FOLLOW-UP REPORT
Department of Finance
Municipal Sales Tax Collection Practices Audit
October 2017

Office of the Auditor
Audit Services Division
City and County of Denver

Timothy M. O’Brien, CPA
Denver Auditor
The Auditor of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies and contractors for the purpose of ensuring the proper and efficient use of City resources and providing other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver’s government.

The Audit Committee is chaired by the Auditor and consists of seven members. The Audit Committee assists the Auditor in his oversight responsibilities regarding the integrity of the City’s finances and operations, including the reliability of the City’s financial statements. The Audit Committee is structured in a manner that ensures the independent oversight of City operations, thereby enhancing citizen confidence and avoiding any appearance of a conflict of interest.

Audit Committee

Timothy M. O’Brien, CPA, Chairman
Rudolfo Payan, Vice Chairman
Jack Blumenthal
Leslie Mitchell
Florine Nath
Charles Scheibe
Ed Scholz

Audit Management

Timothy M. O’Brien, CPA, Auditor
Valerie Walling, CPA, CMC®, Deputy Auditor
Heidi O’Neil, CPA, CGMA, Director of Financial Audits
Dawn Wiseman, CRMA, Audit Manager

Audit Team

Cody Schulte, CPA, CIA, Audit Supervisor
Ronald F. Keller, CIA, CFE, Senior Auditor

You can obtain copies of this report by contacting us:

Office of the Auditor
201 West Colfax Avenue, #705
Denver CO, 80202
(720) 913-5000 • Fax (720) 913-5247

Or download and view an electronic copy by visiting our website at: www.denvergov.org/auditor
Audit report year: 2016
Dear Mr. Ellington:

In keeping with generally accepted government auditing standards and the Audit Services Division’s policy, as authorized by D.R.M.C. § 20-276, our Division has a responsibility to monitor and follow-up on audit recommendations to ensure audit findings are being addressed through appropriate corrective action and to aid us in planning future audits.

This report is to inform you that we have completed our follow-up effort for the Municipal Sales Tax Collection Practices audit issued August 18, 2016. Our review determined the Treasury Division’s Tax Compliance Section has adequately implemented some of the recommendations made in the audit report. Despite the section’s efforts, auditors determined the risk associated with the audit team’s initial findings has not been fully mitigated. As a result, we may revisit these risk areas in future audits to ensure appropriate corrective action is taken.

For your reference, this report includes a highlights page that provides background and summary information on the original audit and the completed follow-up effort. Following the highlights page is a detailed implementation status update for each recommendation.

This concludes audit follow-up work related to this audit. I would like to express our sincere appreciation to you and to the Tax Compliance Section personnel who assisted us throughout the audit and follow-up process. If you have any questions, please feel free to contact me at 720-913-5000 or Cody Schulte, Internal Audit Supervisor, at 720-913-5066.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
Municipal Sales Tax Collection Practices
October 2017

Status
The Treasury Division has implemented five, partially implemented three, and not implemented one of the recommendations made in the August 2016 audit report.

Background
Denver’s authority to administer its own local sales and use tax is established by the Colorado Constitution through the concept of home rule, and the City uses the Denver Revised Municipal Code to set tax rates and establish any exemptions from these taxes. The Department of Finance, Treasury Division’s Tax Compliance Section is responsible for billing, collecting, payment-processing, recording, and reconciling all collected taxes, including sales and use tax. The Tax Compliance Section utilizes a software system called GenTax to collect, record, deposit, and enforce compliance of all City administered taxes.

Purpose
The purpose of the audit was to determine whether effective controls, processes, and practices exist to ensure that sales and use tax is collected and distributed properly; to collect and respond to stakeholder feedback; and to increase online registration, filing, and payment. The audit also assessed what action the City has taken to enforce the collection and remittance of sales tax on internet sales and whether additional actions can be taken.

Highlights from Original Audit
In the original audit, we found that the Tax Compliance Section had established policies and procedures that support the collection process and developed an adequate customer feedback process. However, we identified five areas where improvement would further strengthen operations. We also discussed actions that the City takes to collect sales tax on internet sales as well as additional actions that could be taken.

