

**AUDIT TEAM**

***Jim Williamson, CPA, CIA, City Auditor***  
***Matt Weller, CPA, Assistant City Auditor***  
***Lori Rice, MBA, Audit Manager***

**FINANCE DEPARTMENT  
REVENUE ENFORCEMENT PROGRAM**

**MARCH 28, 2017**

**MAYOR AND CITY COUNCIL**

<b><i>Mick Cornett</i></b>	<b><i>Audit Committee, Mayor</i></b>
<b><i>James Greiner</i></b>	<b><i>Ward 1</i></b>
<b><i>Ed Shadid</i></b>	<b><i>Ward 2</i></b>
<b><i>Larry McAtee</i></b>	<b><i>Audit Committee, Ward 3</i></b>
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<b><i>John A. Pettis Jr.</i></b>	<b><i>Ward 7</i></b>
<b><i>Mark K. Stonecipher</i></b>	<b><i>Ward 8</i></b>



March 28, 2017


The Mayor and City Council:

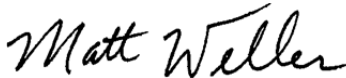
The Office of the City Auditor has completed an audit of revenue enforcement procedures for monitoring sales and use tax collections remitted to the City by the Oklahoma Tax Commission.

Based on the results of our audit, as of June 30, 2016, we believe that established sales and use tax collection monitoring procedures are identifying unpaid taxes; however, we could not determine the adequacy of those procedures due to a lack of documentation. The results of our audit also indicate that all sales tax collections are not reviewed semi-annually as intended, semi-annual reviews are not efficient when performed, and use tax collection reviews could be expanded. Related recommendations, discussed in more detail in the attached report, are summarized as follows:

- Periodic reviews of all sales tax collections should be performed within timeframes specified in procedures established by management and electronic data extraction and analysis should be used to perform the reviews. See Recommendations 1 and 2.
- Use tax collections from taxpayers with a generally consistent payment history should be periodically reviewed for anomalies and random audits should be considered for taxpayers in industries where larger use tax liabilities are common. See Recommendations 3 and 4.
- Sales and use tax reviews should be completely documented, identified concerns should be compiled in one location, and all review documentation should be examined by a supervisor. See Recommendations 5, 6 and 7.

All comments, recommendations and observations arising from our audit have been discussed in detail with appropriate management representatives. These discussions were held to assure a complete understanding of the content and emphasis of items in this report. Responses from management are attached to this report.

  
Jim Williamson  
City Auditor

  
Matt Weller  
Assistant City Auditor

  
Lori Rice  
Audit Manager

## REVENUE ENFORCEMENT PROGRAM AUDIT

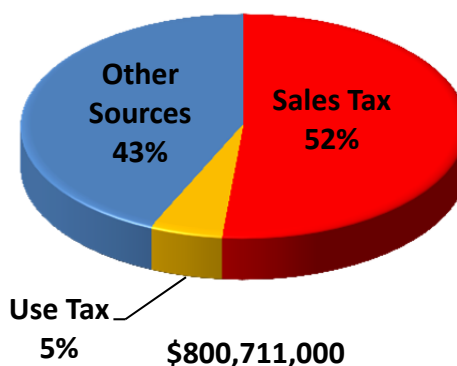
### AUDIT OBJECTIVE, BACKGROUND, SCOPE AND METHODOLOGY

The objective of this audit was to evaluate the adequacy and determine the effectiveness, as of June 30, 2016, of procedures for monitoring sales and use tax collections remitted to the City by the Oklahoma Tax Commission (OTC).

The City Treasurer's Office within the Finance Department is responsible for the City's Revenue Enforcement Program (Program). The Program includes monitoring all taxes and fees in-lieu of taxes (i.e. franchise, 911) received by the City. Sales tax represented more than half of City revenues and combined with use tax comprised 57% of all City revenues for fiscal year 2016 as shown in Exhibit 1.

