CITY OF TALLAHASSEE
OFFICE OF THE CITY AUDITOR

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City Auditor

HIGHLIGHTS

Highlights of City Auditor Report #0911, a report to the City Commission and City management

WHY THIS AUDIT WAS CONDUCTED

This audit was conducted to: 1) verify the reasonableness and appropriateness of the information supporting the City of Tallahassee (City) Revenue Division's request to the City Commission to increase the local Communications Services Tax (CST) rate from 5.49% to 6.1%, effective February 1, 2009; 2) provide assurance that a Florida Department of Revenue (FDOR) audit finding requiring the City to repay $1.4 million is adequately supported; and 3) determine the accuracy of Leon County addresses and assigned jurisdictions in the FDOR CST address database.

WHAT WE RECOMMENDED

We provided recommendations during the audit to the Revenue Division to address each of the identified issues. All action plan steps were completed and/or actions planned. The action plan steps included:

- Continue monitoring CST collections and make adjustments to the CST local tax rate that are necessary to ensure that expected tax collection levels are maintained. *[On-going procedures were put in place in December 2008]*
- Address the audit report concerns with FDOR and request that the $1.4 million adjustment be waived. *[To be addressed]*
- Request that FDOR include the providers' "qualifying discount" in the calculation of what the jurisdictions owe back to FDOR when adjustments are determined. *[To be addressed]*
- Work with the City ISS staff and County GIS staff to update and correct the Leon County addresses in the FDOR Database, and implement a process to periodically verify its accuracy. *[Completed when Leon/Tallahassee GIS staff replaced all Leon/Tallahassee addresses in the FDOR address database on March 6, 2009.]*

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April 7, 2009

AUDIT OF REPAYMENT OF LOCAL COMMUNICATIONS SERVICES TAX

The City should not be required to repay $1.4 million in communications services taxes identified as overpayments by the Florida Department of Revenue

WHAT WE CONCLUDED

Based on our audit, we made the following four conclusions:

1) The City Revenue Division's basis for requesting the City Commission to increase the CST local rate from 5.49% to 6.1% appears to be a reasonable and appropriate response to previous years under-collections and the recent FDOR adjustment (made up of audit and non-audit adjustments). However, we were also made aware that additional FDOR audit adjustments are forthcoming, as the first adjustment of $1.4 million was based on the 45-50% audits completed through November 2008. We were not able to provide assurance that the tax rate increase will be sufficient to compensate for future supported FDOR adjustments.

2) Our review of FDOR audit documentation and discussions with FDOR auditors showed their audit testing methodology for verifying the accuracy of assigned jurisdictions in the providers' billing database was not statistically valid. Our concern is that FDOR is using imprecise audit methodologies to calculate precise audit adjustments. Therefore, we do not agree with FDOR's overall audit conclusion that the City should repay $1.4 million.

3) Assigned jurisdictions and wrong addresses in FDOR audit testing resulted in the largest portion of the FDOR audit adjustments. Our review of the Leon/Tallahassee address and assigned jurisdictions in the FDOR CST address database indicated that the accuracy had not been verified since it was originally submitted in 2000. Since then, FDOR added address information from the United States Postal Service Master Address Listing causing duplicate addresses, but some with wrong assigned jurisdictions. Inaccurate address and jurisdictional designations data can result in incorrect FDOR audit adjustments.

4) Other issues identified during the audit related to the FDOR audit processes included: a) FDOR was not including providers' "qualifying discounts" taken on the CST returns when determining adjustments; and b) providers will most likely continue to make CST payments to inaccurate jurisdictions in the future, as they were not likely to correct errors identified in FDOR audits.

Office of the City Auditor

Audit Report

Sam M. McCall, CPA, CGFM, CIA, CGAP
City Auditor

Repayment of Local Communications Services Tax

Report #0911 **April 7, 2009**

Executive Summary

The objectives of this audit were to: 1) verify the reasonableness and appropriateness of the information supporting the City of Tallahassee (City) Revenue Division's request to the City Commission to increase the local Communications Services Tax (CST) rate from 5.49% to 6.1%, effective February 1, 2009; 2) provide assurance that the FDOR audit finding requiring the City to repay $1.4 million is adequately supported; and 3) determine the accuracy of Leon County addresses and assigned jurisdictions in the Florida Department of Revenue (FDOR) CST address database.

Based on our review, we concluded the following.

1) The City Revenue Division's basis for requesting the City Commission to increase the CST local rate from 5.49% to 6.1% appears to be a reasonable and appropriate response to previous years under-collections and the recent FDOR adjustment (made up of audit and non-audit adjustments). The rate increase should help ensure that the City receives expected CST collections. We are also aware that as of November 2008, FDOR had completed 45-50% of the planned audits. Therefore, we are not able to provide assurance that the tax rate increase will be sufficient to compensate for future supported FDOR adjustments. We recommend that the City Revenue Division continue monitoring CST collections and make adjustments to the CST local tax rate that are necessary to ensure that expected tax collection levels are maintained.

2) We do not believe FDOR's audit finding requiring the City to repay $1.4 million is adequately supported, and therefore do not agree with FDOR's overall audit conclusion that the City should repay $1.4 million. The $1.4 million adjustment consists of a <$2,148,581> audit adjustment and a $724,214 non-audit adjustment. Our review of FDOR audit documentation and discussions with FDOR auditors showed their audit testing methodology for verifying the accuracy of assigned jurisdictions in the providers' billing database was not statistically valid.

   The FDOR audit scope was limited by the amount of information providers made available for the audits and amount of information accepted by FDOR as sufficient for the audits. For example, the providers made available only one month's billing and address information for the entire audit period, ranging from one to three years. The FDOR auditors test the accuracy of the address data (verifying the assigned jurisdiction) in the provider billing information for the one-month of information, develop error ratios, and project their findings to the entire audit period.

   For the audit testing to be statistically valid, FDOR auditors should have selected their sample from the population of billing information for the entire audit period, e.g., one to three years. Then, the testing results could be statistically projected to the population of billing data for the entire audit period. Even so, a projected error (underpayment) would be correct only within a given range (or margin) of error.

As noted above, the FDOR sampling methodology was to test the assigned jurisdictions in one month's of the providers' data and then to project the results (through error ratios) to the entire period. We do not agree with this methodology.

Additionally prior to 2003, as discussed in item #3 below, FDOR added Leon/Tallahassee addresses to the FDOR address database with address information from the United States Postal Service's (USPS) Master Address Listing database. In doing so, some addresses were duplicated but with differently assigned jurisdictions. Duplicate addresses with conflicting assigned jurisdictions could negatively affect the audit testing results when FDOR attempted to match a provider's address data to FDOR's address data.

Our concern is that FDOR is using an imprecise audit methodology to calculate precise audit adjustments (over and under payments of CST taxes). The result is that FDOR has identified a net overpayment and is requiring the City to repay $1.4 million ($724,214 - $2,148,581). It is possible that if all facts were known, the City could owe more, or nothing at all. Therefore, we recommend that the City Revenue Division address these concerns with FDOR and request that the $1.4 million adjustment be waived.

3) Our comparison of addresses and jurisdictions in the Tallahassee-Leon County Geographicl Information System (GIS) database to those recorded in the FDOR address database identified instances where addresses could not be matched because street names were misspelled or incomplete (342 instances of 5,187 or 7%). It is likely that some of these instances resulted in unmatched addresses between the FDOR and providers' address database. And, as stated above, those instances, in turn may have resulted in FDOR errors during their audits.

