



presents

Managing Sales Tax Audits - The Auditors Speak

State Revenue Officials Share Insights for

Removing the Agony From Audits

A Live 100-Minute Audio Conference with Interactive Q&A

Today's panel features:

Jim McGrady, Senior Revenue Consultant, **Florida Revenue Department**, Tallahassee, Fla.

Rich Unen, Process Group Manager, **Florida Revenue Department**, Tallahassee, Fla.

Vicki Gibbons, Audit Bureau Director, **Wisconsin Revenue Department**, Madison, Wis.

Isaac Torres, Auditor, **Texas Comptroller of Public Accounts**, Austin, Texas

Jim Kuhl, Supervising Tax Auditor 3, **California Board of Equalization**, Sacramento, Calif.

Wednesday, June 10, 2009

The conference begins at:

1 pm Eastern

12 pm Central

11 am Mountain

10 am Pacific

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Program Outline

Managing Sales Tax Audits - The Auditors Speak Teleconference

June 10, 2009

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Program Agenda

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Richard Unen/Jim McGrady, Florida Revenue Department	
Procedural Aspects Of The Audit.....	Pages 6-7
Isaac Torres, Texas Comptroller of Public Accounts	
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Vicki Gibbons, Wisconsin Revenue Department	
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James Kuhl, California State Board of Equalization	

I. Preparation For The Audit

A. States' procedures for assigning auditors

- 1) Auditing experience
 - a) Experience with the DOR
 - i. Tax auditor levels (I, II, III, & IV)
 - b) Knowledge of a specific industry
 - i. Utilizing an auditors' past auditing experience in specific industries
 - (a) Inexperienced auditors assist experienced auditors
 - c) Audit type
 - i. Bankruptcy, refund verification, transfer liability
2. Taxpayer's size and activity in the state
 - a) No locations vs. multiple locations
 - b) Materiality of activity
 - i. Dollar amount of sales, purchases, etc.
 - c) Organizational structure
 - i. Divisions, subsidiaries, etc.
 - ii. Complexity of potential issues

B. Scope of auditor's pre-audit research

1. Research DOR internal databases
 - a) SAP
 - b) Secretary of State information
2. Research information available through the Internet
 - a) Taxpayer's Web site

- b) Search engines
- 3. Third party information
 - a) Federal information
 - b) Other states
- 4. Review prior audits and results
 - a) Issues addressed
 - b) Records used
 - c) Procedures utilized
 - d) Budgeted hours
- 5. Examine and analyze sales and use tax returns
 - a) Taxable/exempt sales ratio
 - b) Effective tax rate
 - c) Use tax remittances
 - d) Filing irregularities
 - e) Credits
- 6. Research statutes and rules for specific industries
 - a) Statutes and rules
 - b) Standard industry guide
 - c) Legal research
 - d) Technical assistance advisements
 - e) Audit plan

C. The pre-audit meeting

- 1. Contact information

2. Confirmation of key data
 - a) Name, address and FEI number
 - b) Verify ownership and legal entity
3. Organizational structure and related entities
4. Verify location of books and records
5. Format of books and records i.e. – hard copy vs. electronic, or combination of two
 - a) Policy of copying records
6. Florida business activities and locations
7. Records to be utilized and their availability

II. Auditor's Expectations For Conduct Of The Audit

- A. What to expect from initial contact with the auditor
 1. Accounting policies and procedures
 2. Controls and taxing decisions
 3. Records used to prepare tax returns
 4. Record availability
 - a) Control records
 - b) Electronic records
 5. Taxpayer's bill of rights
 6. Sampling techniques
 - a) Statistical sampling
 - b) Non-statistical sampling
 - c) Judgmental sampling

7. Internal controls
8. Timeframes and timelines for conduct of audit

B. Preparation for the opening conference

1. Adequate office or workspace
2. Records discussed for fieldwork should be available at workspace
3. Who will be assisting/meeting with the auditor
4. Provide brief explanation of company's business
5. Discussion with person(s) responsible for preparing returns
6. Turnaround times for any additional record requests

C. Comments from other panelists

1. Vicki Gibbons, Wisconsin Revenue Department

III. Procedural Aspects Of The Audit

A. Most common mistakes in audit samples

1. Certificates are a large portion of errors in detail and sample audits. There are various errors that can be attributed to certificates, both resale and exemption
2. Missing invoices can affect both sales and purchase audits. The invoices are required to prove the contention that the items were either taxable or nontaxable
3. Missing documentation can also result in errors: missing work papers that show why a credit was taken could result in a denial of the credit taken