**Exhibit 1 – City Revenues by Source**

**FY 2016**



Source: Fiscal Year 2016 Comprehensive Annual Financial Report.

Sales tax is levied on gross receipts from all sales subject to such tax, as defined by Oklahoma Statutes. Use tax is levied in lieu of sales tax on goods purchased in other states, yet imported into Oklahoma for use. The OTC collects and remits sales and use tax to the City monthly.

Program sales and use tax collection monitoring procedures generally include:

- Internal review of collections for potentially unpaid taxes and reporting the responsible taxpayers identified to the OTC for further investigation and/or audit.
- Identification and audit of taxpayers responsible for potentially unpaid taxes by one of two independent sales and use tax audit firms under contract with the City.
- Reviewing the actual physical location of taxpayers, registered with the OTC in neighboring cities and unincorporated county areas for tax distribution purposes, to determine the accuracy of those registrations.

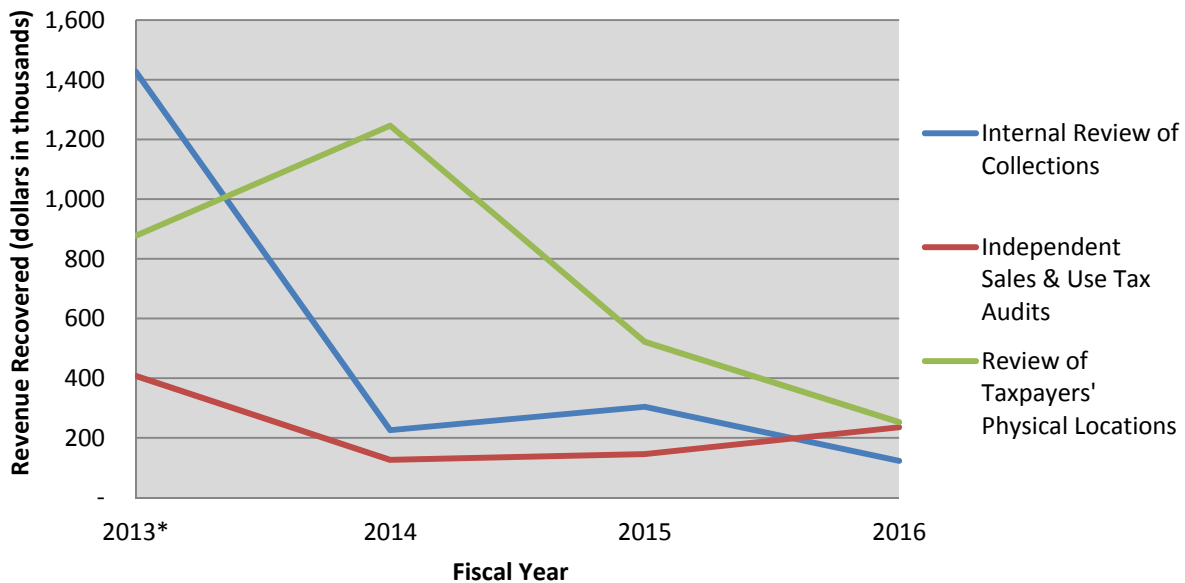
Informal surveys of sales and use tax monitoring procedures performed by other cities did not reveal any significant alternative monitoring procedures that should be considered for implementation by the City. Further, Program personnel have excelled at identifying unexplored areas for specific consideration, such as:

- On-line retailers not charging the correct sales tax rate on purchases by City residents.
- Furniture stores located outside of City limits but delivering sold items to City residents without charging City sales tax.

- Hotels undergoing renovation that may not be paying use tax on construction materials purchased from outside the state.
- Vendors charging sales tax at an incorrect rate on personal purchases.