   As part of their audit process, FDOR compares (matches) addresses and related jurisdictions from the FDOR address database to those in the CST providers' address database. When the jurisdictions for matched addresses differ, FDOR identifies the related taxes collected for services rendered at that address as an audit exception. Those exceptions are summarized and totaled to determine audit adjustments (over and underpayments of CST taxes). These circumstances require that the addresses and the jurisdictions recorded in the FDOR database be complete and accurate and emphasize the importance of the accuracy of addresses and jurisdictions in the provider's address database.

   While City and County staff have consistently submitted timely updates to the FDOR for address additions and changes (e.g., new premises and annexations), staff has not reviewed the FDOR address database to ensure its overall accuracy. During our audit, FDOR auditors indicated prior to 2003, they added address information from the USPS's Master Address Listing database to the FDOR address database. The added information created duplicate addresses in the database, but some addresses had the wrong assigned jurisdictions, resulting in inaccurate audit testing results. The address data should be corrected. We recommend that the Revenue Division work with the County and City GIS staff to enhance current efforts to ensure the accuracy of Tallahassee-Leon County addresses and assigned jurisdictions in the FDOR address database.

4) Additionally, we discovered two issues that also impacted the adjustments:

   - FDOR auditors were not including the provider's "qualifying discount" received on the original CST return in the calculation of what the jurisdictions owe back to FDOR when adjustments are determined. The qualifying discount, either .25% or .75%, could impact the City up to $10,683. While this amount may not appear significant to the City, the cumulative effect to all Florida jurisdictions over the years could be significant. From these initial audits, FDOR will receive over $60 million in overpayments from Florida jurisdictions; the total impact to Florida jurisdictions could be up to $450,000. We recommend that the City Revenue Division request FDOR to include the provider's "qualifying discount" in the calculation of what the jurisdictions owe back to FDOR when adjustments are determined.

- FDOR auditors, based on experience, stated that providers often do not correct address errors identified during FDOR audits. Accordingly, providers will continue to make CST payments to inaccurate jurisdictions resulting in repetitive audit adjustments. As shown in item #2 above, a majority of the audit adjustments in the four audits we reviewed were due to jurisdictional errors.

We would like to acknowledge the full and complete cooperation and support of management and staff from the Treasurer-Clerk's Office, the Leon County and City GIS Divisions, and FDOR CST Audit Division.

Scope, Objectives, and Methodology

The specific objectives of this audit were to:

1) Verify the reasonableness and appropriateness of the information supporting the City Revenue Division's request to the City Commission to increase the local Communications Services Tax (CST) rate from 5.49% to 6.1%, effective February 1, 2009.
2) Provide assurance that the FDOR adjustment requiring the City to repay $1.4 million is adequately supported.
3) Determine the accuracy of Leon County addresses and assigned jurisdictions in the FDOR CST address database, which is used by FDOR to determine the accuracy of providers' addresses and assigned jurisdictions.

To achieve our objectives, we reviewed Florida Statutes (FS) related to the CST; analyzed past City CST collections; recalculated expected City CST collections; reviewed FDOR CST audit methodologies, workpapers, and reports related to four FDOR audits reporting $2,127,106 (of the total $2,148,581 audit adjustments) in overpayments to the City; interviewed FDOR CST auditors and audit managers, Leon County GIS staff and managers, and City GIS staff and managers; and compared the Leon County addresses and jurisdictions in the FDOR address database to the Leon County GIS address database.

According to FS Sections 202.195, 213.053(8)(v), and 213.053(2), the proprietary business information (including billing and payment records) related to the CST that FDOR provided to the City for our audit is confidential and exempt from public records laws. Therefore, this audit report will not disclose provider names, billings, payments, or taxes paid by and pertaining to communications services providers.

We conducted the audit in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

<u>Communications Services Tax</u>

FS Chapter 202, Communications Services Tax Simplification Law, provides the authorization for the tax and legal requirements related to the taxes applied to sales of communications services. Communications services are defined as the "transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals, including cable services, to a point, or between or among points, by or through any electronic, radio, satellite, cable, optical, microwave, or other medium or method now in existence or hereafter devised, regardless of the protocol used for such transmission or conveyance." Providers in Leon County include businesses that provide home and business telephone services, cellular phone services, cable television, and Internet services. Providers of taxable communications services bill and collect applicable taxes from customers and remit the taxes to the FDOR on monthly CST returns.

Prior to October 2001, all providers reported and remitted the collected CST to each of the estimated 467 separate Florida jurisdictions (counties and municipalities) on a monthly or quarterly basis. The Florida legislature passed the Communications Services Tax Simplification Law (CST Statute), effective October 1, 2001. The CST Statute was intended to reform the communications tax laws thereby resulting in "a fair, efficient, and uniform method for taxing communications services sold in this state." Pursuant to the CST Statute, the law was implemented to:

- Restructure state and local taxes and fees to account for the impact of federal legislation, industry deregulation, and the convergence of service offerings that is now taking place among providers.
- Promote the increased competition that accompanies deregulation by embracing a competitively neutral tax policy that will free consumers to choose a provider based on tax-neutral considerations.
- Spur new competition by simplifying an extremely complicated state and local tax and fee system.
- Lower the cost of collecting taxes and fees, increase service availability, and place downward pressure on price.
- Increase efficiency by reducing the number of returns that a provider must file each month.
- Ensure that the growth of the industry is unimpaired by excessive governmental regulation by restructuring separate taxes and fees into a revenue-neutral communications services tax centrally administered by FDOR.
- Replace taxes and fees previously imposed, not impose a new tax.

Under the CST Statute, the provider bills the customer for rendered communications services and charges and collects the applicable CST based on the rate established for the customer's jurisdiction. The provider determines the customer's jurisdiction based on the customer's service address. Customers' billing and address information is maintained in the providers' database. Monthly, providers complete and remit the Florida CST Return (Form DR-700016) to FDOR reporting the taxable sales subject to the CST and the CST collected by jurisdiction. The provider then remits the collected taxes to FDOR. FDOR then distributes the CST collections submitted by the provider to each jurisdiction, as reported on the provider's CST return.

The CST Statute did not intend to reduce or increase the CST collections to local governments, but to simplify the reporting and payment processes. Accordingly, when local governments encounter a shortfall in CST collections, the CST Statute provides conditions for which local governments may adjust the CST local rate upward to the extent necessary to generate the "expected" amount of revenue on an ongoing basis (FS Section 220.20(2)(a)(1)). The "expected" revenue was determined to be the CST collections during fiscal year 2000-2001, plus the average growth of the collections over the immediately preceding 5-year period. As shown in Table 1, based on the 2001 collections ($8,496,000) and the City's average growth rate for the fiscal years 1997 - 2001 (6.47%), the City's expected CST collections is $9,045,955 annually.

