



CITY OF GALVESTON SALES TAX AUDIT

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INCREASING INTERNAL CONTROLS TO PROTECT THE CITY OF GALVESTON SALES TAX REVENUES



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THE HOW AND WHY

OBJECTIVE, SCOPE AND METHODOLOGY

Objective: The objective of the audit was to evaluate the adequacy of the State's audit coverage for the City's sales tax collections.

Scope: The audit scope included a review of the City of Galveston sales tax audits performed by the Texas Comptroller. Our test period covered September 1, 2013 to April 30, 2018.

Methodology: To achieve our objective we took a sample of 11 commercial remodeling building permits issued by the City of Galveston after September 1, 2013 up to April 30, 2018. We compared the sample to Galveston's Sale Tax Confidentiality Report received from the Texas Comptroller to identify any possible risks for non-compliance.

OUR FINDINGS

Out of the 11 commercial remodeling samples selected the City Auditor's Office proved:

- Ten projects paid sales tax on materials, but not labor.
- One project paid sales tax on materials and labor, but sent the payments to another city.

The total estimated additional amount in sales tax due to the City of Galveston was \$250,000 of which we actually collected \$161,000.

These 11 samples were written up separately in an audit format and sent to the Texas Comptroller of Public Accounts in Austin, Texas for review. After nine months and numerous calls, the City Auditor's Office was told by the Comptroller's Office that some of the 11 samples had been audited by the State. No other information was communicated. Also, the Texas Comptroller of Public Accounts ceased to operate in a joint effort with the City Auditor's Office.

OPPORTUNITY FOR IMPROVEMENT

THE PROBLEM

In Texas, the materials and "labor" spent on commercial remodeling projects is subject to sales tax. This requirement differs from residential and new construction, where materials are subject to sales tax but labor is not.

As a result, often times business owners and contractors fail to make sales tax payments, possibly because of confusion as to who is responsible to send the sales tax payment to the State.

It is also difficult for the Texas State Comptroller Auditors to detect since they cannot keep track of every time a commercial entity remodels a building or property.

A City Auditor or City Finance Director would be better suited to detect non-payment of sales tax on commercial remodeling projects because they work in the area and have access to building permits in the City's Planning Division.

THE CASE FOR A JOINT EFFORT

Municipalities and the State of Texas have a vested interest in the collection of sales tax because it is a substantial source of revenue to each of them. A joint effort would be a cost-effective way to gain more audit oversight and address the non-compliance issues with commercial remodeling projects. The City Auditor estimates that the City of Galveston is not collecting around 1 million dollars annually on sales tax on commercial remodeling projects.

HOW TO STRUCTURE A JOINT EFFORT

To help structure this joint effort, commercial remodeling permits within a City would require an applicant to answer a certain set of questions before the permit is issued, including information about the material and labor costs.

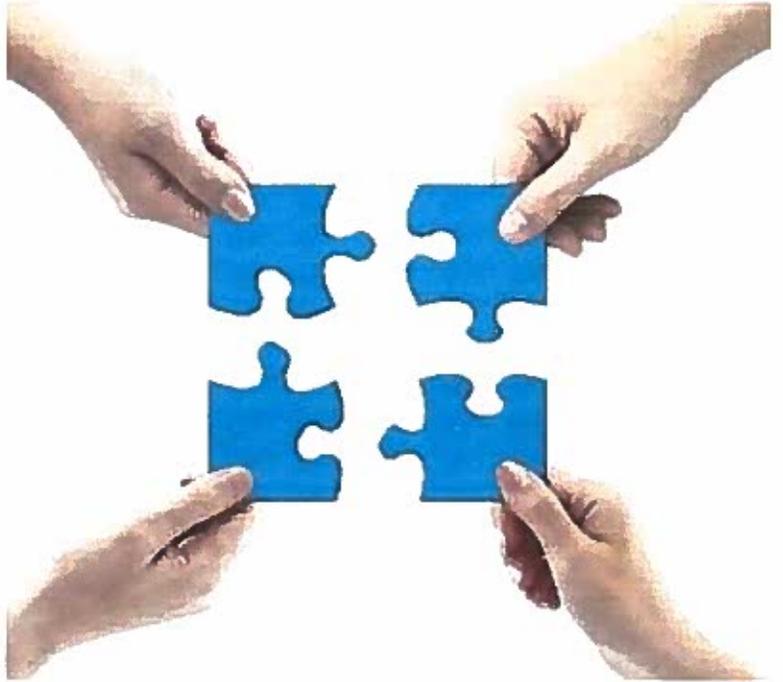


OPPORTUNITY FOR IMPROVEMENT

STRUCTURING A JOINT EFFORT (CONT.)

Code enforcement employees would check the accuracy and veracity of the building permits through statistical data and field audits.

The permit applicants would also be provided with the state law on sales taxes and how to make those payments correctly. Proper proof of sales tax owed and payments made would be required before a Certificate of Occupancy is approved by the City.



The Texas Comptroller's Office would send back verification to the City of the payment received and any instances of non-compliance would result in a sales and use tax audit conducted by the State of Texas. Results of those audits would be sent back to the municipalities in the form of a confidential report.

We need to work jointly to help the State Comptroller's Office finish these types of audits in a more timely manner so that the four year statute of limitations for the collection of sales tax does not expire. The statute begins on the date the sales tax was due.

Working together would create greater audit efficiency of compliance monitoring and better audit coverage, as well as effective audit cost reductions for the Texas Comptroller's Office. In turn, the Texas Comptroller's Office as well as all Texas municipalities would see an increase in sales tax revenues.