



THE UNIVERSITY OF TEXAS AT DALLAS

OFFICE OF INTERNAL AUDIT
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October 6, 2017

Dr. Richard Benson, President,
Ms. Lisa Choate, Chair of the Institutional Audit Committee:

We have completed an audit of Tax Compliance as part of our fiscal year 2017 Audit Plan, and the report is attached for your review. The objective of our audit was to ensure compliance with tax laws regarding foreign persons, independent contractors and unrelated business income tax.

Opportunities to enhance tax compliance are included in this report. Management has reviewed the recommendations and has provided responses and anticipated implementation dates. Though management is responsible for implementing the course of action outlined in the responses, we will follow up on the status of implementation subsequent to the anticipated implementation dates. We appreciate the courtesies and considerations extended to us during our engagement. Please let me know if you have any questions or comments regarding this audit.

Toni Stephens, CPA, CIA, CRMA
Chief Audit Executive



Executive Summary

Audit Objective and Scope

To ensure compliance with tax laws regarding foreign persons, independent contractors and unrelated business income tax.

Conclusion

Based on the audit work performed, we found that improvements to current processes are needed to comply with tax laws regarding foreign persons, independent contractors and unrelated business income tax.

Audit Recommendations by Risk Level

Recommendation	Risk Level	Estimated Implementation Date
(1) Ensure Completeness and Accuracy of 1042S Reporting	High	March 31, 2018
(2) Ensure a Tax Compliance Review Is Performed for Independent Contractors	High	September 1, 2017
(3) Enhance Independent Contractor Identification Procedures to Ensure Accuracy for 1099 Reporting	Medium	January 1, 2018
(4) Establish University-wide Tax Compliance Policies and Procedures	Medium	August 31, 2018
(5) Enhance Procedures to Identify Activities Generating Unrelated Business Income	Low	August 31, 2018

Responsible Vice President

- Mr. Terry Pankratz, Vice President for Budget and Finance

Responsible Party

- Dr. Kim Laird, Associate Vice President for Budget and Finance and Controller
- Dr. Reda Bernoussi, Associate Controller
- Ms. Deborah Reynolds, Executive Director for Procurement Management
- Ms. Nancy Barganier, Tax Compliance Manager

Staff Assigned to Audit

Project Leader: Hiba Ijaz, CPA, CIA, Senior Auditor

Report Distribution

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- Mr. Gurshaman Baweja
- Mr. Bill Keffler
- Mr. Ed Montgomery
- Ms. Julie Knecht

UT Dallas Members

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- Dr. Kyle Edgington, Vice President for Development and Alumni Relations
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- Dr. Calvin Jamison, Vice President for Administration
- Mr. Rafael Martin, Interim Vice President for Research
- Dr. Inga Musselman, Interim Provost
- Mr. Terry Pankratz, Vice President for Budget and Finance
- Mr. Timothy Shaw, University Attorney, ex-officio

Responsible Parties

- Dr. Kim Laird, Associate Vice President for Budget and Finance and Controller
- Dr. Reda Bernoussi, Associate Controller
- Ms. Deborah Reynolds, Executive Director for Procurement Management
- Ms. Nancy Barganier, Tax Compliance Manager

External Agencies

The University of Texas System

- System Audit Office

State of Texas Agencies

- Legislative Budget Board
- Governor's Office
- State Auditor's Office
- Sunset Advisory Commission



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Background

Even as a tax-exempt institution, the University of Texas at Dallas must comply with regulations from the Internal Revenue Service (IRS). Several IRS regulations affect higher education institutions including, but not limited to, laws regarding non-resident aliens, independent contractors, and unrelated business income tax.

