

# **Final Audit Follow-Up**

*As of September 30, 2009*



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City Auditor

## **Repayment of Local Communications Services Tax**

**(Report #0911, Issued April 7, 2009)**

**Report #1003**

**November 17, 2009**

### **Summary**

This is the first and final follow-up on the action plan steps originating from the audit of the Repayment of Local Communications Services Tax (report #0911) issued on April 7, 2009. The Revenue management has completed all action plan steps identified in the audit as of September 30, 2009.

Our original audit was conducted to 1) verify the reasonableness and appropriateness of the information supporting the City of Tallahassee (City) Revenue Division's request to the City Commission to increase the local Communications Services Tax (CST) rate from 5.49% to 6.1%, effective February 1, 2009; 2) provide assurance that an FDOR audit finding requiring the City to repay \$1.4 million is adequately supported; and 3) determine the accuracy of Leon County addresses and assigned jurisdictions in the Florida Department of Revenue (FDOR) CST address database.

We provided recommendations during the audit to the Revenue Division to address the identified issues. There were four action plan steps identified in the audit. The following two action plan steps were completed prior to the report being issued on April 7, 2009:

- Monitoring CST collections and adjusting the CST local tax rate to ensure that the expected tax collection levels are maintained. [The Revenue Division indicated that the collections from the revised rate are meeting the expected tax collection levels.]
- Working with City Information Systems

Services and County Geographic Information Systems (GIS) staff to monitor the accuracy of the Leon County addresses in the FDOR address database. [Additional address updates have been submitted to FDOR.]

The two steps completed during this follow-up period were related to:

- Requesting documentation from FDOR to support current and future adjustments. Revenue Management reported that they received notice from the FDOR that the most recent FDOR adjustment was a \$99,991 underpayment (i.e., the City will receive this amount).
- Requesting FDOR to a) waive the City's adjustment (\$1.4 million to be repaid) and b) include the "qualifying discount" in the FDOR calculation of what jurisdictions owe back to the FDOR when adjustments are determined.

In March 2009, FDOR informed the City they do not have the statutory authority to "waive" the City's \$1.4 million adjustment for the determined overpayment of the CST distributions. Therefore, the City will be repaying the \$1.4 million overpayment over a three-year period ending March 2012. The Revenue Manager indicated that during the summer 2012, they will re-evaluate the sufficiency of the CST local tax rate to determine whether the rate should be adjusted to insure revenue neutrality compliance, as provided in Florida Statutes Section 202.20(2)(a).

We appreciate the full cooperation provided during this audit follow-up by Revenue Division staff.

## *Scope, Objectives, and Methodology*

We conducted the original audit and this subsequent follow-up audit in accordance with the International Standards for the Professional Practice of Internal Auditing and 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.

### *Original Report #0911*

The scope of the original audit was to: 1) verify the reasonableness and appropriateness of the information supporting the City of Tallahassee (City) Revenue Division's request to the City Commission to increase the local Communications Services Tax (CST) rate from 5.49% to 6.1%, effective February 1, 2009; 2) provide assurance that an FDOR audit finding requiring the City to repay \$1.4 million is adequately supported; and 3) determine the accuracy of Leon County addresses and assigned jurisdictions in the Florida Department of Revenue (FDOR) CST address database.

### *Report #1003*

This is our first and final follow-up on action plan steps identified in audit report #0911. The purpose of this follow-up is to report on the progress and status in completing all action plan steps as of September 30, 2009. To obtain information we reviewed relevant documentation and interviewed key Revenue managers and staff.

## *Background*

### Communications Services Tax

FS Chapter 202, Communications Services Tax Simplification Law, provides the authorization for the tax and legal requirements related to the taxes applied to sales of communications services.

Communications services are defined as the "transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals, including cable services, to a point, or between or among points, by or through any electronic, radio, satellite, cable, optical, microwave, or other medium or method now in existence or hereafter devised, regardless of the protocol used for such transmission or conveyance." Providers in Leon County include businesses that provide home and business telephone services, cellular phone services, cable television, and Internet services. Providers of taxable communications services bill and collect applicable taxes from customers and remit the taxes to the FDOR with monthly CST returns.

Prior to October 2001, all providers reported and remitted the collected CST to each of the estimated 467 separate Florida jurisdictions (counties and municipalities) on a monthly or quarterly basis. The Florida legislature passed the Communications Services Tax Simplification Law (CST Statute), effective October 1, 2001. The CST Statute was intended to reform the communication tax laws thereby resulting in "a fair, efficient, and uniform method for taxing communications services sold in this state." Pursuant to the CST Statute, the law was implemented to:

- Restructure state and local taxes and fees to account for the impact of federal legislation, industry deregulation, and the convergence of service offerings that is now taking place among providers.
- Promote the increased competition that accompanies deregulation by embracing a competitively neutral tax policy that will free consumers to choose a provider based on tax-neutral considerations.
- Spur new competition by simplifying an extremely complicated state and local tax and fee system.
- Lower the cost of collecting taxes and fees, increase service availability, and place downward pressure on price.