Finding 1 discussed the five areas where enhancements could be made to the Tax Compliance Section’s operations. First, tax adjustment approval policy and processes were not sufficiently detailed or formalized. Second, the Treasury Division did not periodically analyze or report on the financial impact of specific sales tax exemptions and report the findings to City decision makers for them to review the efficacy of the exemptions. Third, instructional guidance on the Denver Sales Tax Form was not detailed enough to help ensure that vendors conducting sales from a physical store-front location in Denver also report online sales. Fourth, the handling of mail-in delinquent tax payments had an unnecessary step that resulted in a process inefficiency. Finally, there was minimal cooperation between the Treasury Division and the state Department of Revenue to share taxpayer registration and taxable sales information to help improve the City’s tax collection rates.

The audit also assessed what action the City had taken to enforce the collection and remittance of sales tax on internet sales and whether additional actions could be taken. Finding 2 discussed the complexity of this issue as well as the ongoing legal efforts and challenges to enforce the collection of sales tax on remote sales, which primarily includes e-commerce transactions. Specifically, the audit found that the City was not receiving sales tax revenues from all remote sellers who sell to its residents, and that a change in purchasing practices and ongoing issues associated with remote-sales federal legislation had directly impacted the City’s ability to anticipate, collect, and rely on revenues from taxes associated with these transactions.

Findings at Follow-up
The Treasury Division implemented five of the nine recommendations made in the August 2016 audit report. Two of the nine recommendations regarding separation of duties within the waiver and write-off adjustments approval process have not been fully implemented; supervisors are still able to both request and approve adjustments. Regarding monitoring of the legal challenge to C.R.S. § 39-21-112 (3.5)(d), Treasury’s implementation efforts have been limited because the Colorado Department of Revenue (DOR) has not yet received any untaxed transaction reports for the Tax Compliance Section to assess at this time. Finally, the Tax Compliance Section still needs to analyze the report of sales and use tax business registrations received from the state.

For a copy of this report, visit www.denvergov.org/auditor or contact the Auditor’s Office at 720-913-5000.
## Recommendations: Status of Implementation

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Auditee Action</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FINDING 1:</strong> The City Has Sound Sales and Use Tax Collection and Customer Feedback Practices, but Some Improvements Could Further Enhance Effectiveness and Efficiency</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 The Treasury Division’s Tax Collections unit should periodically review and reassess the new Policy Regarding Waivers and Write-Offs (Adjustments) to ensure that it provides Tax Revenue Agent personnel with sufficient guidance.</td>
<td>A new adjustments policy was put into effect June 9, 2016. Follow-up audit work confirmed that Tax Revenue Agents (TRAs) have not approved adjustments on accounts assigned to them. However, at the conclusion of our follow-up work, the Tax Collections unit had not made any updates or adjustments to the policy since it took effect. Further, we noted a few instances where TRA supervisors approved their own requested adjustments. Because of this, Treasury personnel explained that they are making changes to controls within GenTax (see Recommendation 1.2 below) and expect to make revisions to the new adjustments policy reflecting the GenTax changes.</td>
<td>Not Implemented</td>
</tr>
<tr>
<td></td>
<td>Original target date for completion: June 2017</td>
<td></td>
</tr>
</tbody>
</table>
Recommendations: Status of Implementation

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Auditee Action</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.2</td>
<td>The Treasury Tax Compliance Section stated that they worked with Fast Enterprises (the GenTax vendor) to create a system control so that Tax Revenue Agents (TRAs) below the supervisory level cannot request and approve their own adjustments. Further, a supervisor or manager must approve adjustments greater than $2,000. Based on our audit follow-up work, Treasury Division personnel realized that GenTax should also have a control in place so that no employees, regardless of level, can request and approve their own adjustments. The division stated that they met again with Fast Enterprises to request the change, which is expected to be implemented in the near future. Treasury stated they will also update the Waivers and Write-Offs (Adjustments) policy accordingly.</td>
<td>Partially Implemented</td>
</tr>
<tr>
<td>1.3</td>
<td>Treasury prepared estimates of the impact of exemptions using various methodologies for calculation. Treasury provided an analysis, dated October 31, 2016, to the City’s Chief Financial Officer for consideration and will continue to conduct these estimate reviews annually.</td>
<td>Implemented</td>
</tr>
<tr>
<td>1.4</td>
<td>Treasury has made changes to the Sales Tax Return form, specifying that reported sales should include online sales.</td>
<td>Implemented</td>
</tr>
</tbody>
</table>
## Recommendations: Status of Implementation

