

May 23, 2006

Members of the Legislative Audit Committee:

The State Auditor's Office has verified that 520 randomly selected businesses accurately self-reported their locations to the Comptroller of Public Accounts (Comptroller's Office). The accuracy of location information that businesses self-report--specifically the incorporated city in which a business reports it is located--is important because the Comptroller's Office relies on that information to allocate city sales tax revenue. Verifying the accuracy of location information provides assurances to cities that they are receiving the proper amount of sales tax revenue.

Approximately \$3 billion in sales tax revenue was allocated to Texas cities in fiscal year 2005. Results of a survey the State Auditor's Office sent to six cities indicated that these cities have not implemented processes to independently ensure they receive the amount of city sales tax revenue owed to them.

520 Businesses Tested Accurately Self-reported Their Locations

Over the last three years, the City of Austin's Office of the City Auditor conducted a series of audits to determine whether the City of Austin was receiving the correct amount of sales tax revenue. These audits focused on the risk that city sales tax revenue may not be allocated correctly to the City of Austin because some businesses may not be accurately self-reporting the incorporated city in which they were located to the Comptroller's Office. The Office of the City Auditor's 2005 audit report recommended that the City of Austin monitor sales tax information to identify businesses that were not accurately reporting the incorporated city in which they were located to the Comptroller's Office.¹

As a result of the information in the audit reports issued by the City of Austin's Office of the City Auditor, the State Auditor's Office randomly selected 520 businesses with active city sales tax permits. The 520 businesses selected had self-reported to the Comptroller's Office that they were located in smaller cities that border five larger cities: Bryan, Forth Worth, Houston, Plano, and San Antonio. The State Auditor's Office verified that all of the 520 businesses had accurately reported either (1) the incorporated city in which they were located or (2) the incorporated city to which they owed city sales tax.

Cities That Responded to a State Auditor's Office Survey Do Not Independently Ensure They Receive City Sales Tax Revenue Owed to Them

The State Auditor's Office sent a survey to six cities to inquire about the processes cities use to independently ensure they receive city sales tax revenue owed to them (see the attachment to this letter for the survey questions). Fiscal officers from the cities of Austin, Houston, Fort Worth, and San Antonio responded to the survey; the cities of Bryan and Plano did not respond. For the cities that responded, the

¹ See *Sales Tax 2005: Data Reliability*, May 2005, City of Austin, Office of the City Auditor.

percentage of the annual city budget funded by city sales tax revenue ranged from 15.75 percent to 27.2 percent.

Cities that responded to the survey stated they do not currently perform processes to independently ensure they receive the amount of city sales tax revenue owed to them. However, the City of Austin is starting to implement a city sales tax monitoring process through which it will (1) monitor newly permitted businesses to ensure that they are accurately reporting their locations and (2) perform periodic reviews of sales tax information. The City of Austin will be using various reports provided by the Comptroller's Office to perform this monitoring (those reports are discussed in more detail below).

Three cities indicated that state law prevents them from obtaining detailed sales tax collection information for the businesses located within their cities limits. Texas Tax Code, Section 321.3022, restricts cities that have a population of greater than 275,000 from access to the amount of city sales tax remitted by each business. The City of Austin's Office of the City Auditor has recommended that the City of Austin pursue action to change the statute that restricts larger cities' access to this information.²

**Five Sales Tax Reports Available to
Cities from the Comptroller's Office**

Quarterly reports:

- List of Sales and Use Tax Taxpayers Paid Up
- List of Delinquent Sales and Use Tax Taxpayers

Other reports available upon request:

- List of Businesses by ZIP Code or Jurisdiction
- List of New Sales Tax Permit Holders with Local Information
- Sales Tax Area Report

Cities have access to five different reports from the Comptroller's Office that would allow for them to verify businesses' self-reported locations (see text box for a list of those reports). Unless a city elects not to receive them, the Comptroller's Office regularly sends two quarterly reports to each city. Upon request, the Comptroller's Office will also provide three additional reports to any city. Using these reports would enable cities to perform the same location verification process the State Auditor's Office performed for 520 randomly selected businesses.

The Comptroller's Office Is Implementing a New Automated Tax Jurisdiction System

The Comptroller's Office is in the process of implementing a new geographic information system called the Automated Tax Jurisdiction System. This system will be used to identify the local entity that levies sales tax and the sales tax rate at a physical business location. After this system is implemented, the Comptroller's Office will no longer rely solely on businesses' self-reported location to allocate sales tax revenue.

The Automated Tax Jurisdiction System will also have a Web-based address look-up function to enable the public to view local sales tax rate information for a specific location. The Web site may also be used to determine local sales tax rate for deliveries. After inputting a street address with the city and/or zip code, the system will return the names and tax rates of the local sales tax jurisdictions where the address is located, the state sales tax rate, and the total sales tax rate for the location.

² See *Sales Tax Series*, Calendar Year 2003, City of Austin. Office of the City Auditor.

We appreciate the cooperation and assistance of the Comptroller's Office and the cities of Austin, Bryan, Fort Worth, Houston, Plano, and San Antonio during this review. If you have any questions, please contact Susan Riley, Assistant State Auditor, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

Attachment

cc: The Honorable Carole Keeton Strayhorn, Comptroller of Public Accounts
Mr. Billy Hamilton, Deputy Comptroller, Comptroller of Public Accounts
Mayors, City Council Members, and Fiscal Officers for the cities of Austin, Bryan, Fort Worth, Houston, Plano, and San Antonio

Summary of Objectives, Scope, and Methodology

The objective of this review was to review city revenue processes to determine how cities ensure that the correct amounts of city sales taxes are collected from businesses located in the city limits. To accomplish this objective, auditors:

- Determined whether the information provided by businesses to the Comptroller of Public Accounts in relation to city sales tax is accurate and complete.
- Assessed the processes the cities use to verify receipt of sales tax from all businesses operating within their city limits.

The scope covered all businesses that had active sales tax permits as of March 29, 2006.

The methodology consisted of data analysis and surveying selected cities.

This project was a review; therefore, the information in this report was not subjected to all the tests and confirmations that would be performed in an audit.

The following members of the State Auditor's staff performed the review:

- Liz Roberts (Project Manager)
- Veda Bragg Mendoza, CIA (Assistant Project Manager)
- Mary Goldwater
- Adama Thiam, MBA
- Olin Davis, MBA (Information Systems Audit Team)
- Worth Ferguson, CPA (Quality Control Reviewer)
- Susan Riley, CPA (Assistant State Auditor)



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Attachment

Survey Questions

The State Auditor's Office sent a survey regarding city sales taxes to fiscal officers for the cities of Austin, Bryan, Fort Worth, Houston, Plano, and San Antonio.

The survey asked the following questions:

1. What activities does the city perform to determine whether businesses that should be paying city sales tax to your city are doing so?
2. What process does the city use to determine if the amount of city sales tax remitted from the Texas Comptroller of Public Accounts (Comptroller's Office) is accurate?
3. Does the city receive reports from the Comptroller's Office that enable it to determine whether the correct amount of city sales tax is remitted from the Comptroller's Office?
4. If the city does receive reports from the Comptroller's Office, how often does it receive the reports, what are the names of the reports, and what information is contained in those reports?
5. If the city does receive reports from the Comptroller's Office, who receives those reports and in what city departments do those individuals work?
6. If an error in city sales tax is found, what steps does the city take to address or resolve it?
7. How much of the city's annual budget is comprised of city sales tax revenue?
8. Does the city encounter any hindrances in determining whether it is receiving all required city sales tax from businesses within the city's incorporated borders?