- Increase efficiency by reducing the number of returns that a provider must file each month.
- Ensure that the growth of the industry is unimpaired by excessive governmental regulation by restructuring separate taxes and fees into a revenue-neutral communications services tax centrally administered by FDOR.
- Replace taxes and fees previously imposed, not impose a new tax.

Under the CST Statute, the provider bills the customer for rendered communications services and charges and collects the applicable CST based on the rate established for the customer's jurisdiction. The provider determines the customer's jurisdiction based on the customer's service address. Customers' billing and address information is maintained in the providers' database. Monthly, providers complete and remit the Florida CST Return (Form DR-700016) to FDOR reporting the taxable sales subject to the CST and the CST collected by jurisdiction. The provider then remits the collected taxes to FDOR. FDOR then distributes the CST collections submitted by the provider to each jurisdiction, as reported on the provider's CST return.

The CST Statute did not intend to reduce or increase the CST collections to local governments, but to simplify the reporting and payment processes. Accordingly, when local governments encounter a shortfall in CST collections, the CST Statute provides conditions for which local governments may adjust the CST local tax rate upward to the extent necessary to generate the "expected" amount of revenue on an ongoing basis (FS Section 220.20(2)(a)(1)). The "expected" revenue was determined to be the CST collections during fiscal year 2000-2001, plus the average growth of the collections over the immediately preceding 5-year period. As shown in Table 1, based on the 2001 collections (\$8,496,000) and the City's average growth rate for the fiscal years 1997 - 2001 (6.47%), the City's expected CST collections are \$9,045,955 annually.

**Table 1**  
**Determination of the Expected Replacement Revenue After CST Statute was Implemented on October 1, 2001**

FY 2001 collections	\$8,496,000
FY 1997 – 2001 average revenue growth	6.47%
<b>Expected revenue in FY 2002</b>	<b>\$9,045,955</b>

Source: City Revenue Division analyses and audit recalculations

The CST Statute authorizes the FDOR to administer and enforce the collection of communications services taxes, interest, and penalties. To ensure compliance with the CST Statute, FDOR conducts audits of providers. FDOR is required to notify providers 60 days prior to the start of an audit and can audit any period within the prior three years. FDOR auditors request a copy of the provider's customer service address and billing database for the selected audit period and then perform various analyses, including testing the accuracy of the jurisdiction assignments to customer addresses and tax amounts collected from customers and remitted to FDOR.

The FDOR audit results are used to determine whether jurisdictions have been underpaid or overpaid. Periodically, the FDOR CST Division notifies the jurisdictions of the audit results that include the additional amounts they will receive or the amounts that they have been overpaid and will need to repay. The City received its first notification from FDOR in the fall 2008. That notification reported that the City was overpaid \$1.4 million in CST collections and must repay this amount to FDOR over a 36-month period.

#### Common CST Errors Made by Providers

FDOR auditors indicated the most common types of errors observed during their audits of communications services provider CST returns were reporting errors, tax rate and application errors, and jurisdiction errors. Table 2 lists the most common types of errors and their potential impacts to local governments. A small percentage of the reporting errors may be identified based on the CST return as submitted (e.g., errors detectable by reviewing the CST return), but the majority of

the errors cannot be identified until an audit of supporting records is performed.

The overall FDOR adjustment of \$1,424,367 consists of audit adjustments and non-audit adjustments. Audit adjustments of <\$2,148,581>

were discovered during FDOR audits of providers. Non-audit adjustments of \$724,214 were made by the providers, generally resulting from errors made by their tax preparer.

**Table 2  
Types of Errors Resulting in Adjustments to  
Providers and Local Governments**

Type of Error	Description of Error	Potential Impact to Local Governments
Reporting Errors	Providers make errors on their monthly CST returns.	1) Taxes collected are distributed to the wrong jurisdictions. 2) More tax is due. 3) Less tax is due.  Each of these impacts results in redistribution of CST collections among local governments.
Tax Rate and Application Errors	Providers use the wrong tax rates; providers do not collect taxes from customers for taxable services; providers collect taxes for nontaxable services; and/or providers collect taxes from customers using the wrong jurisdiction’s tax rates.	
Jurisdiction Errors	Providers assigned the incorrect jurisdiction to the customer’s billing address.	