However, sales and use tax recoveries resulting from Program monitoring procedures have generally declined overall since fiscal year 2013 as shown in Exhibit 2 below. Management has reported that declining recoveries are a result of stricter penalties imposed by the OTC for recurring tax payment delays and improvements to OTC taxpayer registration.

**Exhibit 2 – Sales and Use Tax Recoveries by Monitoring Procedure FY 2013 - 2016**



Source: City Treasurer’s Office revenue recovery records.

\*Internal collection reviews identified \$750,000 due from a single taxpayer for this fiscal year.

Procedures performed during this audit included interviews with relevant department personnel; reviews of relevant State Statutes and City Ordinances, agreements, previous audit reports, and selected sales and use tax collection data; review and assessment of sales and use tax monitoring procedures performed and reporting of related monitoring results; assessment of the usefulness of business license and building permit data maintained in other City databases for identifying unpaid sales and use tax; and informal surveys of other municipalities for best monitoring practices.

We did not audit the accuracy or completeness of sales and use tax collections remitted to the City by the OTC, the sufficiency of the independent sales and use tax auditors’ identification and audit of taxpayers, or the impact of stricter penalties imposed or process improvements made by OTC on sales and use tax recoveries resulting from the City’s monitoring procedures.

We conducted this audit in accordance with generally accepted government auditing standards (GAGAS). GAGAS requires that we plan and perform the audit to obtain sufficient, appropriate

evidence to provide a reasonable basis for our audit 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.

The following section of this report includes recommendations intended to provide constructive suggestions for improving sales and use tax collection monitoring procedures. Included in the body of this report are management responses to each recommendation. Management responses are attached to this report in their entirety.

## RESULTS OF WORK PERFORMED

*The results of our audit indicate that, as of June 30, 2016, established sales and use tax collection monitoring procedures are identifying unpaid taxes; however, we could not determine the adequacy of those procedures due to a lack of documentation. The results of our audit also indicate that all sales tax collections are not reviewed semi-annually as intended, semi-annual reviews are not efficient when performed, and use tax collection reviews could be expanded.*

### Semi-Annual Review of All Sales Tax Collections

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**Semi-annual review of all sales tax collections had not been conducted within the last 15 months, since March 2015.** Stated sales tax monitoring procedures included supplementing monthly reviews of sales tax collections from the top 25 taxpayers by industry with semi-annual review of all sales tax collections. Monthly sales tax collections from the top 25 taxpayers by industry only account for approximately 60% of monthly collections from 4% of the taxpayers<sup>1</sup>. Unpaid sales tax by taxpayers not included in monthly reviews could go undetected without routine review of all sales tax collections.

Additionally, each sales tax collection amount was manually reviewed during the last semi-annual review conducted. This approach could require examination of sales and use tax collection amounts for more than 20,000 taxpayers and 6,000 taxpayers, respectively<sup>2</sup>. Manual review of this amount of data is not efficient, prone to errors, and requires more staff time than would be necessary if Excel, Access, or data extraction and analysis software were used.

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<sup>1</sup> Collection and taxpayer percentages were calculated based on the data included in monthly sales tax collection reports received from the OTC for November 2015 through June 2016.

<sup>2</sup> Taxpayer totals were obtained from monthly sales and use tax collection reports received from the OTC for June 2014 through May 2016.

## Recommendation 1

All sales tax collections should be reviewed semi-annually in accordance with the stated procedure. The next review of all sales tax collections should include all collections since the last review of all collections in March 2015.

### ***Finance Department Response 1***

*Concur with recommendation. In recent years, this review has been transitioned to an annual review rather than a semi-annual review. Procedures will be formalized to establish set schedules for annual reviews. The most recent twelve month review of all taxpayers in Oklahoma City was completed in November 2016 and included all collections through calendar year 2015. The next annual review of calendar year 2016 is scheduled for May 2017.*

## Recommendation 2

Excel, Access, or data extraction and analysis software should be used for all sales and use tax collection reviews.

