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Audit Standards

The Audit Sub-committee was given two tasks. One was to develop recommended procedures or standards for the “Certification” of Models 1, 2 and 3 and the other was to set forth recommendations for the audit of entities responsible for collecting the sales/use tax under Models 1, 2 and 3. In addition we were asked to make recommendations about who would perform the certification and audits. The Audit sub-committee has divided the tasks into two separate papers. This one will deal with compliance audit issues and recommendations.

The Audit Sub-Committee considered suggestions that were appealing from some perspectives but were unacceptable to many states for various reasons. One suggestion was to allow an accuracy standard of less than 100% (this was primarily discussed in connection with Model 3 in determining the correct amount of sales tax as an incentive for retailers to join the project. This proposal was inconsistent with most state’s audit policies and ultimately found to be unacceptable.

Even though the Committee concluded that some suggestions could not be included, the Committee believes that if the following recommendations are accepted, the burden on retailers will be significantly reduced and the states will be able to achieve a satisfactory level of compliance. **(It should be noted that these recommendations only apply to sales. Purchases will remain subject to use tax compliance audits.)**

Following the recommendations are discussions of audit procedures.

Audit Sub-Committee Recommendations

1. Audits will be conducted (where practicable from the states’ perspective) using statistical sampling techniques 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. The states should offer a multi-jurisdiction audit option to agents or retailers, subject to the limits of an auditor's ability to adequately represent the number of states that wish to audit the taxpayer. However, Model IIA and Model III may elect to have audits performed by states individually.
3. 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. The agreement poses some restrictions to states' ability to audit for sales tax outside of the agreement. **The Committee is preparing a separate issue paper with additional information.**
4. States will be responsible to provide the needed audit resource, be it personnel, or funding relative to the number of audits that they participate in. To the extent that states provide adequate resources, the restrictions mentioned above would have less impact. **The Committee is preparing a separate issue paper with additional information.**
5. When errors in tax calculations, reporting or remittance are discovered, the information will be provided to each state participating in the audit. 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. 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.
6. Audits under the agreement generally will cover a three-year audit period. Agents and retailers will not be precluded from extending the audit period to cover returns due in periods subsequent to the original audit period. States with longer statutes of limitations can apply the results based on their state's statute of limitations. The three year limit applies to filed tax returns. Limits for unfiled returns will apply on a state by state basis. Generally there is no limit for audit of unfiled returns. Waiver requirements will be based on the statutes of each member state, unless the Governing States adopt a uniform waiver.
7. As provided in the SSUTA Agreement, retailers and certified service providers will be held harmless for errors as a result of relying on erroneous information in the Taxability Matrix created by the states. However, it is the responsibility of the retailers and Certified Service Providers to complete a monthly review of each member state's matrix and to implement changes in a state's Taxability Matrix within 30 days of the end of the month or the effective date of the change, whichever is later. Failure to timely implement changes in a state's Taxability Matrix will void the hold harmless provision and result in

assessments being made during the audit process on all transactions that occur after the date that a change should have been implemented. (The 30 day grace period in this recommendation is provided only to ease administrative burden on retailers and certified service providers and does 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.)

8. The governing board shall provide a process for retailers and certified service providers to ask questions about how to interpret uniform definitions and seek clarification or help in correctly identifying the nature of a product or service. Retailers and certified service providers will be required to ask their questions in writing using the format approved by the governing board. The format approved by the governing board will be electronic and will archive questions and answers in a database for others to review. Retailers and certified service providers shall presume that products that are tangible personal property are taxable until advised otherwise. Retailers and certified service providers shall presume services sourced to (name the states) are taxable until advised otherwise. Retailers and certified service providers should presume services sourced to all other states are exempt until notified otherwise. Retailers and certified service providers will be held harmless for related errors from the date of inquiry to 48 hours after a response is provided electronically to the requestor and posted in the database.

Compliance Audit Procedures

Regardless of the Model used by a retailer, 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. As such, the same general audit procedures apply in each situation. The entity to be audited depends upon the model being used by the retailer.