Source: Original Audit #0911 (FDOR CST Division auditors and audit managers)

***Previous Conditions and Current Status***

In report #0911, we concluded that:

1) The City Revenue Division’s basis for requesting the City Commission to increase the CST local tax rate to 6.1% appeared to be a reasonable and appropriate response to previous years under-collections and the 2008 FDOR adjustments requiring the City to repay \$1.4 million and prepare for potential additional FDOR adjustments. (Note: future adjustment amounts remain unknown.)

2) Our review of FDOR audit documentation and discussions with FDOR auditors showed their audit testing methodology for verifying the accuracy of assigned jurisdictions in the providers’

billing database was not statistically valid. Our concern is that FDOR is using imprecise audit methodologies to calculate precise audit adjustments. Therefore, we do not agree with FDOR’s overall audit conclusion that the City should repay \$1.4 million.

3) Assigned jurisdictions and wrong addresses in FDOR audit testing resulted in the largest portion of the FDOR audit adjustments. Our review of the Leon/Tallahassee address and assigned jurisdictions in the FDOR CST address database indicated that the accuracy had not been verified since it was originally submitted in 2000. Since then, FDOR added address information from the United States Postal Service Master Address Listing causing duplicate addresses, but some with wrong assigned jurisdictions. Inaccurate address and jurisdictional designations data can result in incorrect FDOR audit adjustments.

4) Other issues identified during the audit related to the FDOR audit processes included: a) FDOR was not including providers’ “qualifying discounts” taken on the CST returns when determining adjustments; and b) providers will most likely continue to make CST payments to inaccurate jurisdictions in the future, as they were not likely to correct errors identified in FDOR audits.

Management identified four action plan steps to address the recommendations provided in the audit report to enhance their operations. Two of the steps were completed prior to the issuance of the audit report. Table 3 provides a summary of the remaining two management’s action plan steps due to be completed as of September 30, 2009, and their current status.

**Table 3  
Action Plan Steps from Report #0911  
Due as of September 30, 2009, and Current Status**

Action Plan Steps Due As of September 30, 2009	Current Status
<i>To ensure that the FDOR adjustments are accurate</i>	
<ul style="list-style-type: none"> <li>• Revenue Division continue to request documentation from FDOR to support the current and future adjustments.</li> </ul>	<p>✓ <b>Completed.</b> There is a process in place to review the adjustments resulting from the FDOR audits and request supporting documentation when determined necessary. Revenue Management reported that they received notice from the FDOR that the most recent FDOR adjustment was a \$99,991 underpayment (i.e., the City will receive this amount). Requests were sent to FDOR about how this amount will be distributed.</p>
<ul style="list-style-type: none"> <li>• Revenue Division address the City’s concerns with FDOR and request FDOR to:                             <ul style="list-style-type: none"> <li>a) Waive the City’s adjustment.</li> <li>b) Include the providers’ “qualifying discount” in the calculation of what the jurisdictions owe back to FDOR when adjustments are determined.</li> </ul> </li> </ul>	<p>✓ <b>Completed.</b> The City Treasurer-Clerk officially requested to FDOR that the adjustment be waived and the qualifying discount be included in their adjustment calculations.</p> <p>Note: FDOR did not waive the adjustment and has not credited any further monies to the City for the prior questioned “qualifying discount” calculations. However, FDOR CST Audit Division management indicated that they have changed their auditing processes and the Revenue Division manager believes the changes made will make the FDOR audits and adjustments more fair and equitable.</p>

**Table Legend:**

- Issue addressed in the original audit
- ✓ Completed

### *Conclusion*

As described in Table 3, Revenue management completed both action plan steps due as of September 30, 2009.

Additionally, the Revenue Manager indicated that during the summer 2012, they will re-evaluate the sufficiency of the CST local tax rate to determine whether the rate should be adjusted to insure revenue neutrality compliance, as provided in Florida Statutes Section 202.20(2)(a). This will be after the City has finished repaying the \$1.4 million overpayment in March 2012.

We appreciate the full cooperation provided during this audit follow-up from Revenue and Accounting Services management and staff.

### *Appointed Official's Response*

#### **City Treasurer-Clerk:**

I am very pleased with the actions taken by staff. Staff's interaction with the Florida Department of Revenue (FDOR) appears to have improved FDOR's audit methodology. The most important factor is that the new CST rate adequately offset the negative adjustment, sustained revenue neutrality for FY09 and seems capable of generating sufficient reserves if future audits negatively affect the City's distribution. I also commend the audit staff for their thorough analysis.

Copies of this audit follow-up #1003 or audit report #0911 may be obtained from the City Auditor's website (<http://www.talgov.com/auditing/auditreports.cfm>) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (Office of the City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail ([auditors@talgov.com](mailto:auditors@talgov.com)).

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