations. For example, Gibbins *et al.* (2001) built a model of auditor/client negotiations that focused on a specific issue being negotiated, the negotiation process and the negotiation outcome, and they used their model to structure a questionnaire that elicited information about auditor/client negotiations. In another study, Beattie *et al.* (2000) obtained questionnaire responses from British auditors and obtained evidence about negotiations about contentious issues. The authors developed a model that emphasized linkages between context, negotiation strategy and outcome.

More recently, Bobek *et al.* (2012) investigated the resolution of challenges faced by audit professionals. The authors used a field-based questionnaire to elicit practicing auditors' experiences with resolving audit engagement challenges. Most of the audit engagement challenges were resolved through increased communication with other auditors and with the client. These results provide evidence confirming theory-based research indicating the importance of communication. The findings also extend prior research on the components of professional judgment (Gibbins and Emby, 1985; Emby and Gibbins, 1988; Gibbins and Mason, 1988) by providing insight into challenges encountered during an audit and how effective communication can lead to successful resolution of such challenges.

Field-based questionnaires provide insight into the negotiation process, but with the obvious loss of experimental control. However, experimental research is difficult to undertake because of the difficulty of obtaining access to practicing auditors. In one recent study, Fu *et al.* (2011) investigated the effects of two factors – auditors' negotiation experience and client negotiation style – on auditors' perception of the outcome in terms of a contentious issue regarding asset impairment write-downs. They found that negotiation experience led to a higher write-down for a client with a contentious negotiation style, suggesting that negotiation experience is useful when the

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client is difficult to deal with. Negotiation experience had no effect for a client with a collaborative negotiation style.

Virtually no prior research in auditing has used participant observation as a research methodology. The difficulties mentioned above with respect to the experimental approach are even more evident with a participant observation approach, in that it would be rare for the researcher to also be a practicing auditor. Consequently, the current study is unique in terms of its methodological approach. The participant observation approach also has drawbacks in comparison with the research questionnaire approach, in that a larger sample of auditing challenges can be obtained with a research questionnaire approach. However, given the six-year period of time that the auditor/researcher was engaged in governmental tax compliance audits in this study, a wide spectrum of auditing challenges and issues was observed and documented by the researcher.

Based on the prior literature the following research question is proposed for this study:

RQ. Can a participant observation research approach provide insights into the auditor/client negotiation and communication process in relation to auditing challenges in governmental tax compliance audits.

3. Differences between governmental and private sector audits

One factor that may impact upon the findings of this paper is the difference between public sector and private sector audits. Dittenhofer (2001) suggests that there are significant operational differences between public and private sector audits, including:

- *Performance criteria*. The private sector has client satisfaction converted as a measure of performance. The public sector uses efficiency, effectiveness and conformance to budgets as performance measures. These criteria are subjective and, therefore, difficult to measure.
- *Susceptibility of government decision-making to external influence*. All government work is open to the public, to interest groups, and to the media. Businesses, except in directors' meetings, can operate in reasonable privacy. Thus, the public official may be responding to conflicting priorities and values.
- *Conflict between government policymakers and administration*. Elected officials usually make policy, and the administration carries it out. These two groups generally have different goals and objectives, respond to different interests and are rewarded for different functions.
- *The employment contract*. Patronage and civil service systems in government reward employees for political activities or seniority rather than for efficiency and productivity.
- *Intense scrutiny by the media and public interest groups*. Because government resources come from the public in the form of taxes, the government is subject to media scrutiny and public-interest groups. Government officials, thus, exert much time and effort in protecting themselves, which is counterproductive to innovation and risk-taking.
- *Emphasis on stability and reliability*. The emphasis in government is on reliability, accountability and legality rather than on maximum effectiveness and flexibility.

- *Atmosphere of control and mistrust*. Because the government worker is subject to strict controls designed for the lowest common denominator in capability and trust, the capable and trustworthy employee may conform to these low expectations.
- *Difference in status*. Working for the government is, in many ways, considered a lower-status occupation than working for private-sector organizations. This situation introduces a morale problem in many government agencies.

These factors will need considered when interpreting the findings of the paper.

4. Background of government tax compliance audits for wineries in the USA

Wine production in the USA is regulated pursuant to the *Federal Alcohol Administration Act* (initially enacted August 29, 1935, and most recently amended November 18, 1988, 102 Stat. 4517, 4521.) The taxation and regulation of alcohol and tobacco production in the USA began with the creation of the US Treasury Department in 1789. Originally, the regulatory goals of the US government were focused on excise taxation of distilled spirits, primarily whiskey. Currently, the regulation of the alcohol and tobacco industries is carried out by the US Treasury TTB, which was created in January of 2003, when the Bureau of Alcohol, Tobacco and Firearms was extensively reorganized under the provisions of the Homeland Security Act of 2002.

TTB's mission is to collect alcohol, tobacco, firearms and ammunition excise taxes; to protect consumers of alcoholic beverages through enforcement of regulations regarding safe production and proper labeling of products; and to assist industry members to understand and comply with excise taxation, production and marketing requirements pertaining to the regulated commodities. The TTB uses more than 500 personnel throughout the USA. The professional staff includes auditors, financial analysts and trade investigators, plus other professional staff. Among the tasks of the TTB are the verification of the proper payment of alcohol, tobacco, firearms and ammunition excise taxes; prevention of misleading labeling and advertising; and ensuring that technology and business practices meet the legal requirements of the federal laws.

Because the focus of this paper is on challenges faced by auditors while engaged in audits of regulated wineries, it is important to understand the legal definition of "wine" according to the US federal law. Pursuant to federal regulations, wine is defined to include every kind of product "produced" in bonded wine premises, derived from grapes, other fruit (including berries) or other suitable agricultural products (such as rice for sake), containing not more than 24 per cent alcohol by volume. "Produced" is a technical definition in which a product is fermented, plus any volume increases arising from amelioration, wine spirits addition, sweetening or addition of wine spirits. A fermented product is not taxable as wine if it contains less than 1/2 of 1 per cent alcohol by volume. Permits are required for different types of wine making operations, including:

- a bonded wine cellar (BWC);
- a bonded winery (BW); or
- a tax-paid wine bottling house.