Table 1
Determination of the Expected Replacement Revenue After CST Statute was Implemented on October 1, 2001

FY 2001 collections	$8,496,000
FY 1997 – 2001 average revenue growth	6.47%
Expected revenue in FY 2002 (1)	**$9,045,955**

Source: City Revenue Division analyses and audit recalculations
Note (1): Slight calculation difference due to rounding

The CST Statute authorizes the FDOR to administer and enforce the collection of communications services taxes, interest, and penalties. To ensure compliance with the CST Statute, FDOR conducts audits of providers. FDOR is required to notify providers 60 days prior to the start of an audit and can audit any period within the prior three years. FDOR auditors request a copy of the provider's customer service address and billing database for the selected audit period and then perform various analyses, including testing the accuracy of the jurisdiction assignments to customer addresses and tax amounts collected from customers and remitted to FDOR.

The FDOR audit results are used to determine whether jurisdictions have been underpaid or overpaid. Periodically, the FDOR CST Division notifies the jurisdictions of the audit results which include the additional amounts they will receive or the amounts that they have been overpaid and will need to repay. The City received its first notification from FDOR in the fall 2008. That notification reported that the City was overpaid $1.4 million in CST collections and must repay this amount to FDOR over a 36-month period.

Common CST Errors Made by Providers

FDOR auditors indicated the most common types of errors observed during their audits of communications services provider CST returns were reporting errors, tax rate and application errors, and jurisdiction errors. Table 2 lists the most common types of errors and their potential impacts to local governments. A small percentage of the reporting errors may be identified based on the CST return as submitted (e.g., errors detectable by reviewing the CST return), but the majority of the errors cannot be identified until an audit of supporting records is performed.

The overall FDOR adjustment of $1,424,367 in overpayments to the City consists of audit adjustments and non-audit adjustments. Audit adjustments of <$2,148,581> were discovered during FDOR audits of providers. Non-audit adjustments of $724,214 were made by the providers, generally resulting from errors made by their tax preparer.

Table 2
Types of Errors Resulting in Adjustments to Providers and Local Governments

<table>
<tr><th>Type of Error</th><th>Description of Error</th><th>Potential Impact to Local Governments</th></tr>
<tr><td>Reporting Errors</td><td>Providers make errors on their monthly CST returns.</td><td rowspan="3">1) Taxes collected are distributed to the wrong jurisdictions.
2) More tax is due.
3) Less tax is due.

Each of these impacts results in redistribution of CST collections among local governments.</td></tr>
<tr><td>Tax Rate and Application Errors</td><td>Providers use the wrong tax rates; providers do not collect taxes from customers for taxable services; providers collect taxes for nontaxable services; and/or providers collect taxes from customers using the wrong jurisdiction's tax rates.</td></tr>
<tr><td>Jurisdiction Errors</td><td>Providers assigned the incorrect jurisdiction to the customer's billing address.</td></tr>
</table>

Source: FDOR CST Division auditors and audit managers

Audit Results, Conclusions, Issues, and Recommendations

The results and conclusions from our audit are provided as related to each of the three audit objectives. In our review of the four CST audit results, we also noted some data limitations that the FDOR auditors worked with to calculate adjustments. Where applicable, we identified these limitations, discussed their potential impact, and provided recommendations.

1) Verifying the reasonableness and appropriateness of the information supporting the City of Tallahassee (City) Revenue Division's request to the City Commission to increase the local CST rate.

We concluded that the City Revenue Division's basis for requesting the City Commission to increase the CST local rate from 5.49% to 6.1% appears to be a viable and reasonable response to the previous years under-collections and the recent FDOR adjustment. The rate increase should help ensure that the City receives expected CST collections. We are also aware that as of November 2008, FDOR had completed 45-50% of their planned audits. Therefore, we are not able to provide assurance that the tax rate increase will be sufficient to compensate for unknown future supported FDOR adjustments.

Prior to the implementation of the CST Statute in October 2001, local governments had the authority to audit providers to determine compliance with the local CST requirements. After October 1, 2001, only FDOR was authorized to audit providers.

In August 2008, FDOR notified local governments of the adjustments resulting from the first round of completed FDOR CST provider audits. As of November 3, 2008, FDOR had completed approximately 45-50% of the initially planned audits. The City was notified it was required to repay $1,424,367 in CST overpayments erroneously received between December 2001 and November 2008, based on the results of 72 completed audits. FDOR is requiring the City to repay this amount in monthly installments of $39,566 over a three-year period ($474,789 annually) beginning on March 1, 2009. As more FDOR CST audits are completed, it is possible that the City may either be required to repay more overpayments or receive additional collections for underpayments.

The City expected CST collections to continue to be $9,045,955 for each year after 2001. In 2006, the City adjusted the CST rates from 5.22% to 5.49% in order to increase CST collections from $8,226,414 to the expected $9,045,954.

For FYs 2002 – 2008, before the FDOR audits, the City had collected $1.16 million less than expected ($63,321,685 - $62,160,837). The FDOR audit results identified that the City was overpaid $1.5 million between fiscal years 2002 – 2008, and underpaid $80,468 in fiscal year 2009 totaling an overpayment of $1.4 million. When the adjustments are included, the City's CST collections over the seven-year period were $2,665,683 less than expected ($63,321,685 – $60,656,003). The results of this analysis show that the City encountered a "shortfall" and was therefore authorized by the CST Statute to increase the CST local rate to produce CST collections equal to the expected $9,045,955.

Table 3 shows that the City's CST collections between fiscal years 2002 – 2008 were 2% more than the FDOR audit results indicated they should have been, and 4% less than the City expected they should have been after the FDOR adjustments were included.

Table 3
CST Local Rates, Expected Collections, Actual Collections, FDOR Adjustments, and Total Adjusted Collections for Fiscal Years 2002 – 2008

Fiscal Year	City's CST Rate	CST Expected Collections	CST Actual Amount Collected (before FDOR Adjustments)	FDOR Adjustments for each Fiscal Year (1)	Total Adjusted Collections with FDOR Adjustment included
2002	5.22%	$9,045,955	$9,140,493	($229,127)	$8,911,366
2003	5.22%	$9,045,955	$9,685,240	($498,180)	$9,187,060
2004	5.22%	$9,045,955	$8,717,111	($334,672)	$8,382,439
2005	5.22%	$9,045,955	$8,334,106	($209,549)	$8,124,557
2006	5.49%	$9,045,955	$8,226,414	($367,845)	$7,858,569
2007	5.49%	$9,045,955	$8,916,927	$26,078	$8,943,005
2008	5.49%	$9,045,955	$9,140,547	$108,460	$9,249,007
Totals		**$63,321,685**	**$62,160,837**	**($1,504,835)**	**$60,656,003**
Percentage of CST Expected Collections			**98%**		**96%**
Percentage of Actual CST Collections				**(2%)**	**98%**

Source: City financial reports, Treasurer-Clerk Revenue Division analyses, and audit calculations.

Note 1: As of 11/3/08, the total underpayment (overpayment) included audited periods in FYs 2001 - 2009. Total amount to repay = $1,424,367 ($1,504,835-80,468 from Table 4). FY 2002 also includes $622 from FY 2001.

In November 2008, the City Commission approved the Revenue Division's request to increase the local CST rate from 5.49% to 6.1%. The increase was intended to generate the amount of CST collections that will hold the City harmless (i.e., achieve the $9,045,955 annually) and collect monies to hold in reserve in order to repay any additional FDOR adjustments should FDOR identify additional overpayments in future audits that can be supported. Should future FDOR adjustments be underpayments rather than overpayments, the Revenue Division plans to reduce the CST local rate to arrive at the CST expected collections.