### ***Finance Department Response 2***

*Concur with recommendation. Staff will research the use of electronic analysis for reviewing taxpayer activity and implement any available options by June 30, 2017.*

## Use Tax Collections Review

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**Monthly reviews of use tax collections from the top 25 taxpayers by industry are not supplemented with any other routine, structured reviews or procedures.** Occasional reviews of use tax collections from certain high-risk industries, hotels with changes in ownership, or specific taxpayers recommended by the independent sales and use tax audit firms have resulted in the identification of unpaid use tax and should continue. Routine monthly reviews of use tax collections from the top 25 taxpayers by industry only account for approximately 66% of monthly collections from 4% of the taxpayers<sup>3</sup>.

The inconsistent nature of use tax collections is an inherent limitation on performing a meaningful review of all use tax collections. However, 20% of all taxpayers paying use tax during the 24 months ending in May 2016 made a payment each month, accounting for 75% of use tax collections. Supplementing monthly reviews with a routine, structured review of taxpayers with a generally consistent payment history would allow for review of a reasonably large portion of use tax collections.

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<sup>3</sup> Collection and taxpayer percentages were calculated based on the data included in monthly use tax collection report received from the OTC for June 2016.

One informally surveyed municipality uses random use tax audits to identify unremitted use tax. We noted 10 recent use tax audits performed by the City's independent sales and use tax auditors resulted in City use tax assessments averaging \$27,000 with a cost to the City of approximately \$2,100 each on average<sup>4</sup>. Supplementing monthly and routine, structured reviews of consistently paying taxpayers with random use tax audits would further mitigate the risk of unpaid use tax.

### **Recommendation 3**

Use tax collections from taxpayers with a generally consistent payment history should be reviewed semi-annually for anomalies such as no payment, significant credits, or significant decreases in amounts paid, potentially requiring investigation.

### ***Finance Department Response 3***

*Concur with recommendation. Use tax collections, even those remitted on a regular basis, are often volatile which increases the potential for fluctuations and could result in a high level of research for fluctuations that may, in the end, prove to be valid. However, to address this recommendation, staff will implement annual reviews of use taxes collected and paid by remote sellers (primarily online retailers) and use taxes reported and paid by businesses. Remote sellers are most likely to have consistent remittances month-to-month. A process will be implemented to review each remote seller (with an account ID prefix of 'SVU') in conjunction with the annual review detailed in recommendation 1. The remaining use tax remitters (those with an account ID prefix of 'SCU') will typically not have consistent monthly sales. As such, these taxpayers would be reviewed at an industry level to determine if there are any additional taxpayers that are not currently remitting use tax. These procedures will be implemented by June 30, 2017.*

### **Recommendation 4**

Consideration should be given to using the City's independent sales and use tax audit firm to perform random use tax audits of taxpayers in industries where larger use tax liabilities are common (e.g. medical, construction, etc.).

### ***Finance Department Response 4***

*Concur with recommendation. Staff agrees that additional independent sales and use tax audits of taxpayers within certain key industries can be implemented; however, would prefer to pursue a more structured approach to initiating audits. Since reviews are currently being performed on the top 25 use tax payers, any issues determined by these reviews can and are referred for*

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<sup>4</sup> A comprehensive list of use tax audits performed by the independent sales and use tax auditors was not available. The average cost to the City of these use tax audits (the City and State share costs for audits resulting in assessments for both entities) and average resulting City use tax assessments were calculated using cost and use tax assessment information included on a listing produced by the OTC of recent audits and audits with outstanding assessments performed by the City's independent sales and use tax auditors. That list also included ten joint sales and use tax audits performed for the City that resulted in City use tax assessments averaging \$3,500 each at an average cost to the City of \$1,300 each.