TAX COMPLIANCE

TAXATION FOR NON-RESIDENT ALIENS



Calendar Year 2016:
 Total Form 1042S issued: **486**
 Gross reportable payments to foreign persons: **\$2,670,413.80**
 Taxes withheld: **\$29,613.71**

TAXATION FOR INDEPENDENT CONTRACTORS



Calendar Year 2016:
 Total Form 1099 issued: **832**
 Total payments: **\$24,031,158**

UNRELATED BUSINESS ACTIVITIES AND INCOME



Fiscal Year 2016:
 Recreational Sports (Outside Sales): **\$36,209**
 Advertising: **(\$17,622)**

The University must withhold taxes and provide a Form 1042S to foreign persons with income from U.S. sources.¹ U.S. income sources applicable for 1042S reporting may include taxable scholarships provided to foreign students, payments to foreign vendors for services and payments to foreign employees subject to tax treaties. In addition, the University is required to report payments for services performed by independent contractors and provide each independent contractor a Form 1099.²

Tax-exempt entities must report and file a Form 990-T for unrelated business income.³ The University of Texas System files a consolidated form for all UT System institutions. All UT System institutions, including UT Dallas, are responsible for identifying possible unrelated business activities and providing this information to UT System.

The University has a centralized Tax Compliance team within the Financial Management Services department of the Office of Budget and Finance.

The Tax Compliance team includes the Tax Compliance Manager, International Tax Specialist and Tax Accountant. The Tax Compliance Manager reports to the Associate Controller. In addition, several areas within the University, such as Human Resources, Payroll, Student Financial Services, the Career Center and Procurement Management, have responsibilities regarding tax compliance over various processes.

Audit Objective

To ensure compliance with tax laws regarding foreign persons, independent contractors and unrelated business income tax.

¹ <https://www.irs.gov/individuals/international-taxpayers/discussion-of-form-1042-and-form-1042s-and-form-1042>

² <https://www.irs.gov/businesses/small-businesses-self-employed/reporting-payments-to-independent-contractors>

³ <https://www.irs.gov/charities-non-profits/unrelated-business-income-tax>



Scope and Methodology

The scope of this audit was calendar year 2016 to current operations, and our fieldwork concluded on August 30, 2017. To satisfy our objectives, we performed the following:

- Documented and gained an understanding of the 1042S reporting, 1099 reporting and UBIT identification processes.
- Reviewed all relevant policies and procedures, interviewed staff responsible for the processes, and performed a risk assessment of tax compliance.
- Determined the accuracy of the 1042S reporting process by ensuring taxes were appropriately withheld for taxable scholarships and that tax forms were appropriately prepared.
- Determined whether a tax compliance review occurs for payments to independent contractors to ensure independent contractors are accurately classified
- Determined if individuals providing services to the University are appropriately classified as independent contractors per tax laws.
- Evaluated the reasonableness of the process in place for identifying and allocating expenses to unrelated business activities.

We conducted our examination in conformance with the guidelines set forth in The Institute of Internal Auditor’s *International Standards for the Professional Practice of Internal Auditing*. The *Standards* are statements of core requirements for the professional practice of internal auditing.

Additionally, we conducted the audit in accordance with 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.

Audit Results and Management’s Responses

Strengths and Controls Noted during the Audit
The University has a Tax Compliance function within the Office of Budget & Finance to oversee and ensure compliance with tax laws.
Procurement Management has a reporting process in place for vendors identified as requiring a 1099.



Although the above strengths and controls were noted, other opportunities to enhance operations and compliance are recommended below. Risk Levels are defined in the [Appendix](#) on page 10.

