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OFFICE AUDIT OF SALES REFUNDS

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STATE DOCUMENTS

Office Audit of Sales Refunds
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Due to budget cuts that have been occurring in state government for the last few years, it has been necessary for managers to review processes that possibly could be modified, enhanced, or deleted. Not being able to replace valuable personnel has challenged managers to try to maintain work loads without overloading the remaining personnel.

BACKGROUND

The South Carolina Department of Revenue is responsible for collecting approximately ninety one percent of all revenue for the state. The Office Audit section of the Department is a part of the Audit Division. It is made up currently of 12 Office Auditors, 1 Administrative Assistant, and 1 Revenue Manager. While the section is largely responsible for the review and examination of Individual Income Tax returns, it also has duties involving Estate Tax, Fiduciary Tax, and Sales Tax.

The Sales Tax area responsibilities are to review refund requests from vendors who have paid and reported the sales tax. After review of the requests, the section is then required to process the refund of correct tax, along with any appropriate interest. Currently, the Department's mainframe system is capable of processing and documenting the original returns submitted by the vendor. The system allows for changes to the original return to be made online, however, it does not accept the automated processing of an amended return. It should be noted that the amending of a sales tax return should be minimal due to the fact that the majority of vendors have no need to file corrected returns. The Office Audit section considers a request for refund to be a corrected or

amended return. Therefore, any sales refund processed must be manually corrected on line.

The auditor's responsibilities also require extensive knowledge of the sales tax code. They are required to review the reason for the refund request and make a determination of its validity as well as verifying the correctness of the amount of tax paid and the proper amount to refund. Reasons for filing a refund request vary, but primarily it involves a deduction being claimed due to one of the exemptions in the South Carolina Code being met. For example, a customer who purchases equipment used for the purpose of manufacturing is exempt from sales tax. When the item is originally purchased, the customer had paid the sales tax but later advises the vendor of the primary use of the equipment and requests a refund. This review process is detailed on page 1 of Appendix A.

The Office Audit section is responsible for collecting 12.1 million dollars during this past fiscal year. Of this total collection, the review of the sales refunds were approximately 1.3 million dollars in reduced refunds. This total represents the reduction of refund amounts or those denied due to our examination. In other words, if the process were automated the refunds requested would have been issued without examination. The following table represents last fiscal year statistics for the Sales Tax area. When reviewing the table it should be noted that one refund may reflect multiple periods. One refund request may involve three years. For a monthly filer of Sales Tax, that would mean that there would be a refund that included thirty six months of returns. While the table may show a total of 1288 refunds, that total may represent as much as 46,368 specific tax periods. Our refund system allows the employee to enter the refund for each

tax period, but if there are multiple periods for one vendor then only one check will be issued for the total.

FISCAL YEAR JULY 2002 - JUNE 2003				
	# REFUND	\$ REFUND	# REDUCED REFUNDS	\$ REDUCED REFUNDS
JULY	120	\$334,811.12	27	\$33,390.35
AUGUST	156	\$389,052.02	35	\$82,327.18
SEPT	100	\$472,354.12	27	\$83,788.66
OCT	98	\$220,330.08	33	\$48,085.25
NOV	164	\$907,625.06	21	\$20,719.56
DEC	77	\$476,933.91	17	\$99,172.59
JAN	143	\$365,432.39	21	\$26,166.66
FEB	164	\$696,276.87	33	\$83,641.88
MARCH	69	\$2,396,096.03	36	\$28,052.13
APRIL	140	\$480,247.83	34	\$295,098.34
MAY	43	\$87,771.55	46	\$148,393.15
JUNE	14	\$36,525.22	3	\$344,906.13
TOTAL	1288	\$6,863,456.20	333	\$1,293,741.88

For ten months of this period, the Department had 2 Office Auditors assigned to review and issue the refunds. One of the auditors retired at the end of April, 03. A decision, driven by the budget, did not allow the Department to hire a replacement. The last two months of the fiscal year reflects a decrease in the number of refunds issued.

One of the primary challenges facing the Office Audit section these past few months was the process of the Sales tax refund. As shown above, without one examiner to perform the duties, the need to maintain the number of refunds issued is paramount. If we do not issue refunds promptly, then there will be an increased number of calls from taxpayers. Additionally, if the Department does not issue a refund in a timely manner then interest will be added to the tax. This interest total can be that much more costly to the state.

The following table of the same statistics for the period of July, 2003 through December, 2003 reflects the continued decline of the number of refunds issued.