*audit, either by the City or the Oklahoma Tax Commission. It should be noted larger audits that affect multiple jurisdictions are often not approved for local audits but are performed by the Oklahoma Tax Commission. Sales and use tax audits are also pursued by Treasury staff on any issues reported to the City by its independent sales and use tax auditors during the course of other audit assignments. In addition to these leads, staff will also consider issues uncovered in the reviews proposed in Recommendation 3 for potential audits. This procedure will be implemented by June 30, 2017.*

## **Documentation of Collection Review Procedures**

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### **Sales and use tax collection review documentation was not complete or was not retained.**

Documentation was not available of:

- Criteria used to identify sales and use tax collection variances requiring explanation and/or further investigation during monthly reviews.
- Sales and use tax collection variances identified during monthly reviews deemed of sufficient significance to require further investigation by the OTC.
- Review procedures carried out and evidence supporting the findings resulting from the March 2015 semi-annual review of all sales tax collections.

Lack of complete documentation of sales and use tax collections reviews does not allow for the adequacy and effectiveness of the review to be confirmed by a supervisor.

### **Recommendation 5**

Sales and use tax collection reviews should be completely documented and retained to allow for confirmation of the adequacy and effectiveness of the review by a supervisor. Review documentation should include, but not be limited to:

- All criteria used to identify variances requiring explanation and/or further investigation.
- Variances deemed of sufficient significance to require further investigation by the OTC.
- Review procedures carried out and evidence supporting the findings resulting from those procedures.
- Evidence of supervisory confirmation of review adequacy and effectiveness.

### **Finance Department Response 5**

*Concur with recommendation. Staff has established procedures to maintain a record of sales and use tax collection reviews, including the criteria outlined in this recommendation. This record will be reviewed and electronically signed by the Revenue Auditor's direct supervisor (Assistant City Treasurer) and available for periodic review by the City Treasurer.*



## **Documentation of Concerns Identified During Collection Reviews**

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**All concerns regarding unpaid taxes identified during sales and use tax collection reviews are not documented in one location and the concerns documented do not include a status.** A spreadsheet is used to log concerns regarding unpaid taxes identified during semi-annual sales tax collection reviews. However, the spreadsheet does not include concerns regarding unpaid taxes identified during monthly reviews of sales and use tax collections and does not include a status (e.g., explained, assigned for audit, audit result, denied for audit, etc.) of the documented concerns.

The lack of a complete listing of concerns identified during collection reviews and the status of those concerns does not allow for a complete assessment of concern disposition and increases the risk of those concerns going unresolved.

### **Recommendation 6**

All concerns regarding unpaid taxes identified during collection reviews should be documented in one location and should include all relevant details including the current status of the concern.

### ***Finance Department Response 6***

*Concur with recommendation. Staff has implemented procedures to formally document outstanding issues for tracking purposes and have this information readily available for monitoring by the Assistant City Treasurer and City Treasurer.*

## **Collection Review Supervision**

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**Collection review supervision is limited to Assistant City Treasurer examination of variances identified during monthly reviews to prepare the City Manager's Report to the City Council.** Collection review documentation, including concerns identified regarding unpaid taxes and the status of those concerns, are not currently examined by a supervisor. Supervisory review is essential to ensuring the work has been adequately and effectively carried out, and identified concerns have been appropriately addressed.

### **Recommendation 7**

All review documentation, including concerns identified regarding unpaid taxes and the status of concerns identified, should be examined by a supervisor.

### ***Finance Department Response 7***

*Concur with recommendation. Staff concurs with this recommendation as addressed in responses to Recommendation 5 and 6.*

## **Use of City Business License Data to Identify Unpaid Sales Tax**

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**Sales tax account numbers obtained by the Development Services Department when issuing business licenses could be used to identify potential unpaid sales tax concerns.** All businesses obtaining licenses do not have sales tax accounts or may have an account but not be required to pay sales tax.