B. Reconciliations

1. Gross sales are reconciled against various records: federal income tax returns, bank statements, profit and loss statement are a few examples
2. Sales tax is reconciled against the tax collected, usually a sales tax accrual account or a sales tax account

C. Review of transactions

1. Depending on the size of records or the number of customers, a detail audit is used to review the records for the audit. These audits are generally small audits with few issues and/or customers
2. Another method used to complete more complex and voluminous audits is sampling. Sampling is utilized when performing a detail audit would be impractical
 - a) Transaction sample - Dollar stratified samples are computer generated samples utilizing software that stratifies the different dollar amounts and groups them accordingly. The dollar stratified samples are used when there is a large volume of transactions
 - b) Transaction sample – Manual transaction sampling is used when certain records/transactions are selected randomly by using invoice numbers, check numbers, batch numbers, page/line numbers, etc. It is recommended when the computed minimum sample size is less than 1,000 transactions
 - c) Cluster sampling - Cluster samples consist of blocks of contiguous items within a population. Cluster sampling should be used for samples larger than 1,000 transactions

d) Time period sampling - Time periods are clusters of uneven size containing hundreds or thousands of transactions with varying dollar amounts. It is mainly used when other sampling methods are not feasible

D. Comments from other panelists

1) Jim McGrady and Richard Unen, Florida Revenue Department

IV. Alternatives To Conventional Audit Process

A. Managed audit program

1. General information

- a) A contract between DOR and your business
- b) Timeline outlining activities and expected completion dates
- c) Allows taxpayer to perform some, or all, of the audit functions
- d) Specific written instructions provided
- e) Assistance provided throughout the course of the audit
- f) Review by DOR

2. Benefits

- a) Better understanding of how tax laws apply to your business activity
- b) Less disruptive to your regular business operations
- c) In exchange for your time, states may waive certain charges (e.g., penalties, portion of interest)

3. Qualification

- a) DOR generally determines who may participate
- b) Generally less complex businesses
- c) History of compliance
- d) Availability of the taxpayer's records

4. Example: Wisconsin has used the managed audit for specific industries. A publication is drafted and checklists provided on taxability to make the process easier for a taxpayer

5. States with formal managed audit programs (list is not all-inclusive)

- a) Arizona

<http://www.azdor.gov/Audit/Managedaudit/Managed Audit Procedures.pdf>

b) California

<http://www.boe.ca.gov/pdf/pub53.pdf>

c) Colorado

<http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1191399127088&ssbinary=true>

d) Connecticut

<http://www.ct.gov/drs/lib/drs/publications/pubsip/2004/ip04-11.pdf>

e) Georgia

<https://etax.dor.ga.gov/compliance/managedauditprogram.aspx>

f) New Mexico

<http://www.tax.state.nm.us/pubs/FYI-404.pdf>

g) Texas

http://www.window.state.tx.us/taxinfo/map/map_tp.htm

h) Washington

http://dor.wa.gov/content/DoingBusiness/Audits/doingBus_MgdAudit.aspx

B. Formula use tax reporting

1. General information

- a) A formula is created giving a single taxable percentage (STP). Generally, the primary component of the STP will be derived from a statistical sample of taxpayer purchases
- b) More than one taxable percentage may be used if both the taxpayer and DOR agree it is necessary
- c) May be based on an audit already performed
- d) Certain categories of accounts may be excluded from formula reporting
- e) The STP must be adjusted by taxpayer if changes in law, business operations, etc., significantly affect the formula accuracy

- f) An audit may be done after the formula reporting method is used by taxpayer for a specified period of time
- g) The purpose of the audit is to test the accuracy of the formula reporting method used by taxpayer. The audit will result in a redetermination of the STP
- h) A higher STP will result in an assessment and a lower STP will result in a refund. The initial field audit period is generally four years after the formula reporting method has begun

2. Benefits

- a) Makes it easier on taxpayers to calculate use tax

3. Qualifications

- a) DOR approval generally required
- b) A direct pay permit may be required for the periods used for formula use tax reporting