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As of 2010, there were 7,548 BWCs and BWs in the USA, 3,308 of which were located in California. The total wine excise tax collected by the TTB in 2010 was $899 million. Other wine operations requiring separate licenses include wholesalers, importers and volatile fruit-flavor concentrate plants. These are collectively called wine premises.

To be granted a license to operate by the TTB, every wine premise must submit an *Application to Establish a Wine Premise* (TTB F 5120.25), and if they produce wine (BWC or BW); they also require a Federal Alcohol Administration Act Permit (TTB F 5100.18). In addition to location and ownership information, these applications include information important to the audit of winery operations, such as: a diagram of the winery and its equipment, organizational information such as Articles of Incorporation, operating or partnership agreements, signing authority (such as power of attorney), names of corporate officials and corporate or partnership meeting minutes.

The wine premises must be bonded to insure against non-payment of taxes. TTB's role in the wine industry is to approve new winery facilities, assure proper collection of excise tax revenue, ensure consumer protection and ensure fair trade practices. It is the job of the TTB auditor to verify that the proper tax has been paid on any wine that leaves the wine premises (is "removed") to assure compliance with the Code of Federal Regulations (CFRs), to assess internal controls and to review labeling and product integrity. The CFRs are based on two federal laws:

(1) the Internal Revenue Code, which deals with Federal Excise Taxation and Special Taxes, if any; and

(2) the Federal Alcohol Administration Act, which is concerned with labeling, wine production, designation of American Viticultural Areas, health warnings and trade practices.

5. Participant observation as a methodology of auditing research

Most auditing research is based on the analysis of data collected from archives, surveys or experiments, with very little research being conducted through participant observation. Participant observation is a type of research methodology frequently used in disciplines such as anthropology, sociology and social psychology (Mead, 1928; Malinowski, 1929; Evans-Pritchard, 1940). The goal of participant observation is to gain a close familiarity with a particular group of individuals and to observe their practices through an intensive involvement with people in their natural environment, usually over an extended period of time.

In anthropology, participant observation is often referred to as ethnography (Geertz, 1984). A key principle of the ethnographic approach is that the researcher does not merely observe, but also finds a role within the group observed from which to participate in some manner. Such research typically uses a range of data collection procedures, including:

- informal interviews;
- direct observation; and
- participation in the life of the group, group discussions, analysis of documents produced by the group, introspective analysis and life-histories.

Although participant observation is often characterized as a qualitative research, it can also include quantitative dimensions. Participant observation is usually undertaken

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over an extended period of time, ranging from several months to many years. An extended research time period means that the researcher is able to obtain more detailed and accurate information about the people he/she is studying. Observable details (like daily time schedules) and more hidden details (like hidden agendas and conflicts) are more easily observed and understandable over a longer period of time. A major advantage of participant observation over long periods of time is that researchers can discover discrepancies between what organizational participants say should happen (the formal system) and what actually happens. In contrast, a questionnaire or an experiment is unlikely to reveal conflicts between different aspects of the social system or between conscious representations and behavior.

5.1 Methodology used in this study

The evidence gathered for this paper was derived from the direct observation and participation by the primary researcher over a period of six years while working as an auditor in the TTB. The author started documentation for this study on the first day of the first audit in 2005. One article for a major wine industry trade publication was published based on early results (Hayes, 2008) and a wine industry tutorial was published using that research (Hayes, 2009). During the course of the study, the auditor/researcher was a full-time professor of accounting at a public university in the western USA and a part-time auditor with the TTB. The activities of the auditor/researcher included training and field experience as a staff auditor and occasionally as an Auditor-in-Charge (AIC). Over the six-year period, the auditor/researcher participated in approximately 27 audits in the State of California. Due to restrictions imposed by US Federal law, no identifiable information about the audited entities can be disclosed. However, the audited entities were concentrated in the alcoholic beverage industry, including wineries, bonded wine cellars and distilled spirits. In most cases, the auditor/researcher served as a staff auditor; however, on some audits, the author also served as the AIC, and in one case as a researcher. The number and types of audits in which the auditor/researcher participated in is shown in Table I.

Not included in Table I due to US government restrictions on disclosure of individual cases are listing of scope, findings and reporting of each audit. However, the general scope, findings and reporting is given below.

5.1.1 Scope. The audit plan generally includes the following audit procedures. Procedures may be added or deleted based on the circumstances of the audit (industry, repeat audit, internal controls, company size, years of operation, etc.)

- Review laws and regulations applicable to the organization type regulated by the Department of Treasury's TTB.
- Conduct interviews with the company's management and personnel responsible for purchasing, production, packaging and distribution. Document and collect information on policies and procedures in place regarding internal controls.
- Conduct data analysis, process flow of inventory and documentation and detailed testing of transactions to source documents to determine that excise tax revenue were fairly stated.
- Review all excise tax returns filed during the audit period for proper calculation, timely reporting and payment of federal excise taxes.
- Test and trace data reported in monthly report filings to supporting daily records.

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Table I
Audits in which the researcher participated

Audit	Type	Researcher role
1	Distilled spirits	Audit staff
2	Distilled spirits	Audit staff
3	BWC	Audit staff
4	Winery	Audit staff
5	Winery/distilled spirits	Audit staff
6	Winery	Audit staff
7	Winery	Audit staff
8	Winery	Audit staff
9	Winery	Audit staff
10	BWC	Audit staff
11	Winery	Auditor in charge
12	Winery	Audit staff
13	Distilled spirits	Audit staff
14	BWC	Audit staff
15	BWC	Audit staff
16	brewery	Audit staff
17	BWC/distilled spirits	Auditor in charge
18	Winery	Audit staff
19	Winery	Audit staff
20	Brewery	Research
21	Winery/distilled spirits	Audit staff
22	Distilled spirits	Audit staff
23	Winery	Audit staff
24	Winery	Audit staff
25	BWC	Audit staff
26	Tobacco	Audit staff
27	Winery	Audit staff

- Perform a statistical or judgmental sample of taxable removals (merchandise sold). Include a review of the source documentation for required elements, and compare the documents to computer data used to prepare the tax returns and monthly reports of operations.
- Perform a judgmental or statistical sample of non-taxable removals (testing, family withdrawal, destruction, allowed consumption, certain losses or export). Review the source documentation for required elements and compare the documents to computer data used to prepare the tax returns and monthly reports of operations.
- Examine a judgmental or statistical sample of the transfers in bond (merchandise shipped to other wineries or alcohol companies with a TTB permit or to other facilities of the same permitted company) and trace the source documentation to summary records and the monthly reports filed with the National Revenue Center.
- Perform a 100 per cent count (normally) or sample count of the finished goods physical inventory and reconcile to the general ledger accounts.
- Document and collect information on policies and procedures regarding internal controls.

