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Audit Standards

The burden on sellers will be significantly reduced and the states will be able to achieve a satisfactory level of compliance if the following audit procedure recommendations are adopted. Refer also to the *SST Testing Process for Certification of Service Providers/Automated Systems* and the *SST CSP Site Administration* documents. **(It should be noted that these recommendations only apply to sales. Purchases will remain subject to use tax compliance audits.)**

Audit Committee Recommendations

1. Audits may be conducted using statistical sampling techniques (where appropriate from the states' perspective) in accordance with generally accepted auditing standards as published by the American Institute of Certified Public Accountants in their publication entitled 'Statements of Auditing Standards'. The certification process for all models will include acceptance of statistical sampling as a valid audit approach.
2. Certified Service Providers (CSPs) should be subjected to one audit per Model 1 seller for all SST states.
3. Each member State shall offer a single audit to sellers per Section 301 of the Streamlined Sales and Use Tax Agreement (SSUTA) that encompasses local jurisdictions as well.
4. Multi-jurisdictional audits should be selected in a process to be determined. One method is by committee, based on requests from states and availability of resources. Some restrictions apply to the states' ability to audit for sales tax outside of the SSUTA. **The Committee is developing internal guidelines on Audit Selection that will remain confidential.**
5. States will be responsible to provide the needed audit resources, be it personnel, equipment and supplies, or funding relative to the number of audits that involves their participation. **The Committee has prepared a separate issue paper with additional information on audit staffing.**
6. When errors in tax calculations, reporting or remittance are discovered, the information will be provided to each state participating in the audit. The audit will identify what prompted the errors discovered and distinguish between

liability caused by the CSP/CAS' errors as opposed to mistakes prompted by a state's lack of proper taxability or tax rate notification.

7. Sellers should be given an opportunity to review the audit workpapers before they are finalized by the auditor. Each State will determine whether or not an assessment or refund is required, determine the amount of underpayment or overpayment, and handle all billing or refund functions. Sellers will have the ability to prepay an assessment to reduce interest accruing. States shall issue assessments within 90 days of the receipt of the audit report by the state. Refunds based on the audit report will be issued as soon as possible by each state, with the goal of issuing the refunds within 90 days of the completion of the audit.
8. Compliance audits under the SSUTA generally will cover a three-year audit period. The audit period may be extended to cover returns due in periods subsequent to the original audit period. States with longer statutes of limitations can apply the results based on its statute of limitations. The three-year limit applies to filed tax returns. Limits for unfiled returns will apply on a state by state basis; however, there is generally no audit period limit for audit of unfiled returns. Waiver requirements will be based on the statutes of each member state. An audit plan will be developed at the onset of the audit to establish an estimated timetable for the completion of the audit. Quarterly meetings at a minimum should be held between the seller and auditor to monitor the audit progress in compliance with the proposed audit completion date as projected in the audit plan.
9. As provided in the SSUTA, CSPs and other model sellers will not be assessed for errors as a result of relying on erroneous information in the Taxability Matrix created by the states. However, it is the responsibility of CAS providers and CSPs to complete a monthly review of each member state's matrix and to implement changes in a state's Taxability Matrix as prescribed within the contract. We recommend that all SST states utilize a centralized taxability matrix rather than simply posting its matrix on the state's individual web site. Failure to timely implement changes in a state's Taxability Matrix will void the liability relief provision and will likely result in assessments being made during the audit process on all transactions that occur after the date that a change should have been implemented. (If the Governing Board decides to allow a grace period to ease administrative burden on sellers and CSPs, it will not extend to the purchaser. The purchaser owes use tax on any transaction that should have been taxed, but was not taxed at the time of purchase.)

Compliance Audit Procedures

Regardless of the Model used by a seller, the goal of a sales/use tax audit of sales is to determine whether or not the correct amount of sales tax has been charged, collected and remitted to the correct jurisdiction. The same general audit procedures apply to each model. The entity to be audited depends upon the model being used by the seller.

The specific audit procedures to be used will vary according to the model and the specifics of each system. This document presents the recommendations of the Audit

Committee and offers an overview of the audit approach. Details of how to perform a sales tax audit are well documented in audit manuals of member states and the MTC. In addition to this paper, **the SST Audit Committee is preparing a detailed audit manual as a separate recommendation.**

The following represents a list of the main areas of focus for an audit of all three models.

Compliance Audit Functions

- I. Verify accuracy of:
 - A) Data used to determine location; and
 - B) Identification of item sold (mapping).
- II. Check accuracy of tax calculation:
 - A) Verify tax jurisdiction was properly determined based on approved information provided by states;
 - B) Verify tax rate used is correct for the jurisdiction based on approved information provided by states;
 - C) Verify taxability of goods and services are properly determined based on the taxability matrix of tangible personal property and services provided by states as well as the remainder of the state laws that are applicable; and
 - D) Determine error rate and amount of tax liability due if appropriate.
- III. Verify and examine documentation:
 - A) Substantiate that a clear audit trail exists;
 - B) Verify that exemption certificates issued were completed appropriately by customers;
 - C) Reconcile trade or cash discounts to ensure tax was reduced appropriately;
 - D) Determine if tax was accurately credited to the proper party for returned merchandise or cancelled sales; and
 - E) Verify that bundled transactions were taxed appropriately.
- IV. Verify accuracy of reporting:
 - A) Determine the amount of tax recorded is remitted;
 - B) Confirm that tax charged is recorded to the proper jurisdiction;

- C) Verify figures reported (gross receipts and deductions);
- D) Validate the accuracy and completeness of exempt sales reports;
- E) Reconcile the accuracy of credits, returns and other adjustments;

Re-certification (Audit)

In addition to and separate from the compliance audit will be a re-certification of the CSPs and CAS'. The requirements and methodology will be the subject of another paper. A re-certification audit should confirm that the SSUTA and RFP minimum standards are still being met. A compliance audit can result immediately if the re-certification verification process indicates that the CSP or CAS has not incorporated updates to their system as required and failed to remit the tax due in a timely manner.

The attached matrix indicates which entity has the responsibility for maintaining the documentation required for audit in each area. The responsibility for errors in tax collection and remittance of sales (and use tax on sales) tax is on the CSP in Model I, on the CAS provider and/or the seller in Model II, and strictly on the seller in Model III.

Responsible Entity

Audit Function	Model 1	Model 2	Model 3
Documentation Required	CSP Model	Tax Calc by Cert. Software	Proprietary Model
Receive and Input Information			
Verify data used to determine location	CSP	Software/Seller	Seller
Verify mapping of item sold	CSP	Seller	Seller
Verify identity of purchaser if exemption is claimed	CSP	Seller	Seller
Verify the completeness of any exemption certificate issued	CSP	Seller	Seller
Calculate Tax			
Verify tax jurisdiction was properly determined	CSP	Software/Seller	Seller
Verify tax rate is correct for the jurisdiction	CSP	Software/Seller	Seller
Verify amount of tax was properly determined	CSP	Software/Seller	Seller
Record Transaction			
Verify tax charged is accurately recorded in the proper jurisdiction	CSP	Software/Seller	Seller
Report and Remit tax			
Verify amount of tax recorded is remitted	CSP	Seller	Seller
Verify receipts and deductions	CSP	Seller	Seller
Verify accuracy of exemption reports	CSP	Seller	Seller
Verify credits, returns and adjustments	CSP	Seller	Seller