Observation and Risk Level	Risk/Effect	Recommendation	Management's Response and Action Plan
<p>1. Ensure Completeness and Accuracy of 1042S Reporting (High)</p> <p>We reviewed the 1042S reporting process for calendar year 2016. The following was noted:</p> <ul style="list-style-type: none"> As noted in Appendix 2, a prior year recommendation to include individuals with nonimmigrant visa types in the 1042S reporting process was not implemented. Some scholarship and stipend payments were not included to generate a list of taxable scholarships for foreign students. 8 out of 16 foreign students (50%) did not have the accurate amount of taxes withheld. 11 out of 16 foreign students (69%) with taxable scholarships did not have the accurate amount of taxes withheld. 4 out of 16 (25%) foreign students tested were not enrolled in the Foreign Nationals Information System (FNIS) used to send Form 1042S to recipients. PeopleSoft Financials does not have a vendor's residency status in the vendor file. Foreign independent contractors, who are required to receive Form 1042S, cannot be identified. 	<p>Noncompliance with tax laws may lead to fines and other penalties. For instance, the University may be required to pay for tax that was not accurately withheld on taxable scholarships.</p>	<p>Management should implement a 1042S reporting process that:</p> <ul style="list-style-type: none"> Includes all nonimmigrant visa types and taxable scholarships such as third party scholarships and stipends. Ensures timely and accurate withholding and reporting for taxable scholarships. Ensures foreign students are enrolled into FNIS. Identifies foreign independent contractors within PeopleSoft. 	<p>Management's Response and Action Plan: Nonresident alien tax compliance procedures have been revised and improved with the addition of a new International Tax Specialist in March 2017. All visa types have been added to the processing of nonresident alien taxable scholarships effective spring 2017.</p> <p>Estimated Date of Implementation: 3/31/2018</p> <p>Person Responsible for Implementation: Nancy Barganier, Tax Compliance Manager</p>



Observation and Risk Level	Risk/Effect	Recommendation	Management's Response and Action Plan
<p>2. Ensure a Tax Compliance Review Is Performed for Independent Contractors (High)</p> <p>In reviewing the payments to independent contractors, we noted the following:</p> <ul style="list-style-type: none"> • Out of 112 payments made to independent contractors, 94 (84%) payments were not supported with a documented review or approval from Tax Compliance. • From calendar year 2016 to May 1, 2017, 3,386 check requests were issued for independent contractors. These payments do not include a tax compliance review. • There are three ways to initiate payments to an independent contractor: the independent contractor form, check request forms, and service contracts. A tax compliance review is not performed for payments to independent contractors via a check request or due to a service contract. • Payments were made to independent contractors who may be classified as employees by the IRS. 	<p>The accuracy of the 1099 reporting process is highly dependent on having an accurate and updated W9. The federal tax classification, as noted in the W9, determines whether a vendor should receive Form 1099. The University may be subject to fines and penalties if a 1099 is not provided to required vendors.</p>	<p>Management should put a process in place to ensure an updated W9 is on file for all vendors. In addition, Management should consider adding a vendor's federal tax classification in PeopleSoft to increase oversight over vendors requiring Form 1099.</p>	<p>Management's Response and Action Plan: The independent contractor form in eProcurement was designed with the Tax Compliance area as part of the workflow approval. Procurement will redirect any individual payments that have a tax liability back through the independent contractor form to ensure Tax Compliance review and approval.</p> <p>Estimated Date of Implementation: September 1, 2017</p> <p>Person Responsible for Implementation: Debbie Reynolds, Executive Director, Procurement Management</p>
<p>3. Enhance Independent Contractor Identification Procedures to Ensure Accuracy for 1099 Reporting (Medium)</p> <p>In reviewing the 1099 reporting process, we noted the following:</p> <ul style="list-style-type: none"> • A vendor was not provided a 1099 because a W9 was not on file. • PeopleSoft Financials does not have the vendor's federal 	<p>The accuracy of the 1099 reporting process is highly dependent on having an accurate and updated W9. The federal tax classification, as noted in the W9, determines whether a vendor</p>	<p>Management should put a process in place to ensure an updated W9 is on file for all vendors. In addition, Management should consider adding a vendor's federal tax classification in PeopleSoft to increase oversight over vendors requiring Form 1099.</p>	<p>Management's Response and Action Plan: All new activations and/or reactivations now require a W9 or an updated W9. In consultation with the Tax Compliance Office, the vendor database is being updated and will be maintained with vendor federal tax classification.</p>



