GOVERNMENT GUIDE

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Is the Marketplace Fairness Act Important to State and Local Government?

By Marilyn Mays, CPA, CGMA

The Marketplace Fairness Act (MFA) is federal legislation that has been discussed by Congress for the past several years. This legislation would grant state and local governments the ability to compel online and catalog retailers to collect sales taxes at the time of a transaction based on the location of the consumer instead of the location of the retailer. The issues with this legislation are that the sales tax code is not uniform among the governmental entities and the complexities of tracking sales tax for multiple governmental entities.

So, why is Congress discussing state and local sales tax issues? There are two United States Supreme Court cases that have established federal law regarding remote sales. In the late 1960’s, the Department of Revenue of Illinois tried to force National Bella Hess (a retailer based in Kansas City) to collect Illinois sales taxes on transactions to residents within Illinois. The Court’s decision stated that Illinois could only require the collection of sales taxes from an organization that had nexus (physical presence) within the state. In early 1990’s, North Dakota tried to get Quill Corporation (a retailer based in Delaware) to collect sales taxes on sales within its state. Again, the Court’s decision was in favor of Quill, stating no nexus in the state of North Dakota. In this case, the Court stated that Congress had the authority to enact legislation that would overturn these decisions.

The retail world is vastly different now than it was in the 1960’s primarily due to the internet. State and local sales tax losses from catalog sales in the 1960’s are minimal compared to sales taxes that could be generated from internet sales today. National retailers are reporting a dramatic increase in their online sales which is contributing to closures of physical locations. State and local sales taxes decrease as online sales increase which is a major concern for many governments due to their reliance on that type of revenue.

One of the difficulties in requiring retailers to collect sales taxes from multiple jurisdictions is the complexities and lack of uniformity of the sales tax code. The Marketplace Fairness Act grants states the authority to compel retailers to collect its taxes only if the state has simplified its sales tax laws. Forty-four states and eighty-five businesses have worked over the past decade to simplify and create a uniform sales tax code. A Streamlined Sales and Use Tax Agreement (SSUTA) has been developed and 24 states have already voluntarily adopted the simplification measures. The remaining states would need to enact state legislation to either implement the provisions of SSUTA or implement the minimum simplification requirements described in the MFA.

Another difficulty in collecting taxes for multiple jurisdictions is the complexities of applying the proper tax rate to sales transactions and remitting the tax to multiple governments. What might have been an administrative burden on retailers many years ago is not the case with today’s technology. The MFA contains a provision that requires free software to be provided to retailers to manage the sales tax compliance with all states.

Purchasing via the internet is a way of life and is not going away in the near future. Without any intervention from the federal government like the MFA, state and local government sales tax revenues will decline. Governments and liaison organizations continue their efforts to push Congress for this legislation. Work will continue at the state and local level to align their government with the MFA requirements. The Government Finance Officers Association (GFOA) continues to educate government leaders and politicians regarding the need for the MFA and the impact on state and local governments. You can visit the GFOA’s website for additional information on recent developments regarding the progress of the Marketplace Fairness Act.

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Establishing Effective Internal Controls for Local Governments

By Cailee Arnold, CPA

You hear about it often and you constantly question "how can we establish effective internal controls?" Internal controls are important in the fact that they provide a reasonable assertion that an entity is meeting their operational (effectiveness, efficiency, safeguarding of assets), reporting and compliance objectives. The Government Finance Officers Association (GFOA) best practices recommends that all state, provincial, and local governments adopt the Committee of Sponsoring Organizations' (COSO) Internal Control – Integrated Framework (2013) as their conceptual basis for designing, implementing, operating, and evaluating internal control so as to provide reasonable assurance that they are accomplishing their operational, reporting, and compliance objectives. COSO's framework includes five elements designed to accomplish three basic categories of objectives: the control environment, risk assessment, control activities, information and communication, and monitoring. The three basic categories include operations, financial reporting and compliance.

The control environment is concerned with the actions, policies, and procedures that reflect the overall attitude of management and those charged with governance. Management and those charged with governance should have integrity and ethical values, a commitment to competence, well-documented and established human resource policies and practices, and have a philosophy and operating style that provides clear guidance to all employees about the importance of internal control.

Risk assessment includes identification and analysis of the riskiest areas to the preparation of the financial statements in accordance with GAAP. Management should assess risk as part of designing and operating internal controls to minimize errors and fraud.

Control activities are the policies and procedures that management has established to meet its objectives for financial reporting. This includes adequate segregation of duties, proper authorization of transactions and activities, adequate documents and records, physical control over assets and records, and independent checks on performance.

Information and communication are methods used to initiate, record, process, and report an entity's transactions and to maintain accountability for related assets.

Lastly, monitoring is management's ongoing and periodic assessment of the quality of internal control performance to determine whether controls are operating as intended and modified when needed.

According to the GFOA Best Practices, establishing a comprehensive framework for internal control, in order to implement COSO, a government should do the following three steps:

1. Establish a comprehensive framework for internal control that includes all five essential components identified by the COSO (control environment, risk assessment, control activities, information and communication, and monitoring);
2. Ensure that each component of internal control is functioning in a manner consistent with all relevant principles; and
3. Ensure that the various components complement one another and operate together effectively.

While implementing these three steps does not guarantee that errors or fraud will not occur, it is a great step toward maintaining effective controls to help ensure that your financial statements are free from material misstatement. For more information visit http://www.gfoa.org/best-practices.

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