Table 4 shows the estimated collections based on the new local CST rate of 6.1%.

Table 4
CST Budget Projections, Repayment Schedule, Amounts Under (Over) Paid to City, and Expected Reserves for FYs 2009 - 2013

Fiscal Year	City's CST Rate	CST Expected Collections	CST Budgeted Collections Before FDOR Adjustments	Less Repayment of Known Overpayments (as of 11/3/08)	Plus Amount Due from Known Underpayments (as of 11/3/08) (1)	Excess CST Collections to Hold in Reserve for Future FDOR Adjustments (2)
2009	6.10%	$9,045,955	$9,824,841	($474,789)	$80,468	$304,098
2010	6.10%	$9,045,955	$10,076,760	($474,789)		$556,017
2011	6.10%	$9,045,955	$10,076,760	($474,789)		$556,017
2012	6.10%	$9,045,955	$10,076,760			$1,030,806
2013	6.10%	$9,045,955	$10,076,760			$1,030,806
Totals		**$45,229,775**	**$50,131,881**	**($1,424,367)**	**$80,468**	**$3,477,743**

Source: City Revenue Division analyses and audit calculations
Note 1: Future adjustments are not known at this time. FDOR is continuing to conduct audits of providers and indicated there will continue to be adjustments for local governments.
Note 2: The City Revenue Division will be monitoring CST collections and FDOR adjustments to determine if CST local rate should be reduced to reach the annual expected CST collections amount of $9,045,955.

Our analysis shows that the increased rate should provide adequate funds to repay the current adjustment amounts resulting from the FDOR audits and establish a reserve to fund anticipated subsequent FDOR adjustments resulting from overpayments that can be supported. However, we are unable to provide assurance that the new CST local rate is adequate to create and sustain a sufficient reserve, as future FDOR adjustments are unknown at this time.

<u>We recommend</u> that the City Revenue Division continue monitoring CST collections and make adjustments to the CST local tax rate that are necessary to ensure that expected tax collections are maintained.

<u>2) Assuring the FDOR adjustment requiring the City to repay $1.4 million is adequately supported.</u>

We do not believe the FDOR audit finding requiring the City to repay $1.4 million is adequately supported, and therefore do not agree with FDOR's overall audit conclusion that the City should repay $1.4 million.

In October 2008, FDOR auditors estimated they had completed audits of 45-50% of the total CST collections since December 2001 and had approximately 150 audits currently in process. In November, FDOR notified the City that based on 72 completed audits and provider reported non-audit adjustments, the City had been overpaid $1,424,367 between December 2001 and November 2008.

FS Section 202.20(2)(a)(2), requires FDOR to make complete audit information available to local governments after the FDOR audits, including the resulting redistribution of local taxes for those providers that account for no less than 80% of the amount of CST collections received for fiscal years 2005-2006.

Among the results of the 72 individual audits, there were total overpayments of $2,148,581. In fall 2008, the City Revenue Division requested FDOR documentation supporting four audit adjustments totaling over $2.1 million of overpayments to the City. The audit adjustment for each of the four audits we reviewed is shown below in Table 5.

Table 5
Audit Period and Adjustment for the Four FDOR Audits Reviewed

FDOR Audit	Period Reviewed	Total Adjustments
Audit 1	1/1/03 – 12/31/05 (3 years)	($1,012,178)
Audit 2	1/1/06 – 12/31/06 (1 year)	($619,534)
Audit 3	10/1/01 – 9/30/03 (2 years)	($419,669)
Audit 4	5/1/02 – 11/30/04 (2.5 years)	($75,725)
Total Adjustment for the four audits		**($2,127,106)**
Remaining audit and non-audit adjustments		$702,739
Total FDOR Adjustment to the City		**($1,424,367)**

Source: FDOR detailed listing of adjustments for the City

During the fall 2008, our office attended multiple meetings with FDOR auditors, reviewed CST Statutes, and reviewed documentation provided by FDOR related to the four FDOR audits to obtain an understanding of the FDOR audit methodologies and process.

The reports and other documentation made available by FDOR did not reconcile to the amount reported on the FDOR listing of amount due for each of the four audits. The documentation provided by FDOR included summaries of audit tests, but did not include all documentation supporting each audit test.

At the time of this report, FDOR recognized that the documentation provided to the City was not sufficient to reconcile the audit adjustments and was in the process of developing additional reports to provide to other local jurisdictions that also request such documentation. We recommend that the City Revenue Division, as allowed by FS Section 202(2)(a)(2), continue efforts to obtain complete audit information from FDOR to support the accuracy and appropriateness of current and future FDOR audit adjustments resulting from their audits of CST distributions as deemed necessary.

The accuracy of jurisdictions and the financial impact of providers' errors are based on judgmental audit procedures, instead of statistically supported methodology.

Our review of FDOR audit documentation and discussions with FDOR auditors showed their audit testing methodology for verifying the accuracy of assigned jurisdictions in the providers' billing database was not statistically valid. This is largely due to: 1) limitations resulting from incomplete information made available to FDOR auditors by CST providers; and 2) persistent errors identified in providers' address databases. Each of these is described further below.

The FDOR audit process was limited by the lack of provider customer billing and address information made available to FDOR auditors for the period being audited.

Providers are required to maintain suitable CST records for three years to enable FDOR to audit their records [FS 202.34(1)(a) and 213.35]. FS 202.26(j) describes the types of books and records that must be made available to FDOR as those "kept in the regular course of business…Books and records kept in the regular course of business include, but are not limited to, general ledgers, price lists, cost records, customer billings, billing system reports, tariffs, and other regulatory filings and rules of regulatory authorities."

Our review showed that providers in the four audits we reviewed only made available to FDOR auditors one month of billing information for audit testing. Results from the testing of the one month's data was then extrapolated to an entire audit period, as long as three years. The reason for this is that companies did not maintain historical billing data electronically and the data provided was accepted for the FDOR audits. FDOR assumes that data (customer address and assigned jurisdiction, i.e., city or county) shown for the month provided was the same for the entire audit period.

During FDOR audits, auditors compare (match) the address information in the FDOR address database to a provider's address information. The CST Statute provides that the FDOR address database is the prevailing source for CST address information. When the jurisdictions for matched addresses differ, FDOR identifies the related taxes collected for services rendered at that address as an audit exception. Those exceptions are summarized and totaled to determine audit adjustments (over and underpayments of CSTs). When the addresses do not match, FDOR generally does not question the accuracy of the providers' recorded jurisdiction and therefore, will not detect jurisdiction errors in those instances.

Address errors (incorrect assigned jurisdictions) identified in the provider's database will be applied over the entire audit period, no matter how short the period of information made available to FDOR. These audit adjustments will typically result in either additional payments to jurisdictions that have not received all of the CST collections FDOR determined were due them or repayments due from jurisdictions that received more CST collections than FDOR determined they were due.

During our review of the FDOR CST audit processes, we identified the following concerns that could cause FDOR's audit adjustments related to address data to be incorrect. We were not provided access to the providers' billing data and detailed audit test workpapers, and therefore could not determine the overall impact and significance of these concerns.