- Conduct extensive data analysis and detailed testing of transactions to determine the effectiveness of internal controls in protecting federal excise tax revenue.
- Review all excise tax returns filed during the audit period for proper calculation and timely reporting and payment of federal excise taxes.
- Test and trace data reported in monthly report filings to supporting daily records.
- Statistically select a sample of exports to determine whether they were properly documented according to regulations.

5.1.2 Findings. Findings of the audit can be divided into three types of issues:

(1) tax related;

(2) compliance related; and

(3) internal control.

The most frequent tax issue was inventory shortages requiring additional tax, and the least frequent issue was additional tax required by improper transfers in bond. When a physical inventory is taken, the auditees almost always are short of the amount in the books. The assumption is that if the physical inventory count is less than the book amount, inventory was removed and the removal should be taxable. Also, and issues occurring almost as frequently as inventory shortages is under or overpayment of tax, which the auditor discovers by comparing taxable removal records to tax returns. Late filing of tax returns is also a frequent issue. When merchandise is transferred between wineries, that have TTB permits or between one facility and another of the same winery, this is called transfers in bond because it is covered under the insurance (bond) program. Although documentation of bond to bond transfers is frequently weak (a compliance issue) usually the transfers are appropriate, so there are few findings in this area.

CFRs gives specific tax and non-tax requirements for enterprises under the jurisdiction of TTB. Failure to follow the regulations results in a compliance violation. Auditors list the non-tax compliance issues as compliance. The most frequent compliance issue is failure to update the Application to Establish and Operate Wine Premises (TTB form 5120.17) or Application for Operating Permit (TTB form 5110.25) for distilled spirits plants or Application for Amended Basic Permit Under Federal Alcohol Administration Act (TTB form 5100.24). Also, frequent compliance violations had to do with lack of certification "under penalty of perjury" of inventory and errors in recording excessive bulk wine losses. The smallest numbers of compliance violations were related to maintenance of breakage records and losses in transit.

During this period, the most frequent internal control weaknesses were lack of written policies and procedures including disaster recovery plans followed closely by lack of information system controls. The least frequent internal control weaknesses had to do with proper supervision and security of production equipment. Companies audited were generally small- to medium-sized businesses that did not feel written policies for personnel, production, inventory, etc. were important. Most agreed that a disaster recovery plan in case of natural disaster or emergency was important, but few prepared them. Information system control weaknesses included password construction (most frequent), physical security of

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PC server, monitoring by management of the computer department and computer security. Supervision was usually good and equipment security was generally adequate.

5.1.3 Reporting. TTB issues two reports that summarize and finalize their audits:

(1) a report to the taxpayer (auditee); and

(2) a report to TTB management.

These reports are indexed and cross-referenced by an independent TTB auditor who did not work on the audit.

After the workpapers are reviewed and approved by the AIC and the audit director (equivalent to a partner or director in a public account firm), a report is made to the auditee. This report, called the Management Letter or Taxpayer Letter, explains the tax, compliance and internal control issues discovered by the TTB auditor in their procedures, with reference to the applicable US Code (USC) and CFRs. The dollar amounts owed for tax (if any) are given. The internal control weaknesses are explained. The management of the company is given a specific time period to respond to the findings.

When the taxpayer has had time to respond and any response has been reviewed, the AIC will prepare the report to TTB top management, called the Audit Report. The Audit Report covers the same area as the Taxpayer Letter listing the tax and compliance issues discovered during the audit. The Audit Report also discusses the company background, the procedures that the auditors used and any communication received from the taxpayer in response to the Management Letter.

The procedure under the participant observation methodology is first to become socialized into an ongoing social system, like the TTB, to learn a set of roles and to form relationships. The next step is to make the implicit knowledge gathered as an observer in the system more explicit. The researcher constructs a partial understanding concerning various aspects of the system from recurrent themes that come to his or her attention and tests this understanding against a variety of data. The data can include what the researcher sees or reads, what others tell the researcher, how he or she reacts and how others react to challenges, concerns and questions (Baker, 1977).

In addition to observation and participation, the various audits resulted in the production of documents which were regularly prepared or examined by the researcher including:

- engagement letters;
- management letters; and
- Audit Reports (summarized above).

A sample list of these documents is show in Table II along with a comparison of these documents to similar documents in a Financial Statement Audit.

The documents prepared during an audit ultimately led to a determination regarding a tax or compliance violations. It was rare to find no compliance or tax violations, partially due to the generally poor quality of internal control design and implementation in the wine production industry. The lowest number of violations encountered was one compliance violation related to internal control. The majority of audits resulted in

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Type of evidence	Nature	Comparable evidence in an financial statement audit
Code of federal regulations	Legal document	SAS and PCAOB standards
Engagement letter	TTB document issued to auditee	Engagement letter
Audit plan	Internal TTB document	Audit plan
Management letter	TTB document issued to auditee	Management letter
Audit opinion	TTB document issued to auditee	Audit opinion, but addressee is not the shareholders
Auditee accounting and tax records	Auditee document	Client documents
Auditee legal formation documents	Auditee document	Client's legal documents
Auditee inventory and shipment records	Auditee document	Client's records
Physical observation of inventory	Auditee physical location	Physical inventory

Table II
Documentary evidence in a tax compliance audit

multiple findings and additional taxes and penalties, which were the primary source of the audit challenges observed.

6. Challenges faced by auditors in winery audits

In general, there are three situations which lead to challenges in a TTB audit:

(1) tax violations;

(2) compliance violations; and

(3) internal control deficiencies.

Tax violations include non-payment of the correct amount of taxes, late filing of the excise tax return, late payment of taxes due, incorrect data on the tax returns or not filing electronically if the winery is larger than a certain size. Compliance violations are those that do not conform to TTB regulations, as spelled out in the CFR – 27 CFR Title 24 for wineries, Title 28 for exportation and Title 19 for distilled spirits. Examples of compliance violations would include, for example, absence of documentation, lack of security, etc. Internal control issues, although not specified in the CFRs, are specified in Generally Accepted Government Auditing Standards (GAGAS) ("Yellow Book") published by the US Government Accountability Office (GAO, 2011) (Comptroller General of the USA, 2007). For example, the enterprise may have computer servers in an unsecured area or not change security access codes for employees who leave. The following sections will first discuss challenges arising during the course of an audit, second, challenges arising as a result of audit findings and finally challenges arising from increased penalties.