However, business licenses are classified into business categories within the City's Accela permit system. Business categories including businesses paying sales tax can be identified by comparing sales tax account numbers recorded in Accela to sales tax account numbers from sales tax collection data. Businesses not paying sales tax, but included in business categories with other business that are paying sales tax, might be worthy of investigation for potentially unpaid sales tax.

We identified 188 issued business licenses during the 12 months ending July 2016 for which recorded sales tax account numbers were not included in sales tax collection data, while sales tax account numbers for other businesses classified in the same business categories were included in sales tax collection data.

### **Recommendation 8**

Consideration should be given to periodically using business license data to:

- Compare recorded sales tax account numbers to sales tax collection data,
- Identify business categories assigned to businesses paying sales tax, and
- Identifying businesses assigned to those same business categories, but not paying sales tax, for further investigation.

### ***Finance Department Response 8***

*Concur with recommendation. Staff has communicated with Development Services and Information Technology personnel to address both procedural and system issues to allow for comparison of this information to sales and use tax data. System and procedural changes to improve sales tax data input for data comparisons will be implemented by September 30, 2017.*

## **Use of City Building Permit Data to Identify Unremitted Use Tax**

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**Data obtained by the Development Services Department when issuing commercial building permits could be used to identify contractors responsible for unpaid use tax.** While not necessarily a representative of the contractor responsible for the project, each individual purchasing a commercial building permit is recorded in the City's Accela permit system, including contact information and the expected dollar value of the project.

The individual purchasing the building permit may be contacted using the contact information available in Accela to determine if the contractors and/or sub-contractors responsible for the project can be identified. If the responsible contractors and/or sub-contractors can be identified, use tax collection data could then be reviewed for payment of use tax or to determine whether further investigation might be necessary. Contacts could be limited to projects with expected dollar values exceeding an established threshold, based on available staff time (e.g., permits for 24 projects with expected dollar values exceeding \$10 million were issued during fiscal year 2016).

### **Recommendation 9**

Consideration should be given to periodically using commercial building permit data to:

- Contact individuals purchasing permits for more significant projects,
- Determining if the contractors responsible for the project can be identified, and
- Reviewing use tax collection data to determine if those contractors are paying use tax or further investigation regarding unpaid use tax might be necessary.

### ***Finance Department Response 9***

*Concur with recommendation. Staff has reviewed the permit/licensing system in the past to evaluate the potential for determining potential sales or use tax impact from construction projects. Unfortunately, the system focuses on the permitting of the project with a concentration on the general contractor for the projects. Often, it's the subcontractors that will initiate purchases associated with the project and information on subcontractors is not often readily available. Staff has met with Development Services and Information Technology personnel to request additional reporting on subcontractors. A new report with subcontractor information will be available by September 30, 2017.*

### **Monitoring of Other Tax Revenues**

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**The accuracy and completeness of tobacco excise tax apportionments received from the OTC are not monitored.** Tobacco excise tax is apportioned by the OTC to the City, among others, as described in the authorizing Oklahoma Statute<sup>5</sup>. Tobacco excise tax apportionments to the City average \$5 million per year. The complexity of the tobacco tax apportionment process increases the risk that incomplete or inaccurate apportionments could go unnoticed by the OTC.

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<sup>5</sup> Oklahoma Statute §68-402-3 authorizes the levy, assessment, collection, and payment of this tax.

**Recommendation 10**

The City's share of tobacco excise tax apportionments should be calculated annually using apportionment details available from the OTC and compared to the actual tax revenues received for reasonableness.

***Finance Department Response 10***

*Concur with recommendation. Treasury began drafting a project plan in mid-2016 to begin reviewing apportionments for tobacco excise tax apportionments, however, experienced a delay in this implementation resulting from staff reductions and the completion of a major hotel tax project. Creation of an implementation plan for this project will be completed by June 30, 2017.*



# MEMORANDUM

The City of  
**OKLAHOMA CITY**



TO: Jim Williamson, City Auditor  
THROUGH: James D. Couch, City Manager *Joc*  
FROM: Craig Freeman, Finance Director *CF*  
DATE: March 17, 2017  
SUBJECT: Audit Recommendations for Revenue Enforcement Program

Following are management's responses to recommendations outlined in the recent Revenue Enforcement Program Audit.