1. FDOR assumes, from data supplied by service providers relating to a limited period (i.e. for periods as short as one month), that an address receiving communications services during that period also received the same services and paid the same taxes for the entire audit period (i.e. up to three years). Conversely, FDOR also assumes, from the same data related to the limited period, that an address that was reported not having received any communications services during the limited period would also not have received any services, or paid any taxes, for the entire audit period. If either of these two assumptions is incorrect, audit adjustments related to that address will be incorrect.

2. FDOR assumes that the jurisdiction assigned to an address receiving communications services during the limited period as described above, for which data is provided to FDOR, had the same assigned jurisdiction for the entire audit period. As a result, any changes in jurisdiction made to a provider's address database that occurs during the audit period, and is different from the limited data provided, will not be recognized and the audit adjustment will not be correct.

For one of the FDOR audits we reviewed, the provider made available only one month's billing records for a three-year audit period. FDOR auditors developed ratios and calculated the amount of taxes due to every affected jurisdiction based on that one month of billing data. For this one audit, the City is required to repay over $1 million.

According to American Institute of Certified Public Accountants' Auditing Standards, if the sample of items to be tested can be expected to be representative of the population, all items in the population should have an opportunity to be selected. In this case, the one month of data available for testing is the population and the results of the testing can then only be representative of the one month of data. Whatever the length of the audit period, FDOR auditors should have information for the entire audit period to be able to test in order to project their test results to the entire audit period.

FDOR auditors test the providers' billing and address information to determine if providers have reported (and FDOR distributed) the correct CST payments to the correct jurisdictions and calculate the part of the audit adjustment due to incorrect jurisdictions. Therefore, it is important that FDOR receive complete information from the provider for the entire audit period. Without complete information to audit, FDOR's auditors are limited to testing only a sample period (sometimes as little as one month) and then use estimates and ratios to apply the results from the sample period to the entire audit period. The longer the audit period is, the greater the risk that an audit adjustment will be incorrect.

Audit adjustments due to errors in provider address databases are likely to continue as there is no requirement for providers to correct errors identified in FDOR audits as long as they use one of the approved address database methodologies.

During our audit, FDOR auditors indicated providers typically do not correct address errors in their databases after audits are completed. While the CST Statute allows providers to use the FDOR address database for their own database, they are not required to do so. Additionally, providers are not penalized for wrong jurisdictions in their address data as long as they use one of the approved methodologies to assign jurisdictions. A methodology satisfies the CST Statute's requirements if the provider obtains its information to assign jurisdictions in its database from:

1) A database provided by FDOR.
2) A database certified by FDOR to be 95% accurate.
3) A responsible representative of the relevant local taxing jurisdictions (for example, Leon County GIS).
4) The United States Census Bureau or the United States Postal Service (USPS).

Providers that assign incorrect jurisdictions to billing addresses will then report the incorrect amount of taxes collected for each jurisdiction on their CST returns. FDOR, in turn, will then distribute the incorrect amount of CST monies to the jurisdictions according to the CST returns. When FDOR completes its audits, they identify the amount of CST monies that jurisdictions were either overpaid or underpaid and that amount constitutes the FDOR audit adjustments. Those jurisdictions that were underpaid will receive additional CST distributions and those jurisdictions that were overpaid are required to repay CST distributions.

While not all of the audit adjustments are attributed to jurisdiction errors, such errors can be a significant portion of an adjustment. [See the next section addressing the accuracy of Leon County jurisdictions.]

FDOR auditors indicated that after audits are completed they give the necessary address corrections to the providers so they can correct their database errors. Similar errors identified in subsequent CST returns submitted by providers indicated to FDOR auditors that providers had not been making the corrections to their address database. FDOR stated some providers have suffered consequences, such as the loss of their collection allowance or the hold harmless provision in the statute, for inaccurate address information resulting in inaccurate payments to jurisdictions. Also, many providers have not made adequate efforts to correct their address information.

The FDOR auditors were limited by insufficient information being made available by CST providers and persistent errors identified in providers' address databases. As long as FDOR auditors continue to accept providers' billing and address information related to a limited portion of the audit period and apply the results to the entire audit period as described above, the resulting audit adjustments will not be statistically supported and should be questioned by the City. <u>We recommend</u> the City Revenue Division address these concerns with FDOR and request FDOR to utilize all available measures to require providers to:

1. Make available customer billing and address data for entire audit periods in order to eliminate the need for FDOR to project audit results from incomplete to entire audit periods.
2. Improve the accuracy of customer addresses and jurisdiction assignments within their databases.

Our concern is that FDOR is using imprecise audit methodologies to calculate precise audit adjustments. The result is that FDOR has identified a net overpayment and is requiring the City to repay $1.4 million ($724,214 - $2,148,581). It is possible that if all facts were known, the City could owe more or nothing at all. Therefore, we question whether the $1.4 million net overpayment (2% of the City's actual $62,160,837 collections), as calculated by FDOR, should be charged to the City as an adjustment to be recovered. Therefore, <u>we also recommend</u> that the City Revenue Division request that the adjustment be waived.

<u>3) Determining the accuracy of Leon County addresses and assigned jurisdictions in the FDOR address database.</u>

The accuracy of the Leon County data in the FDOR address database has not been verified since it was originally submitted in the year 2000. Inaccurate address and jurisdiction assignments data can result in incorrect FDOR audit adjustments.

The FDOR address data is used to verify the accuracy of the jurisdiction assignments in providers' billing databases during FDOR audits. When the CST Statute became effective in October 2001, FDOR developed a statewide database of valid addresses with their jurisdiction assignments. Each taxing jurisdiction (typically, the county) was responsible for creating and submitting an electronic database of addresses that met the FDOR formatting requirements. Every six months, the taxing jurisdictions are required to submit to FDOR changes and corrections for their reporting jurisdictions in order to update the FDOR address database. [FS Section 202.22(2)(b)1]

FDOR provided a "Guide for Address Change Requests" to the taxing jurisdictions identifying reasons for updating the FDOR database. These three reasons are:

1) Database Corrections – instances where database records are incorrect.
2) Street Changes – proposed name changes, street extensions, new streets, and number range changes.
3) Government Changes – including annexations, new municipal incorporations, and consolidations.

Leon County is responsible for submitting such changes and corrections for both the City and the County. The City is responsible for approving any changes Leon County GIS recommends being made to the FDOR database that impact City addresses. In 2000, the County GIS Division created and submitted the address database defining jurisdictions (either Tallahassee or Leon). County GIS management and staff indicated that the creation of the initial address database was a very work-intensive process. Every six months County GIS staff followed defined procedures to identify and submit new and changed street names and annexations to the City limits that occurred during that reporting period. While Leon County GIS staff has been reporting the new information, they have not conducted any analyses to verify the accuracy of the existing data.

During our meetings with FDOR auditors, it was disclosed that on at least one occasion, the FDOR added addresses to the FDOR address database from the United States Postal Service's (USPS) Master Address Listing database. Both FDOR audit staff and County GIS staff indicated that using the USPS address listing most likely populated the FDOR address database with inaccurate information (duplicate addresses with differently assigned jurisdictions). The last time FDOR added addresses using the USPS address listing was in July 2003. Since Leon County had been reporting only new information, it is likely that addresses populated by FDOR in 2003 continue to contain errors.

We tested the accuracy of the address information and jurisdiction assignments in the FDOR database for Leon County addresses by comparing the FDOR address data to the Leon County GIS address data. Of the 42,768 Tallahassee/Leon County addresses in the FDOR database, we were only able to match 30,862 records (72%). An address matched when both the address number and street name in both databases were the same, and unmatched when either one was not the same.