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6.1 Challenges arising during an audit

6.1.1 Issue 1: which auditors are assigned to which audits? The audit process begins during a joint planning meeting among all audit staff to discuss the priority audits for the year. This meeting takes place before the beginning of the fiscal year (October 1st). The Audit Director receives a list of audits furnished by the national office selected using a risk model. On the US west coast, the list is generally made up of wineries, distilled spirits plants, arms manufacturers and most recently, tobacco and alcohol import and export warehouses.

Audit plans are flexible documents that balance resources and priorities. The Audit Director provides the risk model, and based on that and other resources, the audits are selected with input from the district staff. The audit teams are changed annually and cross-trained to all industries served by TTB. Auditors are assigned by industry specialization and given the opportunity to audit different industries.

Before the AICs choose a specific audit, they will usually visit the TTB's online database and inquire about the companies by registration number to determine recent history, size, type of business organization, whether the entity is part of a "control group" (a subsidiary of another winery or TTB-regulated company), the outcome of prior audits, and other information that may be helpful. Audits may be initiated as a result of both internal referrals and external referrals from other state and federal agencies[1].

Thus, there is a process of negotiation between the Audit Director, the AICs and the staff auditors as to which audits will be selected and to which audits they will be assigned. The choice of assignments if often based on personal choice factors related to geography or type of audit entity. The Audit Director can resolve challenges, but typically these are resolved in a satisfactory manner among the AICs and the audit staff.

6.1.2 Issue 2: what type of records, where they are kept and for how long? What type of record?

Regulation 27 CFR 24.300 "General"[2] describes the type of records and the content of the records, but does describe the form.

General terms are used to describe the type of required records such as "wine transaction records", "commercial papers", "source records", "supplemental auxiliary records" and "other records". The regulation requires that a proprietor who conducts wine operations must maintain wine transaction records[3]. The regulation further states that any operation or transaction is to be entered into records or commercial papers. The winery must retain all source records and all supplemental or auxiliary records which support entries in other records or commercial papers.

The regulations specify what must be included in the transaction records. For example, regulation 27 CFR 24.310[4] says that the tax paid removal record (removal or sale of wine which is taxed) must show the date of removal, the name and address of the person to whom shipped and the volume, kind (class and type) and alcohol content of the wine. It further states than the volume of wine removed tax paid must be summarized daily by tax class in wine gallons to the nearest tenth of a gallon. The question is: what form should these records take? The form could be a sophisticated computerized accounting database, or data written on a scrap paper, which may create problems for the auditor.

The more challenging records for the auditor are the required daily summary of shipments for taxable removals. Most wineries have computerized accounting systems

and they do not usually print out daily summaries of shipments. The wineries print out or directly transfer to TTB forms any removals each tax period or monthly. Not only is this practice a violation of the regulation, but it creates audit problems in that when audit samples are taken, the sample covers a specific number of days. The bills of lading for a particular day are compared to the daily summaries to determine if all shipments were recorded and that the shipments were taxable or non-taxable.

A winery that does not keep daily summary records may print daily summaries when the auditor requests them, but the problem is that the summaries may have been adjusted to conform to invoices after the fact (possibly three years after the fact). The auditor is therefore forced to either accept the after-the-fact evidence or abandon the audit procedure. Accepting the after-the-fact summaries allows the auditor to complete one of the most important audit procedures – to verify if the tax is correct. Rejecting the summaries means that the auditor must use some alternative basis for determining removal, which is inevitably more difficult and time-consuming. Which choice the auditor makes depends on how much faith he or she has in the management of the company, prior audits, perceived revenue risk and the quality of internal controls.

The most common error is that the winery does not include on inventory summaries the required statement "under penalty of perjury" that the signatory has examined the inventory record and "to the best of their knowledge and belief, it is a true, correct and complete record". This statement must be signed and dated by an authorized representative, as required by 27 CFR 24.313[5]. This type of non-compliance occurred in 13 of the 27 audits. This error was so common that the auditors began to expect to see it. Generally, the staff auditor or the AIC explained to management what the situation was, showed them the CFR and suggested that the winery comply in the future. No winery was fined for this error alone.

In cases where a winery had never taken a physical inventory, there would be no inventory documentation. This would be one of several non-compliance issues which in the aggregate would cause a winery to be the subject of an adverse action which would result in an offer and compromise. Generally, winery management makes no objection to this requirement. Based on business history and the general consensus in the business environment, there is an expectation that a company to which inventory is material will conduct at least annual inventories. Furthermore, an annual physical inventory is required by the CFRs. In effect, the common business expectations and the requirements of CFRs acted together to reduce differences of opinion between the winery management and the auditor.

Several cases involved winery managers that were not able to locate or did not have the source documentation such as Bills of Lading, invoices, packing slips, etc. In these cases, the AIC discussed the issue with management and the management agreed to start keeping the proper documentation. Again, based on general business expectations and the auditors comments backed up by CFRs management understood that the lack of documents would create an audit issue.

How long are records to be kept? Wineries are required to retain all records of wine production at the winery for three years according to 27 CFR 24.300 "General"[6]. The regulation states that all prescribed returns, reports and records (including source records) will be retained by the proprietor for a period of not less than three years from the record date. This regulation is clear, but circumstances may occur such as transfer of ownership or consolidation of wineries so that even though the

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new owner retains the brand names of the wine and the registration number, the records may be lost. Technically the prior owners may be liable for an audit, and must have the records, and arguably, if a new owner takes the registration number, they become responsible for all past records. For practical purposes, however, the auditor may choose to audit only the records starting at the time the new owner took charge. Although there is an understanding that if an enterprise is taken over by another, past records will be essential, the takeover acts as an excuse permissible by similar business histories.

The author did not experience this situation during any audit, but through discussions with colleagues he heard a great deal of discussion about this topic. In addition, the auditor/researcher observed two instances where an audit was canceled and/or postponed for three years when it was learned that the winery had changed ownership.

