



PERFORMANCE AUDIT REPORT

**Retailer Sales Taxes: Assessing Whether the
Amounts Distributed to Localities
Have Been Computed Accurately**

Executive Summary
with Conclusions and Recommendations

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
March 2001**

Legislative Post Audit Committee

Legislative Division of Post Audit

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LEGISLATURE OF KANSAS

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March 15, 2001

To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions, together with a summary of our recommendations and the agency responses, from our completed performance audit, *Retailer Sales Taxes: Assessing Whether the Amounts Distributed to Localities Have Been Computed Accurately*.

This report includes several recommendations for establishing a systematic process for identifying and distributing sales tax payments that come into the system without a tax return, for reviewing the amounts each locality received relating to the initial 3-month conversion process, and for periodically checking a sample of payments to verify that the correct distribution was made to the correct locality. We would be happy to discuss the findings presented in this report with any legislative committees, individual legislators, or other State officials. These findings are supported by a wealth of data, not all of which could be included in this report because of space considerations. These data may allow us to answer additional questions about the audit findings or to further clarify the issues raised in the report.

If you would like a copy of the full audit report, please call our office and we will send you one right away.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is fluid and cursive, with the first letters of each word being capitalized and prominent.

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY
LEGISLATIVE DIVISION OF POST AUDIT

**Question 1: Has the Department of Revenue
Accurately Distributed Local Sales Tax Revenues to
Local Units of Government?**

Most localities in our sample eventually received the correct sales tax amount relating to the “conversion” period, but there were some problems. *During the first 3 months of the new computer system, the Department of Revenue distributed taxes to cities and counties based on estimates. It later went back and made adjustments to reflect actual amounts due. The adjustments didn’t go smoothly. The end result was that the Department recouped about \$13.4 million from cities and counties, and it did a poor job of explaining the adjustments to them. In all, 9 of 10 localities in our sample ultimately were paid the correct amount of sales taxes owed to them during the 3-month conversion period. One city received about \$31,000 more than it was due.* page 7

The Department of Revenue accurately distributed sales tax payments that could be processed, but several million dollars in payments without a return aren’t being distributed quickly. *We reviewed 249 sales tax payments to ensure that they were accurately distributed. Of the 222 tax payments that included the information the Department needed to process and distribute them, 218 (98%) were accurately distributed. 27 sales tax payments (11% of the sample) couldn’t be distributed because the information the Department received from retailers was incomplete or wrong. Most of these involved the Department receiving a sales tax payment, but no return. In fact, more than \$3.2 million in sales tax payments owed to cities and counties hasn’t been distributed because the Department doesn’t routinely research and act on payments that come in without a return.* page 8

Officials in 2 states we contacted told us they eventually distribute sales tax payments even if they haven’t received a corresponding return. The Department could improve its procedures for handling undistributed sales tax payments that are more than a year old and may never be resolved.

The Department of Revenue’s computer system has built-in checks to make sure all sales tax payments that are processed are paid out, but it doesn’t ensure that those moneys went to the right locale. *To address this potential problem, periodically the Department could track a sample of payments through the system, as it did in its recent audit.* . . . page 12

Question 1 Conclusion. *Cities and counties throughout the State depend heavily on sales tax receipts for revenue, and rely on the Department to distribute those receipts to them in a timely manner. Overall, the Department does a good job of quickly and accurately distributing most local sales taxes. But a significant number of payments don't get distributed quickly because a sales tax return didn't come in with them. Even though these undistributed payments may seem small compared to the millions of dollars processed and distributed each month, they still amount to several million dollars and are very important to the localities they're owed to. The Department needs to make sure it works to distribute all sales tax receipts in the most timely and efficient manner.* . . . page 13

Question 1 Recommendations. *We recommended that the Department of Revenue establish a systematic process to identify and distribute sales tax payments that come into the system without a return. We recommended that the Department review the adjustments made to each locality relating to the tax payments made during the conversion period to the new system. Finally, we recommended that the Department periodically check a sample of payments to ensure that the right amount of money is going to the correct locality. In its response to the draft audit, the Department of Revenue generally agreed with the report's findings and recommendations.* . . . page 13

Question 2: Why Did \$19.5 Million Need To Be Transferred from the State General Fund and Highway Fund into Local Sales Tax Funds?

The Department of Revenue informed State budget officials in October 2000 that \$19.5 million needed to be transferred from State funds to several local tax funds. *At that time, the Department needed about \$75 million for upcoming distributions to localities, but the correct amount of money hadn't been put in the local tax fund to cover those distributions.* . . . page 15

We confirmed that \$17.5 million of the transfer related directly to problems with how the new computer system handled utility sales tax payments. *The new computer didn't recognize that some utility "sales" are exempt from State sales tax, so some of the calculations the computer performed were incorrect. This error had no impact on the amounts actually paid to localities—they were paid the correct amounts. When Department staff recognized the shortfall in June 2000, they quit making other routine adjustments to the fund balances, apparently causing some additional shortage. In October 2000, Department staff began making monthly adjustments to compensate for the computer glitch.* . . . page 16

Question 2 Conclusion: *The Department of Revenue's new computer system didn't process certain sales and compensating use tax transactions correctly, which resulted in the local tax holding fund being* . . . page 17

shorted by about \$17.5 million, and the State General and Highway Funds being overcompensated by the same amount. That's the primary reason why the \$19.5 million transfer needed to be made. The Department has identified the computer problems that caused these errors, and plans to have computer fixes in place by April 2001. This appears to be a one-time problem that shouldn't be repeated in the future.

APPENDIX A: *Scope Statement* . . . page 19

APPENDIX B: *A Detailed Explanation of How the Department of Revenue's New Sales Tax Computer System Mishandled Utility Sales Tax Payments* . . . page 21

APPENDIX D: *Agency Response* . . . page 23

This audit was conducted by Chris Clarke, Allan Foster, Scott Frank, and Joe Lawhon. Leo Hafner was the audit manager. If you need any additional information about the audit's findings, please contact Ms. Clarke at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.