Observation and Risk Level	Risk/Effect	Recommendation	Management's Response and Action Plan
tax classification in the vendor file.	should receive Form 1099. The University may be subject to fines and penalties if a 1099 is not provided to required vendors.		<p>Estimated Date of Implementation: January 1, 2018</p> <p>Person Responsible for Implementation: Debbie Reynolds, Executive Director, Procurement Management</p>
<p>4. Establish University-wide Tax Compliance Policies and Procedures (Medium)</p> <p>University-wide policies are not in place to provide guidance to students, faculty, and staff regarding several complicated tax areas.</p>	A lack of written policies and procedures leads to inefficient and ineffective operations. In addition, a lack of guidance on high-risk tax issues to the University may lead to noncompliance of IRS regulations.	Management should establish policies and procedures for high-risk tax areas.	<p>Management's Response and Action Plan: Documented procedures will be enhanced. UT System guidance on University-wide tax compliance policies will be reviewed, and appropriate policy(ies) drafted for high-risk areas by August 31, 2018. Current tax processing information is located in UT Dallas online askYODA knowledge base under categories Payroll – Taxes and Bursar – International Tax Compliance.</p> <p>Estimated Date of Implementation: 8/31/2018</p> <p>Person Responsible for Implementation: Nancy Barganier, Tax Compliance Manager</p>
<p>5. Enhance Procedures to Identify Activities Generating Unrelated Business Income (Low)</p> <p>The Office of General Counsel makes the final determination as to which activities are unrelated for the University. However, it is the University's responsibility to identify potential unrelated</p>	If unrelated business activities are not identified, then the University will not recognize unrelated business income and may be subject to fines and penalties.	Management should obtain more information on revenue generating activities to identify potential unrelated business income.	<p>Management's Response and Action Plan: Unrelated business income processes and procedures will be revised and improved by FY 2018. Tax Compliance will work with Contract Administration and Treasury in the process of establishing new</p>



Observation and Risk Level	Risk/Effect	Recommendation	Management's Response and Action Plan
business activities. As the current process is designed, Tax Compliance does not have sufficient information to identify sources of unrelated income. Questionnaires are sent out after Tax Compliance's review process. The review process lacks communication with departments to gain an understanding of the unrelated business activity.			<p>contracts and merchant departments to identify unrelated business income tax activities.</p> <p>Estimated Date of Implementation: 8/31/2018</p> <p>Person Responsible for Implementation: Nancy Barganier, Tax Compliance Manager</p>

Conclusion

Based on the audit work performed, we found that improvements to current processes are needed to comply with tax laws regarding foreign persons, independent contractors and unrelated business income tax.

We appreciate the courtesy and cooperation received from the management and staff in the Tax Compliance Office and Procurement Management as part of this audit.



Appendix 1

Priority Findings and Risk Matrix

Risk Level	Definition
Priority	High probability of occurrence that would significantly impact UT System and/or UT Dallas. Reported to UT System Audit, Compliance, and Management Review Committee (ACMRC). Priority findings reported to the ACMRC are defined as <i>“an issue identified by an internal audit that, if not addressed timely, could directly impact achievement of a strategic or important operational objective of a UT institution or the UT System as a whole.”</i>
High	Risks are considered to be substantially undesirable and pose a moderate to significant level of exposure to UT Dallas operations. Without appropriate controls, the risk will happen on a consistent basis.
Medium	The risks are considered to be undesirable and could moderately expose UT Dallas. Without appropriate controls, the risk will occur some of the time.
Low	Low probability of various risk factors occurring. Even with no controls, the exposure to UT Dallas will be minimal.



Appendix 2

Status of Prior Audit Recommendations

The following is the status of implementation of the recommendations resulting from Internal Audit Report No. R1617, *Scholarships*, dated February 22, 2016.

Recommendation	Implemented?
Ensure Completeness and Accuracy of Required IRS Tax Reporting (High): Consideration should be given to implementing a reporting process that would allow for accurate and complete tax reporting that is mandated by IRS regulations.	<p>This recommendation had previously been reported as having been implemented; however, when we performed our testing in the Tax Compliance audit, we found that it had not been fully implemented due to an error in a calculation.</p> <p>We observed that management implemented the recommendation during fieldwork. Internal Audit verified implementation by evaluating the criteria used to identify students requiring Form 1042S.</p>