Where must records be kept? The regulations do not specify where records should be kept. Regulation 27 CFR 24.300 allows data maintained on data processing equipment to be kept at a location other than the wine premises. However, records must be retrievable within five business days. Requested records may not be on hand at the main winery premises but in another location. If the other location is in another state or another country, this may cause a delay problem for the auditor.

To compensate for records not being located at the winery and delays in obtaining them, the AIC generally determines the records they will need in advance and requests those records from management in the engagement letter sent to management weeks before the audit starts. This typically solves the problem, but the auditor may face delays if they find they need additional records when the audit starts. Also, requesting the records in advance may give the winery an opportunity to change or modify specific records before the audit starts. Planning becomes an important part of the relationships between the auditor and management so that delays and difference of opinions may remain minimal, driving the audit process ahead.

6.1.3 Issue 3: what is a loss and what is a shortage? Sometimes the terms used in the CFRs are not fully understood or the criteria of interpretation may be unclear – for example, the terms “loss” and “shortage”. Wineries often confuse these terms, and 27 CFR 24.266 “Inventory losses” concerning allowable losses of bulk inventory is not precise regarding every situation. Precision in this definition is especially important because “shortages” are taxable whereas “losses” below a specified amount are not taxable. Losses in the TTB Glossary[7] are defined as “known quantities of a commodity lost due to breakage, casualty, or other unusual cause”. In other words, losses are generally due to error, mistakes and circumstances that are unexpected. A shortage is defined as “an unaccounted for discrepancy (missing quantity) […] disclosed by physical inventory”. A shortage is the difference between book inventory and physical count that is unaccounted for. Shortages are taxable because the assumption is if the items of inventory are not in the physical count, and they cannot be accounted for otherwise, the inventory must have been sold or removed from the premises. Losses and shortages must be reported by the wineries to TTB in their operations reports and tax reports. The winery may confuse these terms and report shortages as losses, thereby avoiding the tax, or losses as shortages, thereby erroneously increasing their tax burden.

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The definition of the amount of loss that is taxable comes from 27 CFR 24.266 "inventory losses"[8]. This section specifies that a loss determined in one of the following ways must be reported:

> […] the loss exceeds three per cent of the aggregate volume of wine on-hand at the beginning of the annual period and the volume of wine received in bond during the annual period; or the loss exceeds six per cent of the still wine produced by fermentation; or the loss exceeds six per cent of the sparkling wine produced by fermentation in bottles; or the loss exceeds three per cent of the special natural wine produced; or the loss exceeds three per cent of the artificially carbonated wine produced; or the loss exceeds three per cent of the bulk process sparkling wine produced.

Challenges arising from losses and shortages occurred in 6 of the 27 audits. In all of these audits, management indicated that they were unaware of the bulk wine loss regulation 27 CFR 24.266. If an analysis of excess bulk inventory losses reveals losses of over 6 per cent of fermentation production and losses over 3 per cent of inventory on hand annually, the winery would technically be out of compliance with the regulation because the limits as described in 27 CFR 24.266 were exceeded. However, at some wineries, the wine on hand and produced is not all sold as wine. In some winery operations a majority of the wine produced is used as distilling material which is reduced to alcohol and used to make brandy and other distilled spirits, which are exempted from this standard under 27 CFR 24.290[9]. The regulation states that still wine may be removed without payment of tax to the production facilities of a distilled spirits plant for use as distilling material. The volume of distilling material may be determined at either the bonded wine premises or the distilled spirits plant. In such cases, the question arises as to whether the wine under consideration was wine or a distilling material.

In resolving this type of issue, the Auditor in Charge first discusses the issue with TTB counsel, other more experienced auditors, and the Audit Director before determining whether the loss regulation applies and whether the loss constitutes a compliance violation. Resolving such issues takes the effort of many participants in the audit process, both at the national and local level, including:

- the auditor;
- winery management;
- legal counsel;
- TTB management; and
- other auditor-experts.

Such challenges often involve unique situations to which often none of the participants have previously been exposed. There is a necessity for communication and cooperation in the negotiation process, largely with a focus on the interpretation of the CFRs.

6.1.4 Issue 4: disposal of 100 per cent solids. Another example of how challenges regarding regulations may not be easily resolved has to do with the destruction of waste wine. Large wineries pump solids into settling ponds, which is a method used to recycle the byproducts of the wine production process. The solids have no sugar, no recyclable pumas, no alcohol and no nutrients. It is necessary, however, under TTB's destruction regulations for a winery to obtain permission from TTB to destroy the solid substances and to report such destruction to TTB on the "Report of Bonded Wine Premises" on the basis of actual wine content of the material.

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In rare cases where the permission and reporting requirements are not understood by the winery, winery management has argued that because there is no actual wine content in the "mud" of solids, the transfer to settling ponds should not be considered a destruction or loss. Based on consultation among AICs, the relevant Audit Directors, TTB legal counsel and the industry liaison to wineries, TTB's coordinated position has been that the solids are a byproduct of the wine making process and subject to the regulatory controls for destructions. The wineries noted above were cited with compliance violations and their management eventually agreed to notify TTB in future when solids were disposed of. Here, as with the situation described in Issue 2, above, interaction between many individuals was required to mediate the project.

6.1.5 Issue 5: what constitutes tax-free samples? Occasionally wineries will give away free samples of their product to customers or to corporate officers. In most cases, they are not required to pay a tax on these samples. Rules are different for breweries which are allowed to remove free samples of beer for personal or family use, including use at organized fairs, exhibitions or competitions, such as home brewing contests, tastings or judging[10], and on premises for employee consumption or tours. Any adult who operates a bonded wine premise as an individual owner or in partnership with others, may remove 100 gallons of wine per calendar year from the bonded wine premises tax free for personal or family use[11]. The wine removed cannot be sold, but there is otherwise no use restriction. The problem occurs in wineries where the winery is a corporation and does not qualify for any personal use removals or transfers to commercial customers for tasting.

Some wineries have sales managers who send sample bottles of wine to prospective customers around the country. On the books, the wineries record these as sales expenses. In such cases, tax should be paid on these shipments, but sometimes it is not. In such cases, the AIC brings the violation to the attention of the winery owner and the sales manager. Having been made aware of the violations, the owner and sales manager usually agree to pay tax on the samples in the future and they pay an estimated amount of tax and penalties on the "promotion samples" as an adjustment to the next excise tax report and the situation requires no further action. Even though management may have felt that they were acting in accordance within normal business customs, they acknowledged when given the explanation that the CFRs prohibition on giving samples to prospective customers are clear and overriding.

