



GARLAND

INTERNAL AUDIT

Sales Tax Compliance

Craig Hametner, CPA, CIA, CISA, CMA, CFE
City Auditor

Prepared By

Marla Hamilton, Staff Auditor

Reviewed By

Jed Johnson, CGAP, Assistant City Auditor

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Authorization

We have conducted an audit of the Sales Tax Compliance. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objectives

1. Assess the Parks, Recreation, and Cultural Arts Department (PRCAD) and Firewheel Golf Park's (FGP) compliance with States Sales Tax laws regarding concession sales and equipment rental.
2. Determine the reliability of Computer Generated Data.
3. Follow-up on 2011 State Audit Findings regarding Utilities & Sanitation, PRCAD and FGP.

Scope and Methodology

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit period covered Fiscal year 2012.

In order to meet the audit objectives and to describe the scope of our work on internal controls, we performed the following:

- Obtained and reviewed the Texas Administrative Code and Texas Tax Code to gain an understanding of Texas Sales and Use Tax for audit purposes (Obj. 1, 3).
- Obtained and reviewed Policies and procedures from the Granville Arts Center, Plaza, Atrium and the Recreation Division to gain and understanding for audit purposes (Obj. 1).
- Obtained and reviewed the 2011 State Audit Report to determine areas of follow-up and review. (Obj. 3)
- Obtained and reviewed Equipment, food and product list from the PRCAD to review for proper sales tax classification (Obj. 1).
- Reviewed equipment, food and products list from the PRCAD to ensure items listed were present and accountable (Obj. 1).
- Obtained and reviewed equipment, food and product lists from the FGP to review for proper sales tax classification as a follow-up to State Audit Findings (Obj. 3).
- Sampled contracts (see Exhibit A) for events held at the Granville Arts Center, Plaza and Atrium for exempt entities to determine if appropriate Tax exempt certificates were on file (Obj. 1).
- Reviewed Tax exempt certificates for exempt entities receiving tax exempt status in the Utility Billing System to ensure that the certificate was on file and appropriately signed as a follow-up to State Audit Findings (Obj. 3).

- Reviewed formulas listed in spreadsheets used by the Granville Arts Center to report sales tax collected on equipment rented during contracted events to ensure appropriate calculation and recording of sales tax (Obj. 2).
- Reviewed formulas listed in the Sales Tax Return reports processed by the Finance Department to ensure appropriate calculation of sales tax reported to the State (Obj. 2).
- Reviewed deposits processed by the Granville Arts Center, Plaza and Atrium to ensure they are properly reviewed (Obj. 1).
- Determined the reliability of computer generated data as follows:
 - CLASS Point of Sales (POS) system utilized by PRCAD to ensure the system properly calculates sales tax (Obj. 2).
 - Interface between the CLASS POS and Cayenta Finance System to ensure the systems were communicating appropriately (Obj. 2).
 - FASTBOOK Booking software utilized by the Granville Arts Center to ensure completeness and integrity of data (Obj. 2).
 - Intermediary software used by Internal Audit to ensure accuracy of data collected for review (Obj. 2).

In our assessment of the reliability of computer generated data from CLASS POS, FASTBOOK and the intermediary software, we (1) performed electronic testing of required data elements, (2) reviewed existing information about the data and the system that produced them, and (3) interviewed agency officials knowledgeable about the data and (4) reconciled data between systems. From this assessment, we determined that the data from CLASS POS systems and software discussed were sufficiently reliable for the purposes of this report. However, we determined that FASTBOOK data could be deleted by users and testing was performed in the production environment rather than in a testing environment.

Garland Foundation for Development sales tax reports to the State were not included in the scope of this audit. These reports will be included in the Firewheel Internal Controls Audit.

Overall Conclusion

In our review of compliance with State Tax Laws, we found that the PRCAD and FGP were in compliance with the majority of the State Sales Tax laws regarding product and concession sales, and equipment rental. However, we noted areas for improvement as follows (Obj. 1):

- PRCAD and FGP should ensure that items listed in their point of sales systems are properly defined for taxing purposes.
- The Granville Arts Center, the Atrium and the Plaza should obtain the appropriate signed Texas State Sales Tax Exemption Certificates to justify those entities that are not charged sales tax for equipment rental.
- Inventory records should be retained and training should be conducted on the CLASS POS inventory module.