The purpose of this paper is not to set forth the details of how an audit will be conducted. The specific procedures to be used will vary according to the model and the specifics of each system. Rather, this document presents the current recommendations of the Audit Sub-Committee and offers a general overview of the audit approach. Details of how to perform a sales tax audit are documented in the audit manuals of most states and the M.T.C. **The Committee will prepare a detailed audit manual as a separate recommendation.**

The following is a list of the main areas of focus for an audit for any of the three models.

Compliance Audit Functions

- I. Verify accuracy of:
 - A) Data used to determine location
 - B) Identification of item sold (mapping)
 - C) Identity of purchaser if exemption is claimed
 - D) Reason for exemption if claimed – ie-was the information on the certificate accurately reported.

- 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 matrix of taxability of tangible personal property and services provided by states.
 - D) Determine error rate and amount if appropriate.

- III. Verify tax charged is recorded in the proper jurisdiction.

- IV. Verify Accuracy of Reporting
 - A) Verify amount of tax recorded is remitted.
 - B) Verify figures as reported (gross receipts and deductions)
 - C) Verify accuracy and completeness of exempt sales reports.
 - D) Verify 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. The requirements and methodology will be the subject of another paper. The re-certification/audit, can result in an assessment if the CSP does not perform updates timely, and accurately and timely remit tax collected. Some of the areas to be considered in a re-certification are:

- 1) Ensure that the proper tax rate was charged to the applicable tax jurisdiction.

- 2) Verify that all tax collected was remitted timely to the appropriate tax authority.
- 3) Review all exemption certificates received from customers to determine validity.
- 4) Utilize statistical sampling to audit transactions to evaluate tax compliance.
- 5) Reconcile if trade or cash discounts reduced the tax base appropriately.
- 6) Determine if tax was credited for returned merchandise or cancelled sales.
- 7) Confirm that fungibles taxed on a percentage basis were handled correctly.
- 8) Substantiate that the required audit trail exists within sales records.

Other areas to be reported on will include recommendations for separate audit procedures for CSPs, CASs and proprietary systems using SSTP matrices, standardized workpapers, standardized training of auditors, standardized reporting.

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 agent in Model 1, varies in the two variants of Model 2, and the retailer in Model 3.

Responsible Entity

Audit Function	Documentation Required	Model 1	Model 2	Model 2	Model 3	
		Agent Model	Tax Calc. by Agent	Tax Calc by Cert. Software	Proprietary Model	
Receive and Input Information	Verify data used to determine location	electronic or paper invoice	Agent	Retailer	Retailer	Retailer
	Verify mapping of item sold	electronic or paper invoice	Agent	Retailer	Retailer	Retailer
	Verify identity of purchaser if exemption is claimed	electronic or paper invoice	Agent	Retailer	Retailer	Retailer
	Verify reason for exemption if claimed	electronic or paper exemption certificate	Agent	Agent	Software	Retailer
Calculate Tax	Verify tax jurisdiction was properly determined	jurisdiction selected and address of purchaser	Agent	Agent	Software/Retailer	Retailer
	Verify tax rate is correct for the jurisdiction	rate used	Agent	Agent	Software/Retailer	Retailer
	Verify amount of tax was properly determined	amount of tax accrued	Agent	Agent	Software/retailer	Retailer
	Determine error rate if necessary		Agent	Agent/Retailer	Software/Retailer	Retailer
Record Transaction	Verify tax charged is accurately recorded in the proper jurisdiction	paper or electronic invoice and access to liability account	Agent	Retailer	Retailer	Retailer
Report and Remit tax	Verify amount of tax recorded is remitted	access to liability account and payment verification	Agent	Retailer	Retailer	Retailer
	Verify receipts and deductions	access to books of record and supporting documentation	Agent	Retailer	Retailer	Retailer
	Verify accuracy of exemption reports	access to reports and supporting documentation	Agent	Retailer	Retailer	Retailer
	Verify credits, returns and adjustments	access to records and supporting documentation	Agent	Retailer	Retailer	Retailer