6.1.6 Issue 6: what constitutes material (reportable) non-compliance? The CFRs indicate that all tax violations are material and all tax violations that occur are reported in the audit workpapers of the TTB audits. Where the difference of opinion among auditors occurs is in regard to the materiality, or "reportability", of non-compliance. According the policies of TTB, all compliance violations are considered reportable except in rare circumstances. This judgment is not left to the AIC alone. Consistent application of the standards from audit to audit is one objective of each Audit Director. If there is a difference of opinion on the reportability of non-compliance, the Audit Director will act as arbiter.

In some audits, discussions arise between the staff auditor and the AIC regarding the need to report compliance issues. In one instance, a winery had some minor issues with compliance regarding a distillery. The AIC believed that this was not material because the winery had not used the still in several months and the distillation was primarily distilling of wine returned from the market. The issue was brought to the Audit Director

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who determined that based on a careful interpretation of the CFRs the issue should be reported. In another instance, the security of outdoor and indoor storage tanks was an issue. The staff auditor discussed this with the AIC who maintained that there were mitigating controls that served as adequate security. In that case, the issue was reported in the staff auditor's workpapers but not reported as an issue.

Materiality, which in the case of a government audit means reportability, is a crucial concept in the decision process of the various auditors, but the clear arbiter regarding questions of materiality is the Audit Director, who applies and interprets the CFRs. What is material in a governmental compliance audit is not within the purview of the AIC and when questions of reportability arise in the field, they are brought to the attention of the Audit Director.

In the case of materiality and reportability, the strictness of the CFRs leads to clear communication of standards.

6.2 Challenges related to findings in an audit. All of the audits in which the auditor/researcher participated resulted in findings of non-compliance and/or tax violations. Typically, tax violations resulted in dollar amounts of penalties that were not sufficiently large enough to be debilitating for the winery. Generally, there were no penalties assessed when a first-time audit revealed a compliance violation. Internal control deficiencies were mentioned in the Management Letter, but did not constitute a compliance violation under the CFRs. The CFRs define the parameters of the governmental tax compliance audit process; however, auditor/client negotiations and communications are defined not only by the CFRs but also the auditor's interpretation of the CFRs.

Violations are typically discovered during the course of an audit. The auditors inform auditee management as soon an issue is discovered, but only after assumptions, data and calculations have been validated. Auditors make sure that their findings are confirmed and that the CFRs have been consulted and re-read because the auditors do not want discuss what they thought was a violation with winery management, if the apparent finding was the result of a miscalculation or misinterpretation. The auditor also considers management's explanation of the finding, alternative interpretations and ways to resolve the issue in the future. Winery management usually accepts the finding or are willing to look into it. By the time the audit is complete, management is aware of all findings and has a good estimate of the costs in terms of added taxes or penalties. When the management of the winery receives the Management Letter after the audit is complete, the management is generally in agreement with the audit results. This is because all significant issues are fully confirmed within the TTB hierarchy and communicated to winery management before the audit results are issued. Thus, the process of communication and negotiation between the auditor and the auditee is based on transparency and clarity.

6.3 Challenges resulting from findings that leads to an "Adverse Action" or "Tax Resolution Case". In those instances in which taxes are assessed, the taxpayer may seek a "tax resolution" with the representatives of TTB. If there are several violations of the tax code, compliance issues are found or if suggestions from a prior audit have been ignored, the auditor may pursue an "adverse action" against the taxpayer's permit. Whether an adverse action is issued is determined by a formal process which includes consideration of the number of tax violations, compliance issues and cooperation of the taxpayer (the winery owner). An adverse action ranges from a warning letter, which

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puts the winery on notice that the it needs to put procedures in place to correct the problems, to dollar penalties (offers in compromise) or to suspension or revocation of the permit to manufacture and distribute wine. Offers in Compromise or actions to suspend or revoke the permit often take several months to resolve. The "adverse action" process has been streamlined recently and the length of time to complete the process has been shortened. If the auditee winery receives a notice of an adverse action other than a Warning Letter, they are requested to meet with TTB at the nearest TTB offices. Participants in the meeting are often the winery owner and management, winery legal counsel, the TTB Auditor, Audit Director and TTB legal counsel. The meeting generally results in a resolution. Examples of these types of challenges were found in 3 of the 27 audits which resulted in adverse actions. The adverse action network includes all of the participants in the audit: auditor, investigator, TTB administration, winery employees and management, TTB legal counsel and other outsiders like winery owners and the winery's legal counsel.

Three audits involving bonded wine warehouses (BWC) developed into tax resolution cases. BWCs hold wine in storage and ship the wine to customers of other, generally smaller, wineries. The BWCs must keep records, including inventory records for their client wineries. The small client wineries may qualify for a Small Producer Domestic Wine Producer's tax credit under 27 CFR 24.278[12]. If the small producers meet the requirements, they can qualify for a tax credit of $0.90 on their first 100,000 gallons of wine, which decreases gradually until a 250,000 gallon production limit, when the credit disappears. Under certain conditions the credit is transferable to the BWC that ships the wine to customers. Two violations can exist here:

(1) inventory records are inadequate; and
(2) the BWC takes the tax credit when the client winery does not meet the requirements of the CFR.

In the challenges observed in the tax resolution BWC audits, the BWCs were assessed a tax and fine for the credit which they took, to which they were not entitled, and a warning letter and/or additional penalties for tax and compliance violations (such as improper records and reporting). Penalties are calculated and set by the National Revenue Center of TTB. In cases where the taxes and penalties assessed are contested in a hearing, the hearing is attended by the auditor, the taxpayer, the Audit Director, legal counsel and a national representative of TTB. In virtually all cases, an offer in compromise is negotiated and the matter is resolved.