In our review of the reliability of computer generated data we noted areas for improvement regarding limiting FASTBOOK users' access to prevent deletion of events in the system and testing should be completed in a testing environment rather than in the production environment (Obj. 2).

In addition, our follow-up review of the 2011 State Audit findings revealed that the City implemented appropriate corrections required by the State of Texas (Obj. 3).

Background

The State of Texas imposes sales and use tax on all retail sales, leases and rentals of most goods and services. Texas cities, counties, transit authorities and special purpose districts have the option of imposing an additional local sales tax for a combined total of state and local taxes of 8-1/4% (.0825). An item is taxable if it is considered to be tangible personal property or a food item that is prepared for immediate consumption by a consumer.

The City of Garland is required by the State of Texas to collect sales tax on goods and services provided to taxable entities and individuals. Sales Tax is collected by various departments throughout the City including the Parks and Recreations Department, Granville Arts Center, and Firewheel Golf Park. In order for an entity to be exempted from sales tax, it must provide the appropriate signed Texas State Sales Tax Exemption Certificate.

In the beginning of Fiscal 2012, the City was audited for compliance by the State of Texas in three specific areas: Utilities, Sanitation, and Misc.; Equipment Rental; and the Golf Course. The State found that the City owed a total combined amount of \$104,768.11 for the period of October 1, 2007 through February 28, 2011 which included penalty and interest. The State Audit found that the City was not collecting the appropriate signed Texas State Sales Tax Exemptions Certificates which allows for a sales tax exemption by entities or individuals.

Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

Finding #1 (Obj. 1)

Condition (The way it is)

The PRCAD and FGP both utilize a point of sale (POS) system to process purchases. In these POS systems, both PRCAD and FGP can code items for sale as taxable or non-taxable. If taxable, the system will automatically assess the appropriate amount of tax. The following table shows the number of items reviewed and the resulting errors in items found:

	PRCAD	FGP
No. of Items Reviewed	291	714
No. of Items that should be taxed, but were not.	36	8
No. of items that should not be taxed, but are currently taxed.	2	3

Source: PRCAD and FGP POS (Audited)

Criteria (The way it should be)

The State of Texas imposes sales and use tax on all retail sales, leases and rentals of most goods and services. An item is taxable if it is considered to be tangible personal property or a food item that is prepared for immediate consumption by a consumer (Texas State Tax Code, Title 2, Subtitle E, Chapter 151, Sec. 151.009 – Tangible Personal Property and Sec. 151.314 – Food and Food Products).

Effect (So what?)

Listing taxable items incorrectly could prevent PRCAD and FGP from collecting and remitting the appropriate amount of sales tax and potentially result in State Sales Tax Penalties and Interest.

Listing non-taxable items as taxable increases product cost for consumers and causes the City to remit unnecessary sales taxes.

Cause (Difference between condition & criteria)

Appropriate review of State Law was not conducted prior to defining these items in the POS systems.

Recommendation

Management should conduct a periodic review of Texas State Tax Code to ensure

that taxable items are listed and that items are defined in the POS system correctly.

Note: Internal Audit provided a list of the errors to Management for their review and correction.

Management Response

Concur

Action Plan

PRCAD - Department immediately modify accounts within CLASS.

Firewheel –

Management is extremely grateful for the excellent work completed by the Internal Audit Department regarding sales tax compliance. State sales tax regulations can often be difficult to interpret and apply, particularly when the seller is a non-profit organization such as the City. While applying sales tax regulations are often difficult, the penalties for non-compliance can be material. The auditing methods used by the State of Texas are particularly punishing even for the smallest oversight. To my knowledge, this is the first City-wide review of our sales tax procedures and it will be extremely beneficial in aiding departments navigate the often confusing compliance issues. I would like to suggest that this audit be repeated every three years to ensure that compliance is maintained.

Implementation Date

7/3/13

Finding #2 (Obj. 1)

Condition (The way it is)

According to the Texas State Comptroller's office, entities may not receive a sales tax exemption unless the appropriate signed Texas Sales Tax Exemption Certificate form is collected. The Granville Arts Center, Atrium and Plaza accepts the Internal Revenue Service letter showing an entity's 501(c)(3) exemption and provides the entity with a sales tax exemption.