Incorrect addresses in the FDOR address database may increase the number of unmatched addresses when FDOR tests the providers' databases, thereby decreasing the accuracy of the audit test results and ultimately decreasing the accuracy of a resulting audit adjustment. In the FDOR audit, if the provider's database has a valid jurisdiction and an invalid address, FDOR accepts the provider's assigned jurisdiction as accurate.

We reviewed the data further to identify why 28% of the addresses did not match. We noted that there were 342 (7%) out of 5,187 street names in the FDOR database that were misspelled or incomplete. These incorrect street names may negatively impact the FDOR audit testing of the providers' address databases by finding less matches, and therefore, relying on the provider's assigned jurisdictions. The impact depends upon the accuracy of the providers' assigned jurisdiction.

As stated above, FDOR auditors use the FDOR address database to determine the accuracy of the provider's billing address database. Therefore, it is very important that the FDOR address database be as accurate as possible. For two of the four audits we reviewed, the entire audit adjustment could be attributed to the providers assigning the incorrect jurisdiction in their address databases (see Table 6 below).

Table 6
Percentage of Audit Adjustment
Attributed to Incorrect Jurisdictions

FDOR Audit	Final FDOR Audit Adjustment	Adjustment Amount Attributed to Incorrect Jurisdiction	Percent of Final Adjustment (1)
Audit 1	($1,012,178)	($1,950,421)	> 100%
Audit 2	($619,534)	($546,590)	88%
Audit 3	($419,669)	($482,076)	> 100%
Audit 4	($75,725)	($73,244)	97%
SubTotal	**($2,127,106)**	**($3,052,331)**	
All other audit and non-audit adjustments	$702,739	We did not review the remaining 68 DOR audit adjustments or non-audit adjustments.	
Total Adjustment	**($1,424,367)**		

Note (1): Adjustments from other audit tests were combined with the incorrect jurisdictions adjustment to reach the FDOR final audit adjustment.

Since we did not have access to the provider address information for these four audits, it is not possible for us to determine how much of an impact the incorrect Leon County address information in the FDOR address database had on these audit adjustments. However, since such a large percentage of the adjustments reviewed were due to incorrect jurisdictions, we can conclude that the FDOR address database is important in the FDOR audit process. Therefore, it is essential for the Leon County address information to be as accurate as possible so that the audit adjustments to the City will be accurate.

<u>We recommend</u> that the City Revenue Division work with the City ISS staff and County GIS staff to update and correct the Leon County addresses in the FDOR Database, and implement a process to periodically verify its accuracy.

<u>4) Other Identified Issue</u>

Providers' "qualifying discounts" should be applied when determining adjustments.

During our review, we also noted that FDOR auditors were not taking into consideration the qualifying discounts that were awarded to providers on their original CST return when calculating adjustments. The impact is that jurisdictions are required to repay more CSTs than originally received.

If providers meet predefined criteria, they can apply a "qualifying discount" (either .25% or .75%) on their CST return to reduce their total taxes due. Jurisdictions receive from providers an amount net of the qualifying discount. After FDOR completes an audit and the amount due to or due from a jurisdiction is determined, the discount is not considered.

The impact to the City based on the $1,434,367 owed back to FDOR could range up to $10,683. While this amount does not appear significant to the total, the cumulative effect to all Florida jurisdictions over the years could be significant. For example, based on FDOR's November 2008 listing of adjustments by jurisdiction, FDOR will receive over $60 million in overpayments from Florida jurisdictions. For the $60 million in total overpayments that will be repaid to FDOR, the total impact of not applying the qualifying discounts to adjustments for Florida jurisdictions could range up to $450,000.

<u>We recommend</u> the City Revenue Division request FDOR to include the provider's "qualifying discount" in the calculation of what the jurisdictions owe back to FDOR when adjustments are necessary.

Conclusion

Our audit was initiated due to the recent FDOR adjustments that indicated the City was required to repay CST revenue overpayments of $1.4 million to FDOR. The $1.4 million consisted of audit adjustments totaling <$2,148,581> and non-audit adjustments totaling $724,214. The results of our audit are summarized below.

- Our analysis shows that the City Revenue Division's basis for requesting the City Commission to increase the CST local rate from 5.49% to 6.1% appears to be a viable and reasonable response to previous years under-collections and the recent FDOR adjustment. The rate increase should help ensure that the City receives expected CST collections. Additionally, while we agree that a tax rate increase is substantiated, we are not able to provide assurance that the tax rate increase will be sufficient to compensate for unknown future supported FDOR adjustments which occur when providers inaccurately report and remit CST taxes collected.
- Our review of FDOR audit documentation and discussions with FDOR auditors showed their

audit testing methodology for verifying the accuracy of assigned jurisdictions in the providers' billing database was not statistically valid.

Our concern is that FDOR is using imprecise audit methodologies to calculate precise audit adjustments. The result is that FDOR has identified a net overpayment and is requiring the City to repay $1.4 million ($724,214 - $2,148,581). It is possible that if all facts were known, the City could owe more or nothing at all. Therefore, we do not agree with FDOR's overall audit conclusion that the City should repay $1.4 million.

- The accuracy of the Leon County data in the FDOR address database has not been verified since it was originally submitted in the year 2000. Inaccurate address and jurisdictional designations data can result in incorrect FDOR audit adjustments.
- Other issues identified during the audit related to the FDOR audit processes include: 1) FDOR was not including providers' "qualifying discounts" when determining adjustments (these discounts were made available to providers when they submitted their CST returns, but were not considered when determining adjustments); and 2) Providers will most likely continue to make CST payments to inaccurate jurisdictions in the future, as they were not likely to correct errors identified in FDOR audits.

We would like to acknowledge the full and complete cooperation and support of management and staff from the Treasurer-Clerk's Office. Additionally, we would like to thank the City ISS and Leon County GIS staff and management and FDOR CST Division auditors for their professional assistance in helping us obtain an understanding of the FDOR address database and CST audit processes and documentation.

City Auditor's Follow-up

At the conclusion of this audit, the Office of the City Auditor and a representative from the Office of the City Treasurer-Clerk met with representatives of the FDOR to discuss with and provide to them our written audit report. We requested FDOR to review the draft report and provide a response for findings needing correction or clarification. The FDOR provided an unofficial response that was timely and helpful. Accordingly, we made changes to our report considered appropriate.

In addition to the City Treasurer-Clerk, we have provided to FDOR our final report contained herein. Should FDOR choose to respond to the audit, their response will be on file in the Office of the City Auditor and available for public inspection. *[FDOR's written response is provided in Appendix A]*

The FDOR was cooperative and responsive to our requests for information during our audit. The significant issue remaining to be resolved is whether FDOR will further adjust its records to remove the $1.4 million they identified as overpayments to the City. We concluded that the FDOR adjustment was not adequately supported for the following reasons.

1. The FDOR agreed with our report issue that statistical sampling methodologies, while preferred, were not used in FDOR sampling of provider records. Further, FDOR is authorized by law to use other sampling methodologies.