Several adverse action cases involved individual wineries that received adverse action "warning letters", which is a letter that puts them on notice that they have very serious violations but that no penalties or actions to suspend their license would be imposed at that time. In some cases, where wineries had numerous compliance violations and owed taxes and penalties, they paid their penalties as soon as they learned the amount during the audit. This can often be the case where a winery is new and very small, has had no experience with TTB, and has no employee or management personnel who understand the regulations. In other cases, wineries have been given warning letters because none of the recommendations from the prior audits have been implemented. In such cases, the auditor determined that a warning letter was justified as considerable effort had been made during the prior audit to help the winery understand the audit process and what was required of them by TTB.

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7. Discussion

Our research question addressed the issue of whether a participant observation research approach can provide insights into the auditor/client negotiation and communication process in relation to auditing challenges in governmental tax compliance audits. We believe that observation of the most frequent and difficult issues in an audit on a systematic basis including documenting contentious issues provides insights into what an auditor might expect when they go on an audit of a similar company in the same industry. Knowing what type of issues are likely to occur and knowledge of how they might "play out" in terms of the component actors – auditee, government audit supervisor, legal department – makes the auditor's job of planning more efficient because he or she can design the audit program to quickly locate and resolve the issues.

The impact of this study on practice may be seen by comparing what is done in government audit to what would be done by an independent auditor. Based on the participant observation experience of the auditor/researcher obtained in this study, resolving auditing challenges differs in a governmental tax compliance audit as compared with an external audit in a number of ways.

- The auditee is the client of the auditor in an external audit of financial statements, whereas the auditee in a government tax compliance audit is the taxpayer winery. This difference in role and status is of fundamental importance.
- In a governmental tax compliance audit, audit risk is established with a national focus, whereas the audit risk in an external audit of financial statements is determined locally by audit partners and managers.
- Government auditors follow government regulations (CFR and USC) as the basis for making decisions regarding compliance, whereas independent public accountants reference Generally Accepted Accounting Practices of the USA (US GAAP) or International Financial Reporting Standards (IFRS).
- Government auditors follow GAGAS, whereas independent external auditors use US Generally Accepted Audit Standards (US GAAS), Public Company Accounting Oversight Board (PCAOB) standards or International Standards on Auditing (ISA).
- Government auditors in the field have less discretion regarding audit procedures and materiality than external auditors. Materiality is based on professional judgment by the audit partner for independent external audits. Materiality for the government auditor is defined as any violation of the CFRs or USC.

7.1 The auditee is the client of the independent external auditor, whereas the auditee is the taxpayer in government audit

The role of the auditee in relation to the auditor differs in fundamental ways between governmental and financial statement auditors. The most important difference is the perceived independence of the auditors. In a governmental tax compliance audit, the auditee is the taxpayer. Government auditors are perceived by the US public as being independent from the taxpayer. The auditee does not pay the auditor and the auditor does not have to bid for their business. The funds collected by additional penalties and interest as a result of the audit are not added to TTB's funding, but rather provide funds to the US Treasury. The taxpayer auditee has no say regarding which audit team visits them or when. Auditing and assuring compliance with regulations (CFR and USC) and

the Internal Revenue Code is the only job of the government auditing organization. Although auditors may offer advice, there is no consulting or other paid service available from the government auditor. The auditee may dispute the government auditor's opinion or assessment after the auditor has given his opinion to the agency. The auditee cannot change auditors. A taxpayer is rarely audited twice by the same audit team, and in fact this is generally discouraged by policy.

The audit participants' expectations during a government audit and a private audit are quite different based on these different organization's objectives and history. In addition to the staff auditors and company management, which are the same for both private and government audits, participants in the governmental tax compliance audit include national management, a national public agency, the US legislative and sometimes executive branches of government, and by extension, the American public. These uniquely governmental actors have a higher expectation of auditor independence.

7.2 Differences in the way audits are chosen

Governmental tax compliance audits are chosen by a national office based on various criteria. The determination of which audit a government auditor undertakes is not up to the auditee. The Risk Management Branch, a segment of TTB's Intelligence Division, annually prepares a list of audits based on a mix of targeting models, statistical sampling selections, local office selections, internal and external referrals. All of TTB's regional tax audit division offices select from that list. Further refinement is made at each office level with input from the staff, utilizing their field experience and knowledge of previous audits and information gathered from years of auditing. Once the audit has been selected, the government auditor, like an external auditor, investigates the background of the auditee, makes sure the audit team has no ethical conflicts, selects staff and communicates with the predecessor auditor – even though that auditor is in the same government organization. No outside experts are contemplated. The engagement letter of the government auditor is in the form of an announcement that the auditor will come to the auditee premises and a request for information. It is not a contract between the auditee and the auditor like the independent public accountant's engagement letter. The government engagement letter does not discuss the responsibilities of the auditor and management. TTB does not seek to increase the number of audits it performs. On the contrary, TTB prefers to educate the taxpayer to comply with regulations so they can reduce the number of audits required.

7.3 Government auditors refer to government regulations (CFRs and USC) as the criteria for compliance, whereas public accountants refer to US GAAP or IFRS

One obvious difference between independent external auditors and government auditors are the criteria on which they base compliance. Financial statement audits by external public accountants have as their criteria US GAAP or IFRS. The government auditor bases compliance on the US CFRs or the USC. CFRs and USCs are very extensive and generally very specific. These regulations are not generally taught in the universities, so they have to be learned after one becomes a governmental auditor.

The auditor's objectives in a compliance audit are to obtain sufficient appropriate audit evidence to form an opinion and report at the level specified in the governmental audit requirement on whether the entity complied in all material respects with the applicable requirements, to identify audit and reporting requirements specified in the

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governmental audit requirements, and perform procedures to address those requirements[13].

7.4 Government auditors use GAGAS, whereas independent external auditors use US GAAS, PCAOB standards or ISA

An external audit means, according to PCAOB, an examination of the financial statements of (a corporation) by an independent public accounting firm in accordance with the rules of the (PCAOB) for the purpose of expressing an opinion[14]. In contrast, government auditors are required to follow GAGAS and should follow all applicable GAGAS requirements and should refer to compliance with GAGAS[15]. Government auditors have a responsibility to consider the entire text of GAGAS in carrying out their work and in understanding and applying the professional requirements in GAGAS[16].

GAGAS encompasses the field work, reporting and general standards pursuant to US GAAS, but also includes additional government standards. Fieldwork additions to GAGAS include materiality guidelines in GAGAS financial audits, consideration of fraud and illegal acts and ongoing investigations or legal proceedings[17]. GAGAS additions to US GAAS in the area of reporting standards include:

- reporting on internal control and compliance with laws, regulations, and provisions of contracts or grant agreements;
- reporting deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse;
- reporting views of responsible officials;
- reporting confidential or sensitive information; and
- distributing reports.

