Penny Wise, Pound Foolish...

By Richard A. Vallari CPA, CMI

This past summer I had the opportunity to manage three audits that resulted in large sales and use tax assessments to my clients. Although these entities are not related in any way, they share a common thread – the majority of their respective assessment may have been avoided with sound bookkeeping services. It never ceases to amaze me that so many businesses fall into the trap of "winging" their bookkeeping responsibility.

In prior articles, I have made suggestions regarding potential areas of concern for auditors, and the need to be proactive rather than reactive in these areas. One specific area of concern is the importance of reconciling revenues between the monthly gross sales reported on the sales tax returns to the general ledger and the federal tax return. If a difference exists, the reason should be fully documented. Additionally, I've suggested reviewing sales invoicing for flaws in format, and for practitioners and clients to periodically discuss sales tax items. Of course, many businesses are cash sensitive, and feel secure playing the audit lottery. However, once the letter from the Nevada Department of Taxation arrives, it is too late to figure things out. When an assessment is delivered, the cost associated with the tax, along with interest and penalties is often much more than the cost of a few hours of general ledger review.

The first audit ended with an underreporting of sales percentage that was significant. Accordingly, the assessment with interest and penalties was quite steep. This particular business was not prepared to pay the assessment and entered into a payment plan. This was difficult for my client to accept, especially since all tax was properly charged. However, due to sloppy bookkeeping, the sales tax returns were consistent in the under reporting of taxable sales. No one ever took the time to review the general ledger sales accounts and reconcile them to the monthly sales tax returns.

The second audit involved a business which was charging sales tax but not applying the sales tax to customer discounts and mandatory surcharges properly. The sales tax was being computed on the full amount of the customer charge without the discount, and not being charged to the mandatory surcharge. Although the discounts and mandatory surcharges appeared on every sales invoice in the audit sample months, the overcharging of sales tax on the customer discount could not be applied to the sales tax owed on the mandatory surcharges.

The final audit was especially disconcerting to me since the client had a fully automated system that correctly calculated sales tax, and the taxpayer's integrity was solid. However, the bookkeeper was reporting net sales with sales tax backed out as gross sales. Additionally, sales reported on the monthly sales tax return did not include some items where sales tax was charged. The reports were prepared with a mechanical mindset, creating a large underreporting of sales. A simple review of how the numbers flowed to the return would have captured this glaring error, and possibly may have resulted in a 'no change' audit.

Had the slightest amount of time been spent as proactive rather than reactive, all three of these audit assessments may have been avoided. When it comes to standard bookkeeping services, being penny wise may lead to pound foolish.