   We agree FDOR is authorized to use other sampling methodologies. However, in our opinion, the term "sampling" is intended to mean drawing a sample from the population of transactions that is reasonably representative of that population. In this instance, FDOR selected one month of transactions and made the assumption that the selected month was representative of the entire population of transactions, which could be as long as three years. We not only disagree with this methodology, but we also believe it is not proper to statistically project one-month of findings to the entire audit period of transactions. The sampling methodology used was not reasonable or proper.

2. The FDOR stated that auditors used the best information made available by providers to compute over and underpayments.

   We understand that the FDOR has the authority to adopt rules relating to the books and records providers were to keep and make available for their audits. "Best information available" appears to be an issue between the FDOR and providers and should not be an issue negatively impacting the City.

3. We are aware that when providers' records were inadequate for purposes of determining whether the provider properly allocated tax to and between local jurisdictions, the FDOR is authorized to determine proper allocations or reallocations based on information available and shall see the agreement of the affected local governments.

   In this instance, the inadequacy of providers' records was an issue for FDOR and the providers to resolve. Also, although the law states that FDOR shall seek the agreement of the local government, the City of Tallahassee received no such request for agreement and does not agree with the $1.4 million overpayment identified.

We recommend that the City Treasurer-Clerk continue to seek resolution to these issues.

City Treasurer-Clerk's Response

We appreciate the professional work conducted by the City Auditor and his staff, which we believe will serve to improve the Florida Department of Revenue's (FDOR) audit procedures. A majority of the action plan steps recommended by the final audit were implemented before or during the audit period. We also thank the City's ISS staff for assisting the Leon County\City of Tallahassee GIS team in replacing the addressing database. It is our hope that this replacement will reduce future errors in the state's distribution of the tax. We have been advised by special legal counsel that although FDOR's procedure for determining that the City had received excess CST distributions was flawed, they did not recommend litigation with FDOR under the circumstances. The Treasurer/Clerk will notify the FDOR that we strongly disagree with the methodology used by the FDOR in their Communications Services Tax audits, that we do not believe they have justified their disbursement audit findings, and that we expect future audits and resulting CST adjustments will be conducted in a manor to properly support their findings and disbursement adjustments.

Florida Department of Revenue's Response

We would like to thank the Florida Department of Revenue for their professional and timely response to our audit report. Due to the importance of this issue, we have included the complete written response as Appendix A.

In his response, the FDOR General Tax Administration Program Director addresses the Department's audit methodology, adjustment distribution plan, and rule making efforts. The Director states the FDOR does not have the statutory authority to grant a "waiver" of $1.4 million to the City.

While we respect the Directors comments, our findings have not changed regarding the FDOR sampling methodology that forms the basis for adjustments to the City of Tallahassee. Accordingly, we continue to recommend the City-Treasurer Clerk seek resolution to the identified issues.

Appendix A – Florida Department of Revenue's Response

FLORIDA DEPARTMENT OF REVENUE

Executive Director
Lisa Echeverri

March 20, 2009

ELECTRONIC COPY VIA FACSIMILE (850) 891-0912
HARD COPY VIA U.S. POSTAL SERVICE

Mr. Sam M. McCall, City Auditor
City of Tallahassee
Mailbox A-22
300 S. Adams St.
Tallahassee, FL 32301-1731

Dear Mr. McCall:

Thank you for providing a copy of your audit report titled "Repayment of Local Communications Services Tax" [the Report] and giving us an opportunity to respond. Your Report concludes that the City of Tallahassee should not be required to repay the approximately $1.4 million in overpayments of communications services tax it has received in recent years because the City does not agree with the Florida Department of Revenue's audit findings. Your report also identified other issues related to our audit process.

In our November 3, 2008 letter we advised you that the adjustment to City's communications services tax distributions would be made over a 36 month period beginning in March 2009. With this response, we intend to address the following issues:

- The Department's audit methodology
- The Department's adjustment distribution plan
- The Department's rulemaking efforts

Department Audit Methodology

The Report accurately notes that the Department's audits of communications services tax providers were hampered by the lack of complete records and data provided by the communications services tax providers we audited. However, the Report also states that the methodology used by the Department in our audits of communications services tax providers was not "statistically valid."

Child Support Enforcement – *Ann Coffin, Director* • General Tax Administration - *Jim Evers, Director*
Property Tax Oversight - *James McAdams, Director* • Administrative Services - *Nancy Kelley, Director*
Information Services - *Tony Powell, Director*

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In almost all of our audits where the provider's records for the audit periods in question were either inadequate or simply unavailable, statistical sampling could not be performed. As alluded to in the Report, to be performed properly, statistical sampling requires a complete set of records and data over the time period in question. Because we did not have sufficient information or records to employ a statistical sampling method, we were often forced to conduct the audits using other audit methodologies or techniques. Florida law guides us when this is the case.

Section 202.34(1)(b), F.S., provides:

> For the purpose of this subsection, if a dealer does not have adequate records of its sales of communications services, the department may, upon the basis of a test or sampling of the dealer's available records **or other information relating to the sales made by such dealer for a representative period, determine the proper basis for assessing tax.** This subsection does not affect the duty of the dealer to collect, or the liability of any consumer to pay, any tax imposed or administered under this chapter. (e.s.)

Section 202.35(3), F.S., provides:

> If a dealer or other person fails or refuses to make his or her records available for inspection so that an audit or examination of his or her books and records cannot be made, fails or refuses to register as a dealer, fails to make a report and pay the tax as provided by this chapter, makes a grossly incorrect report, or makes a report that is false or fraudulent, **the department shall make an assessment from an estimate based upon the best information then available to it for the taxable period of retail sales of the dealer, together with any accrued interest and penalties.** The department shall then proceed to collect the taxes, interest, and penalties on the basis of such assessment, which shall be considered prima facie correct; and the burden to show the contrary rests upon the dealer or other person. **If the dealer fails to respond to a contact made pursuant to s. 202.27(6), or if a dealer's records are determined to be inadequate for purposes of determining whether the dealer properly allocated tax to and between local governments, the department may determine the proper allocation or reallocation based upon the best information available to the department and shall seek the agreement of the affected local governments.** (e.s.)

Section 202.37(1)(a), F.S., provides in pertinent part:

> Audits performed by the department shall include a determination of the dealer's compliance with the jurisdictional situsing of its customers' service addresses and a determination of whether the rate collected for the local tax pursuant to ss. 202.19 and 202.20 is correct.

The Report states that the Department "selected one month of transactions and made the assumption that the selected month was representative of the entire population of transactions, which could be as long as three years." To clarify: we did not "select" one month's worth of records to perform our audits. We requested complete records and information from the providers over the entire audit period(s) in question. However, in most cases, one month's

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worth of records was all that was provided to the Department for our audits, and often the month provided was outside of the actual audit period. Providers told us that the records we sought did not exist and that it would be prohibitively time consuming and expensive to generate such records. We prepared the assessments in question based on the only information made available by the providers. We also complied with our statutory mandate to determine whether the providers in question properly allocated tax to and between local jurisdictions, including a review of the provider's jurisdictional situsing of their customers' service addresses.

Adjustment Distribution Plan

Generally, the Department becomes aware that misallocation errors have occurred: 1) upon audits of providers, 2) when the provider determines that it has made errors and informs the Department that its reporting of tax was flawed, or 3) when local jurisdictions discover anomalies in their monthly tax distributions. (The Department has a "Local Government CST Information Sharing Website" where authorized local governmental personnel may access information related to communications services tax, including monthly distribution information.)