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Auditee Action</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.5</strong> The Treasury Division’s Tax Compliance Section should direct delinquent returns and payments to the City’s Dallas bank lockbox by revising the return address on notices, envelopes, and its website.</td>
<td>Treasury has made the address changes on notices, return envelopes, and the division’s website, directing delinquent returns and payments to the City’s Dallas bank lockbox.</td>
<td>Implemented</td>
</tr>
<tr>
<td><strong>1.6</strong> The Treasury Division’s Tax Compliance Section should obtain the listing of possible incorrectly registered business sites identified in the Colorado Office of State Auditor’s Local Sales Tax audit and investigate whether the possible errors have any local impact.</td>
<td>Treasury obtained a list of possible incorrectly registered businesses from the Colorado Department of Revenue. The list was analyzed and found not to be accurate enough to be reliable.</td>
<td>Implemented</td>
</tr>
<tr>
<td><strong>1.7</strong> The Treasury Division’s Tax Compliance Section should reassess the feasibility of conducting a routine or periodic comparison of the sales and use tax businesses registered by the City with DOR’s sales and use tax business registration records.</td>
<td>The Tax Compliance Section has requested and received a report from the Colorado Department of Revenue of businesses located in Denver and registered with the state. At the time of follow up, the report had not been analyzed by Treasury, but an analysis is expected to be performed and completed by the end of December 2017.</td>
<td>Not Implemented</td>
</tr>
</tbody>
</table>
**FINDING 2: The City Should Continue to Position Itself to Act upon Pending Legal and Regulatory Developments Related to the Collection of Remote Online Sales Tax**

| 2.1 | The Treasury Division’s Tax Compliance Section should continue to monitor the legal challenge to C.R.S. § 39-21-112 (3.5)(d), which requires retailers that do not collect Colorado sales tax to file an annual report for each purchaser by March 1 of each year to notify Colorado tax authorities of the total amount paid for Colorado purchases when sales tax was not imposed. If the Colorado Department of Revenue (DOR) is legally able to pursue collection of the annual reporting requirements outlined in this statute, the City should work with DOR to assess the information reported and determine the usefulness of the information to help inform the Treasury Division’s audit risk assessment function. | Partially Implemented | Original target date for completion: Ongoing |

| 2.2 | The Treasury Division’s Tax Compliance Section should continue to engage in work efforts to standardize local home rule municipalities’ sales and use tax definitions and monitor ongoing legal challenges that could impact the collection of sales tax from remote online sellers. | Implemented | The Tax Compliance Section has continued to work with other Colorado municipalities to standardize sales and use tax definitions. The Denver City Council approved standardized definitions in June 2017. The City’s Treasurer has become a member of the Sales and Use Tax Simplification Task Force created by state legislature, and in this position, he should be able to continue monitoring future changes to legislation that could impact the collection of sales and use tax from remote online sellers. |
Conclusion

Although the Treasury Division has implemented some recommendations made in the Municipal Sales Tax Collection Practices audit report, others have yet to be acted upon or fully implemented. Accordingly, auditors determined that the risk associated with the audit team’s initial findings has not been fully mitigated. Specifically, separation of duties within the adjustments process remained an issue at the time of follow up. Although the Tax Compliance Section appears to be taking action to fully address this issue, the Audit Services Division may revisit this and other unmitigated risk areas in future audits to ensure appropriate corrective action is taken.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from the Treasury Division for their cooperation during our follow-up effort and their dedicated public service.