In a review of 23 entities claiming a tax exempt status and serviced by the Granville Arts Center, the Atrium or the Plaza, we found that 12 submitted a letter from the Internal Revenue Service exempting them from income taxes rather than providing the proper signed Texas Sales Tax Exemption Certificate. (See Exhibit A for Sampling Methodology.)

Criteria (The way it should be)

According to the State Comptroller's office, entities must submit a signed Texas Sales Tax Exempt Certificate to be exempted from sales tax on purchases. The Internal Revenue Service Form provided by the entities exempts them from federal income tax. (Texas Administrative Code, Title 34, Part I, Chapter 3, Subchapter O, Rule §3.287 - Exemption Certificates)

Effect (So what?)

By not collecting the appropriate form, the City may not be in compliance with State Law. As such, the City could be subject to State penalties and interest.

Cause (Difference between condition & criteria)

A lack of management oversight regarding the use of the current jurisdiction form.

Recommendation

Management should ensure that entities claiming a tax exempt status provide the City with the appropriately signed Texas State Sales Tax Exemption Form before allowing an exemption.

Note: Upon notification, Granville Arts Center management immediately responded and assured us that they would collect the appropriate forms.

Management Response

Concur

Action Plan

We are now in compliance with the procedures requested for tax records. All the 2013 contracts have been reviewed to make sure we have tax exempt forms on hand, plus the non-profit paperwork for each contract.

Implementation Date

7/3/13

Additional Considerations

1. Surf and Swim Inventory Records –

In order to determine if Surf and Swim products listed by the CLASS system were valid for sales tax purposes, Internal Audit performed a physical review of the inventory at Surf and Swim. At our review, we found that Surf and Swim tracks inventory manually using a form completed daily by employees and Surf and Swim did not keep the manual inventory records from year to year. In addition, inventory was never properly updated into the CLASS system. Upon notification of this condition to management, it was determined that management did not train a backup individual or assign accountability and responsibility for this function.

Management should consider ensuring:

- That staff is trained and appropriately assigned for this function.
- The records are maintained for three years according to the Texas State Library and Archives Commission (GR1025-05c).

Management Response: Concur. Business Manager has scheduled a time with the Aquatic Manager for training.

Implementation: 9/20/2013

2. FASTBook Event Booking Software –

Internal Audit reviewed events booked in FASTBook to ensure that the City captured the sales tax on all events with equipment charges. As part of our review, we performed a gap analysis on the event numbers listed in FASTBook. From our analysis, we determined that there were 56 gaps. Our inquiry revealed that these gaps were created because users of the software have the capabilities to delete events from the system. In addition, users were requested to create and delete dummy events in the system.

We contacted the company that created the software and found that a report can be generated in FASTBook to show all events that were deleted using the supervisory login ID owned by the IT Department. Upon review of this report, we found that the deleted events were listed. We did no further examination of the events listed in this report.

Management should consider obtaining and reviewing this report periodically to ensure that events are not created and deleted outside of management's knowledge.

Management Response: Concur. Department will talk with IT about developing a test system and request quarterly reports to review any deleted booking.

Implementation: 7/29/2013

Exhibit A

Sampling Methodology

Granville Arts Center, the Atrium and the Plaza Sampling (Obj. 1, Finding 2)

From the 10 months of tax reports provided by the Granville Arts Center, the Atrium and the Plaza, we reviewed the reports for entities that were not charged sales tax. Of the 237 events that occurred during the audit period. We judgmentally select 23 (10% of the total population) to review the tax exempt documentation on file. Our judgmental sample was based on if the entity was not charged tax during the reported periods. We, then, reviewed the sales tax exempt certificates to determine if the certificates were on file and signed by the entity. We found that 12 out of 23 (or approximately 52% of the sampled population) provided the Internal Revenue Service's letter confirming their status as a 501(c)(3) entity. The Internal Revenue Service letter only exempts the entity from income tax. In order to be exempt from sales tax, the entity must provide the appropriately signed Texas State Sales Tax Exemption Certificate form. We could not project the results onto the entire population because not all of the 237 events that were reported were tax exempt.