When the Department determines that a misallocation of tax between jurisdictions has occurred, we are required pursuant to s. 202.18(3)(a), F.S., to make adjustments in distributions to correct such misallocations. This statutory provision governs how such adjustments are to be made.

To accomplish this, the following events occurred:

- On July 10, 2008, we held a meeting to discuss a plan to comply with our requirements under s. 202.18(3)(a), F.S., to make adjustments to communications services tax distributions when we determined that misallocations of tax had occurred. Representatives from several jurisdictions along with the Florida League of Cities, Florida Association of Counties, Florida Government Finance Officers Association (FGFOA) attended this meeting. On July 17, 2008, we posted the plan for adjustment distributions on our Local Government CST Information Sharing System website.
- On July 31, 2008, we posted the 2008 Adjustment Distribution File on our Local Government CST Information Sharing System website. We posted both a detail and summary file containing information about each jurisdiction's 2008 adjustment. We also posted additional adjustment information including a general explanation regarding why these adjustments were necessary.
- Beginning in August 2008, we received numerous calls and e-mails from local governments, including the City of Tallahassee, asking questions about their adjustment distribution.
- Based on the feedback we received from local governments, we conducted a second review of the audit files included in the 2008 Adjustment Distribution File.
- On September 29, 2008, we posted a message on our Local Government CST Information Sharing System website informing local governments that our review may cause a change to a jurisdiction's net adjustment amount.
- On October 31, 2008, we posted a revised Adjustment Distribution File for 2008. In our accompanying message, we noted that the adjustment amounts and information included in the file had changed and may be different than the file posted in July. We indicated that we did not plan to make any further changes and that letters would be sent to each

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jurisdiction on or about November 3, 2008 pursuant to s. 202.18(3)(c)3.a., Florida Statutes.

- On November 3, 2008, we formally notified by letter 468 affected local jurisdictions of the forthcoming adjustments to their communications services tax distributions.
- In December 2008, we began the 2008 adjustment distribution process and placed a message on our Local Government CST Information Sharing System website informing local governments of the basis for their December adjustment.
- In February 2009, we updated and reorganized the Local Government CST Information Sharing System website to include even more information about the 2008 adjustment distributions.

As noted above, the Department shared our adjustment distribution plan with all local governments. Often, when a new message was posted on our Local Government CST Information Sharing System website, a reminder to check the message board was sent by the Florida League of Cities, Florida Association of Counties and FGFOA to their members.

Additionally, our plan included engaging in rulemaking in order to adopt rules that will formalize the plan on a going forward basis. To that end, the Department:

- Published a notice of rule development with the Florida Administrative Weekly on July 25, 2008.
- Posted information regarding this rulemaking effort to our website on or around the same date.
- Filed a notice of proposed rule development workshop with the Florida Administrative Weekly on March 6, 2009. This notice included a draft of our rule to be discussed at the workshop that will be held on April 1, 2009. Information regarding this rulemaking effort can be found on our website at: http://dor.myflorida.com/dor/rules/12a-19080.html

Our plan, which is the subject of rulemaking as described above, is designed so that the impacts that the required adjustments may cause to local governments can be known in time for affected jurisdictions to adjust their budgets accordingly. The plan includes providing preliminary notice to affected local governments on an annual basis in April for adjustments to their communications services tax distributions that will not begin until the following March. Hopefully, this will allow local governments to include forthcoming adjustments to their communications services tax distributions in their budgeting process for the following year. It is important to note that there is no way for the Department to know whether future annual adjustments will be positive or negative for any given jurisdiction.

The Report mentions that the Department did not seek the agreement of the City of Tallahassee before making the required adjustments. There are 481 local taxing jurisdictions for communications services tax. A total of 468 of those jurisdictions are affected by the current adjustment distributions and were notified with letters on November 3, 2008 that adjustments to their communications services tax distributions were necessary. The Department took the steps detailed above to inform all affected jurisdictions of its statutory requirements to make these adjustments in a transparent manner and has worked with affected jurisdictions to assist them in understanding this process. The City of Tallahassee first contacted the Department in early August 2008 concerning its distribution adjustment. Between August 2008 and February 2009, our staff had numerous communications and in-person meetings with City staff in which we discussed the City's adjustment. All of the information given to the City and other local governments through our website and other communications was provided in an effort to obtain the agreement of affected jurisdictions. By sharing your Report with us, the City of Tallahassee has at least preliminarily indicated that it does not agree with the Department's adjustment to the City's communications services tax distributions.

Recordkeeping

The Department has engaged in rulemaking to address recordkeeping requirements of communications services tax dealers. A notice of rule development was published in the Florida Administrative Weekly on August 1, 2008. The Report referenced the Department's authority to engage in such rulemaking. Rule language is currently being drafted and we expect to schedule a rule development workshop for this issue in the near future. Information regarding this rulemaking effort can be found on our website at: http://dor.myflorida.com/dor/rules/12a-19015.html

Other Identified Issues

Your Report indicated that the Department was not taking into consideration the provider's "qualifying discounts" (also known as collection allowance) when determining adjustments. We agree and have corrected this prospectively so that future annual adjustment distributions will account for the collection allowance.

Your Report contains a recommendation that the City request that the audit adjustment be waived. We do not have the statutory authority to grant a "waiver" of the upcoming adjustments to your communications services tax distributions described in our November 3, 2008 letter. If we had such authority, it would necessarily mean that those jurisdictions that should have received the taxes incorrectly distributed to the City of Tallahassee would not be made whole. Also, future annual adjustment distributions may reveal that the City of Tallahassee did not receive taxes that it should have, resulting in an increase in your monthly communications services tax distributions.

Thank you again for providing us a copy of the Report and the opportunity to provide you with a response.

Sincerely,

James R. Evers, Program Director
General Tax Administration
Telephone: (850) 488-5163
E-Mail: eversj@dor.state.fl.us

JRE/mk

Appendix B – Management's Action Plan

Action Steps	Responsible Employee	Target Date
A. Objective: ***To implement processes to achieve expected CST collections***		
1. Revenue Division implement a process to monitor actual CST collections to expected CST collections to ensure that the local CST rate is appropriate and make adjustments to reduce or increase the rate as needed to reach the expected CST collections.	Mike Meeks, Revenue Collections Administrator	Completed December 2008 and Ongoing
B. Objective: ***To ensure that the FDOR adjustments are accurate***		
1) Revenue Division continue to request documentation from FDOR to support the current and future adjustments.	Mike Meeks, Revenue Collections Administrator	On-going
2) Revenue Division address the City's concerns with FDOR and request FDOR to: a) Waive the City's adjustment. b) Include the providers' "qualifying discount" in the calculation of what the jurisdictions owe back to FDOR when adjustments are determined.	Mike Meeks, Revenue Collections Administrator	To be addressed
3) Revenue Division work with the City ISS staff and County GIS staff to update and correct the Leon County addresses in the FDOR Database, and implement a process to periodically verify its accuracy.	Mike Meeks, Revenue Collections Administrator	Completed March 6, 2009

Copies of this audit report #0911 may be obtained from the City Auditor's web site (http://www.talgov.com/auditing/auditreports.cfm), by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

Audit conducted by:
Beth Breier, CPA, CISA, Audit Manager
Sam M. McCall, CPA, CGFM, CIA, CGAP, City Auditor