1. Concur with recommendation. In recent years, this review has been transitioned to an annual review rather than a semi-annual review. Procedures will be formalized to establish set schedules for annual reviews. The most recent twelve month review of all taxpayers in Oklahoma City was completed in November 2016 and included all collections through calendar year 2015. The next annual review of calendar year 2016 is scheduled for May 2017.
2. Concur with recommendation. Staff will research the use of electronic analysis for reviewing taxpayer activity and implement any available options by June 30, 2017.
3. Concur with recommendation. Use tax collections, even those remitted on a regular basis, are often volatile which increases the potential for fluctuations and could result in a high level of research for fluctuations that may, in the end, prove to be valid. However, to address this recommendation, staff will implement annual reviews of use taxes collected and paid by remote sellers (primarily online retailers) and use taxes reported and paid by businesses. Remote sellers are most likely to have consistent remittances month-to-month. A process will be implemented to review each remote seller (with an account ID prefix of 'SVU') in conjunction with the annual review detailed in recommendation 1. The remaining use tax remitters (those with an account ID prefix of 'SCU') will typically not have consistent monthly sales. As such, these taxpayers would be reviewed at an industry level to determine if there are

any additional taxpayers that are not currently remitting use tax. These procedures will be implemented by June 30, 2017.

4. Concur with recommendation. Staff agrees that additional independent sales and use tax audits of taxpayers within certain key industries can be implemented; however, would prefer to pursue a more structured approach to initiating audits. Since reviews are currently being performed on the top 25 use tax payers, any issues determined by these reviews can and are referred for audit, either by the City or the Oklahoma Tax Commission. It should be noted larger audits that affect multiple jurisdictions are often not approved for local audits but are performed by the Oklahoma Tax Commission. Sales and use tax audits are also pursued by Treasury staff on any issues reported to the City by its independent sales and use tax auditors during the course of other audit assignments. In addition to these leads, staff will also consider issues uncovered in the reviews proposed in Recommendation 3 for potential audits. This procedure will be implemented by June 30, 2017.
5. Concur with recommendation. Staff has established procedures to maintain a record of sales and use tax collection reviews, including the criteria outlined in this recommendation. This record will be reviewed and electronically signed by the Revenue Auditor's direct supervisor (Assistant City Treasurer) and available for periodic review by the City Treasurer.
6. Concur with recommendation. Staff has implemented procedures to formally document outstanding issues for tracking purposes and have this information readily available for monitoring by the Assistant City Treasurer and City Treasurer.
7. Concur with recommendation. Staff concurs with this recommendation as addressed in responses to Recommendation 5 and 6.
8. Concur with recommendation. Staff has communicated with Development Services and Information Technology personnel to address both procedural and system issues to allow for comparison of this information to sales and use tax data. System and procedural changes to improve sales tax data input for data comparisons will be implemented by September 30, 2017.
9. Concur with recommendation. Staff has reviewed the permit/licensing system in the past to evaluate the potential for determining potential sales or use tax impact from construction projects. Unfortunately, the system focuses on the permitting of the project with a concentration on the general contractor for the projects. Often, it's the subcontractors that will initiate purchases associated with the project and information on subcontractors is not often readily available. Staff has met with Development Services and Information Technology personnel to request additional reporting on subcontractors. A new report with subcontractor information will be available by September 30, 2017.

10. Concur with recommendation. Treasury began drafting a project plan in mid-2016 to begin reviewing apportionments for tobacco excise tax apportionments, however, experienced a delay in this implementation resulting from staff reductions and the completion of a major hotel tax project. Creation of an implementation plan for this project will be completed by June 30, 2017.