JULY 2003 - DECEMBER 2003				
	# REFUNDS	\$ REFUNDS	# REDUCED REFFUNDS	\$ REDUCED REFUNDS
JULY	52	\$52,129.67	2	\$60,274.76
AUGUST	32	\$167,217.39	5	\$1,577.81
SEPT	44	\$110,277.32	8	\$49,480.70
OCT	27	\$135,328.27	3	\$30,170.19
NOV	32	\$116,253.53	1	\$5.84
DEC	42	\$409,561.08	8	\$9,713.87
TOTAL	229	\$990,767.26	27	\$151,223.17

EXAMINING THE CURRENT PROCESS

After the retirement of one of the examiners and the decision to not replace the position, a review of the personnel and the processes within the control of the Office Audit management needed to be done. Flow charts were developed of the sales refund examination process and the administrative process. The charts shown as Appendix A are reflective of the entire process. The colors that are represented in the charts will be discussed later. Through December, 2003, the examiner was performing all of the duties and steps outlined in all of Appendix A.

An additional factor for management to weigh involved another area of Office Audit. That area was the Estate Tax area. Recent changes to the Federal Estate tax code affected this area of the South Carolina Department of Revenue. Basically, South Carolina's estate tax laws "piggy back" the federal estate law. Due to increase of filing

requirements, the numbers of estates that are required to file a return have decreased by 23%. Additionally, the estate tax that South Carolina collects is calculated as a credit from the federal return. The federal changes included a decrease of this credit by 25% each year. Due to our General Assembly's decision to not change our law, South Carolina will no longer receive any estate returns or estate tax dollars for taxpayers who die after December 31, 2004.

The Estate Tax area of the Office Audit section currently has one examiner and one administrative position. The examiner had already been assigned some additional duties in another tax area. And while the administrative assistant had also received some additional duties, she had proven that the additional duties were not enough.

The process was examined to determine if there were areas that would allow the sales tax examiner to audit the requests and the administrative assistant to absorb some of the responsibilities of the process. After examining the process we found that there was a portion of the process that was common for the administrative assistant in her current duties. The yellow colored steps of page 2 of Appendix A through the end of the steps through page 4 detail a common process for refunding other taxes that the Department administers. It should be noted that many of our taxes are refunded through our Miscellaneous Refund System(MRS). While there are specific differences between the taxes, the MRS system has been designed to allow the users of our agency to enter the data uniformly to send the data to the State Treasurer.

The keying of the data onto the MRS system was not going to be a real issue of training for the administrative assistant. The main issue of training was the entering of data onto the Sales Tax system. This data is critical for historical purposes as well as the necessary

accounting needed for the counties of the state. South Carolina has some counties that have a local option sales tax. This additional sales tax is collected and sent to the appropriate counties for their own revenue use. However, if our agency issues a refund of sales tax from a vendor of one of the local option counties, then a necessary balancing must take place of the funds that are directed to the counties.

From the interviews with the examiner, this process of entering the corrected data into the Sales Tax system was certainly the most time consuming of the entire process. As stated before, one request for refund may involve thirty six tax periods. The examiner's strengths include audit skills and tax knowledge. If critical time is taken away from the review of the reason for refund and review of the supporting documents from the taxpayer, then collections from the reduced refunds will decrease. The state can ill afford to lose any dollars of collections.

Beginning January, 2004, we implemented the new plan. While it would have been beneficial to implement earlier, there were normal steps to hurdle through appropriate channels of the Human Resource department. There was also the need for critical training for the administrative assistant.

Appendix A reflects the entire process. The gray colored boxes represent the new steps for the auditor. The yellow boxes represent the new steps for the administrative assistant.

DOES IT WORK?

Well, certainly one month's worth of data should not be considered conclusive. However, the results have been encouraging. The goal for management always is to improve any process, however, the goal established for this project was to maintain prior

year's standards with less auditors. The following table represents the totals for January, 2004.

	2004			
	# REFUNDS	\$ REFUNDS	# REDUCED REFUNDS	\$ REDUCED REFUNDS
JAN	158	\$749,796.03	10	\$50,314.36

As the table shows, there was a significant increase in the number of refunds issued. The average number of refunds for the previous six months was 38. The change in the process has increased the number by 400%. Additionally, the numbers of reduced refunds have increased by approximately 100% of the average 4.5 number of the previous six months. More importantly, when you compare the average number of refunds per month of fiscal year 02/03, you will also see an increase of almost 50%.

WE ARE NOT THERE YET!

Continued analysis of the new process will be done. The current inventory of the requests for sales refunds are approximately 1,000 in number. Some of these requests have been in our inventory for more than a year. Additionally, we can expect 500 to 1000 more requests to come in next fiscal year.

However, after interviewing the auditor, it is now apparent that he believes that the new process is much better. His job has been refocused on releasing the refunds that are valid to the administrative assistant, and adjusting the refund requests that have problems.

Additional attention needs to be placed upon the current computer systems.

Management needs to determine if there are additional ways to eliminate any unnecessary steps to assist the administrative assistant.

Sales Refund Process

Grey Background = Verification by Auditor

Yellow Background = Admin. Asst. Process