7.5 Government auditors in the field have less discretion regarding audit procedures and materiality than independent external auditors

Generally, the engagement partner in charge of an independent external audit sets materiality using his or her professional judgment. If there is a question of materiality during the field work, it is brought to the partner in charge or perhaps a technical partner to make the decision. In government auditing, the materiality decisions are made by the auditor in the field based on the CFRs, USC and circumstances of that particular audit.

Government auditors have a set of criteria (CFRs and USC) to which the auditee must comply. In theory, if the evidence shows that the auditee is not complying with the criteria, the auditee is in violation of their required minimum standards. One could easily see the problems that could be created by a "rogue auditor" making materiality decisions in the field. For instance, if the prior auditor considered a compliance violation to be immaterial and informs taxpayer's management, management believes that this will always be the case and does not correct the infraction of the regulation. The next audit team, who treat all violations of the criteria as material, may find that that same non-compliance is material and this creates conflict between the new auditor and management. The concepts of materiality are also different. The determination of materiality judgments in a financial statement audit is made by the engagement partner. The determination of materiality for the government auditor is compliance with criteria such as the CFRs and USC.

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8. Conclusion

This paper has focused on challenges faced by auditors when engaged in legally mandated audits of federally regulated wineries in the USA. The evidence for this paper was gathered during a participant observation study conducted by the primary researcher over a period of six years while working as an auditor for the TTB of the US Department of Treasury. Care has been taken not to disclose any taxpayer information because this would constitute a violation of Section 6103 of the Internal Revenue Code. Due to the difficulty of obtaining access to actual audits, very little prior research in auditing has been conducted using participant observation as a research methodology. The paper has been reviewed by the auditor/researcher's superiors from both ethical and legal perspectives. However, auditees and colleagues of the auditor/researcher were not aware of the research.

This paper has discussed various challenges faced by government auditors and how these challenges were resolved. The path to resolution was not always clearly marked. Resolution depended a great deal on the individual auditor's judgment, interpretation of the CFRs and the willingness of the auditee to change the methods and techniques they use in operating and reporting wine operations. Materiality was determined by compliance with the regulation criteria (CFRs and USC) – any non-compliance was considered to be material. Resolution of many of the challenges resulted in an increased payments of excise taxes or penalties by the auditee entities. In other cases, the audit agency allowed the auditees to agree to change or amend their practices to correct a violation or a lack of compliance with US federal government regulations. As such, while the difference in the role and status of the government tax compliance auditor as compared with the independent external auditor did not necessarily lead to a different set of audit procedures, the pattern of communications between the auditor and the auditee in a government tax compliance audit were quite different from an external audit of financial statements. The government tax compliance environment is often more complex, but the auditor may draw on a number of sources of knowledge and communication: CFRs, USC, GAGAS, national audit planning, national experts, winery management, local peers, local government supervision, legal counsel and other auditors.

Various limitations of this study should be acknowledged, including those common to all qualitative research involving lack of replicability and generalizability. In addition, due to restriction imposed by the federal law, the specifics of the audit engagements could not be disclosed. Going forward, more research involving communication, negotiation and the differences between independent public accountants and governmental auditors is called for. International comparisons would also contribute to our understanding.

Notes

1. Issues 2 through 6 are common tax and compliance issues that are often found in TTB audits. A tutorial was created and placed on the TTB Web site to help industry members understand how to avoid these problems. available at: http://ttb.gov/main_pages/tutorials_and_resources.shtml
2. 27 CFR 24.300 "General" available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=506cf0c03546efff958847134c5527d3&rgn=div5&view=text&node=27:1.0.1.1.19&idno=27#27:1.0.1.1.19.15.349.1

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3. 27 CFR 24.300 "General", paragraph (a) available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=506cf0c03546efff958847134c5527d3&rgn=div5&view=text&node=27:1.0.1.1.19&idno=27#27:1.0.1.1.19.15.349.1
4. 27 CFR 24.310 Taxpaid removals from bond record available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=506cf0c03546efff958847134c5527d3&rgn=div5&view=text&node=27:1.0.1.1.19&idno=27#27:1.0.1.1.19.15.349.11
5. 27 CFR 24.313. "Inventory Record" available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=506cf0c03546efff958847134c5527d3&rgn=div5&view=text&node=27:1.0.1.1.19&idno=27#27:1.0.1.1.19.15.349.14
6. Ibid. 27 CFR 24.300.
7. TTB Glossary available at: www.ttb.gov/forms_tutorials/glossary/glossary.html[8] 27 CFR 24.266 "Inventory Losses" available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=184c5b1f3ab328612cdf791374447112;rgn=div5;view=text;node=27%3A1.0.1.1.19;idno=27;cc=ecfr#27:1.0.1.1.19.13.344.2
8. 27 CFR 24.290 "Removal of wine as distilling material" available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=506cf0c03546efff958847134c5527d3&rgn=div5&view=text&node=27:1.0.1.1.19&idno=27#27:1.0.1.1.19.14.346.16
9. 27 CFR § 25.206 Removal of beer available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=2f73635f798ed90d4d53266d514dd80c;rgn=div5;view=text;node=27%3A1.0.1.1.20;idno=27;cc=ecfr#27:1.0.1.1.20.12.390.14
10. 27 CFR 24.75 Wine for personal or family use available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=184c5b1f3ab328612cdf791374447112;rgn=div5;view=text;node=27%3A1.0.1.1.19;idno=27;cc=ecfr#27:1.0.1.1.19.3.332.35
11. 27 CFR 24,278 "Tax credit for certain small domestic producers." available at: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=184c5b1f3ab328612cdf791374447112;rgn=div5;view=text;node=27%3A1.0.1.1.19;idno=27;cc=ecfr#27:1.0.1.1.19.14.344.9
12. AICPA. 2010. AU Section 801 "Compliance Audits", paragraph 10. AICPA.
13. PCAOB. 2011. Rule 1001. Definitions of Terms Employed in Rules. Public Company Accounting Oversight Board.
14. Government Accountability Office, 2007, *Government Auditing Standards*, Comptroller General of the United States paragraph 1.11.
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