C. Projecting forward audit findings

1. General information

- a) Results from an audit to be completed are projected to open years that were not part of the original audit
- b) Computer audit specialists provide guidance in methods of projecting
- c) Primarily used for sales/use tax audits
- d) Generally, error rates from samples are projected forward
- e) Fixed assets may be looked at separately if major plant or office additions during the period
- f) Eliminating penalties in the additional year(s) to obtain agreement for the projection forward will be at the discretion of the supervisor
- g) Audits that result in either an assessment or refund are considered for projection forward

2. Benefits

- a) Very little additional work needs to be done by either DOR or taxpayer (no additional field work and amended return preparation not necessary)
- b) Less interest due to earlier assessment for the year(s)

3. Qualifications

- a) At the conclusion of an audit there are additional year(s) open to adjustment which were not included as part of the original audit period
- b) Determined on a case-by-case basis taking into account:
 - i) Changes in the business operations of the taxpayer
 - ii) Changes in the method of reporting sales/use tax (e.g., direct pay) or the personnel responsible for reporting
 - iii) Tax law changes that affect the taxpayer
 - iv) Issues not agreed upon in the audit
- c) A questionnaire can be given to the taxpayer to obtain above facts
- d) Auditor makes recommendation, with approval by computer audit specialist and supervisor required

D. Mutual commitment date process

1. General information

- a) Process used by the IRS Small Business/Self-Employed Division (SBSE) and the Joint Audit Planning Process used by the Large and Mid-Size Business Division (LMSB) for many years
- b) Taxpayer and auditor mutually agree to the establishment of three time periods relating to the conduct of the audit
 - i) The number of days a taxpayer has to respond to written information requests
 - ii) The deadline for the taxpayer to submit a claim for refund applying to the audit period
 - iii) The deadline for the auditor to provide a notice of proposed audit report to the taxpayer based on the taxpayer and auditor

jointly working together on the audit, or the mutual commitment date

c) WI DOR will begin using the mutual commitment date process with audits starting on or after July 1, 2009

d) For an audit in progress on July 1, 2009, the auditor, supervisor, and taxpayer may implement the Mutual Commitment Date Process for the audit depending on what stage the audit is in

2. Benefits

a) More efficient and timely completion of the audit

b) Promote better communication between the department and the taxpayer during the audit process

c) Establish accountability for the auditor and the taxpayer during the audit process

E. Comments from other panelists

1. Jim McGrady and Rich Unen, Florida Revenue Department

V. After The Audit (<http://www.boe.ca.gov/pdf/pub17.pdf>)

A. Preparation for the post-audit conference – starts with the opening conference!

- 1) Encourage communication throughout audit process
- 2) Receiving all worksheets, schedules and other documentation pertinent to a full disclosure of the audit findings. Ask auditor to provide schedules upon completion – not wait until the end of the process.
- 3) Request specific information required to support that tax is not due or was otherwise satisfied (e.g., XYZ letters)
- 4) Establish a timeline to present additional documentation
- 5) Regarding matters of interpretation, bring appropriate statute, regulation, annotation
- 6) Check prior audit...RTC 6596 relief (<http://www.boe.ca.gov/pdf/reg1705.pdf>)
- 7) Always try to resolve at the lowest possible level

B. Audit conference – BOE office or taxpayers location

- 1) Conference required with audit supervisor in attendance if liability in excess of \$25,000, whether taxpayer agrees or not
- 2) A copy of the field audit report and all supporting schedules are furnished to the taxpayer which:
 - a) Identifies the amount and areas of deficiencies
 - b) Provides suggestions for correcting the areas of deficiency
 - c) Provides the taxpayer an opportunity to state in writing any areas of disagreement
- 3) The taxpayer's rights and appeal procedures are explained, and publications provided (<http://www.boe.ca.gov/pdf/pub76.pdf>)

C. Resolving auditor error and areas of disagreement
(<http://www.boe.ca.gov/pdf/pub17.pdf>)

- 1) During the audit but prior to assessment, pursue the chain of command
 - a) Auditor

- b) Supervisor
- c) District principal auditor

2) After the post-audit conference, pursue administrative appeals

- a) Appeals conference with attorney
- b) Hearing before Board

D. Presenting payment prior to assessment (<http://www.boe.ca.gov/pdf/boe1.pdf>)

1) The pros and cons of pre-paid audit assessments: Reduces interest, yet may require claim for refund (in excess of \$50,000) to be approved by Board

E. Comments from other panelists

- 1) Vicki Gibbons, Wisconsin Revenue Department
- 2) Jim McGrady and Rich Unen, Florida Revenue Department