

# Tax Compliance

Audit Report # 20-113

February 24, 2020



The University of Texas at El Paso  
**Office of Auditing and Consulting**

"Committed to Service, Independence and Quality"



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February 24, 2020

Dr. Heather Wilson  
President, The University of Texas at El Paso  
Administration Building, Suite 500  
El Paso, Texas 79968

Dear Dr. Wilson:

The Office of Auditing and Consulting Services has completed a limited- scope audit of Tax Compliance. During the audit, we identified opportunities for improvement and offered the corresponding recommendations in the audit report. The recommendations are intended to assist the department in strengthening controls and help ensure that the University's mission, goals and objectives are achieved.

We appreciate the cooperation and assistance provided by the Payroll and Disbursement Services staff during our audit.

Sincerely,

A handwritten signature in blue ink that reads 'Lori Wertz'.

Lori Wertz  
Chief Audit Executive

## **Report Distribution:**

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### **Auditors Assigned to the Audit:**

Christy Marquez, Senior Auditor I

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## **EXECUTIVE SUMMARY**

The Office of Auditing and Consulting Services has completed a limited scope audit of tax compliance and reporting. The objective of the audit was to ensure compliance with various tax laws, including payroll tax withholding and Internal Revenue Service (IRS) reporting for faculty, staff, and independent contractors.

During the audit, we noted the following:

- the IRS may classify independent contractors as employees.
- withholdings and reporting of Non-resident Alien taxes do not always follow UTEP policies or IRS regulations.

With the exception noted above, we conclude that there are established controls to limit risks; however, opportunities exist to improve tax reporting through automating processes, tax training for involved parties, continuous monitoring, and creating a centralized tax department.

## BACKGROUND

The Internal Revenue Service (IRS) requires organizations to report wages earned by employees and payments provided to independent contractors for services rendered. Employees and independent contractors may be classified as U.S. citizens, permanent residents, or non-resident aliens (NRA). In addition, The University of Texas at El Paso (UTEP) must also distinguish between an employee and an independent contractor who performs services and accurately report to the IRS based on that classification.

UTEP policies and procedures require that NRAs (employees and contractors) complete a profile in Glacier, UTEP’s tax compliance reporting system. Based on the profile, Glacier will determine:

- Residency tax status (resident or non-resident for tax purposes).
- Eligibility to claim a tax treaty (based on country of residence).
- Non-resident Social Security and Medicare tax exemption.

Taxes are either withheld or exempted based on income type, classification, residency, and U.S. tax treaties, when applicable.

See table below<sup>1</sup>:

### IRS Forms

Description	W2	1099-Misc	1042S	1098-T
Purpose	To report earned income and tax withholdings for employees.	To report miscellaneous payments made to non-employee individuals, such as independent contractors.	To report amounts paid to foreign persons who are subject to income tax withholding, even if no amount is deducted and withheld, because of a tax treaty or exception to taxation.	To report payments received and payments due from students.
Responsible Department	Payroll	Disbursement Services	Disbursement Services Payroll	Student Business Services
Reports to IRS	All Employees	Domestic Independent Contractors	NRA Independent Contractors NRA Employees, if applicable	All UTEP Students
# Tax Forms Filed for CY 2018	<b>7,361</b>	<b>990</b>	<b>358</b>	Not tested in this audit

<sup>1</sup> Glacier files IRS form 1042S directly with the IRS at end of year, based on information reported by the taxpayer and income reported by the Payroll Department. Glacier provides a copy of filed tax forms to UTEP and a confirmation of transmittal.

## AUDIT OBJECTIVES

The objective of the audit was to ensure compliance with various tax laws, including payroll tax withholding and IRS reporting for faculty, staff, and independent contractors.

## SCOPE AND METHODOLOGY

The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and the authoritative guidelines of the *International Professional Practice Framework* issued by the Institute of Internal Auditors.

Audit procedures included performing research, management interviews, and review of 2018 tax forms for employees, independent contractors, and foreign nationals. The scope of the audit is September 1, 2017 through May 31, 2019.

## RANKING CRITERIA

All findings in this report are ranked based on an assessment of applicable qualitative, operational control and quantitative risk factors, as well as the probability of a negative outcome occurring if the risk is not adequately mitigated. The criteria for the rankings are as follows:

**Priority** – 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.

**High** – A finding identified by internal audit that is considered to have a medium to high probability of adverse effects to the UT institution either as a whole or to a significant college/school/unit level.

**Medium** – A finding identified by internal audit that is considered to have a low to medium probability of adverse effects to the UT institution either as a whole or to a college/school/unit level.

**Low** – A finding identified by internal audit that is considered to have minimal probability of adverse effects to the UT institution either as a whole or to a college/school/unit level.

## AUDIT RESULTS

### A. Independent Contractors

The IRS generally defines independent contractors as people who are in an independent trade, business, or profession in which they offer their services to the general public. However, determination is dependent on the facts of each case. IRS Publication 15A outlines three areas of review to determine proper classification of an employee versus an independent contractor:

- behavioral control,
- financial control, and
- type of relationship, which includes the permanency of the relationship, along with the extent to which services performed are a key aspect of the regular business of the entity.

Departments requesting services must complete an authorized personal service (APS) checklist to help Payroll determine proper classification. Disbursement Services is responsible for issuing payment and reporting<sup>2</sup> for independent contractors. In addition, independent contractors are required to complete a Supplier Identification Form (SIF) and Glacier tax profile, if applicable, prior to rendering services.

We tested a sample of 25 payments flagged for 1099-Misc/1042S reporting to verify that:

- vendor payments were properly classified, correctly identified and monitored,
- IRS forms were complete and accurately reported, and
- Non-resident vendor registration was completed in Glacier prior to the service start date, if applicable.

#### A.1. IRS may classify independent contractors as employees.

A total of \$83,328 was paid to three of the 25 (12%) individuals who performed services which may be considered a key aspect of UTEP's regular business.

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<sup>2</sup> Payments, in the amount of \$600 or more, for services performed by non-employees must be reported to IRS on forms 1099-Misc or 1042S, if non-resident.

Calendar Year 2018			
Contractor	# of Vouchers Processed	Payment Frequency	Total \$
1	54	4.5/month	\$42,440
2	52	4.33/month	\$29,088
3	12	1/month	\$11,800
<b>Totals</b>	<b>118</b>		<b>\$83,328</b>

All payments listed above were reported to the IRS on form 1099-Misc.

Disbursement Services issues non-PO vouchers for contracted work based on the classification determined by Payroll without adherence to steps and guidelines outlined in the current APS process/checklist to determine proper classification.

### Recommendation:

*Payroll and Disbursement Services should:*

- *Review APS forms/checklists for completion and proper classification in conjunction with Disbursement Services' current payment tracking system.*
- *Recommend that departments process frequently used suppliers through a purchase order for tracking purposes.*
- *Work with Human Resources to classify identified potential employees, if applicable.*

**Level:** This finding is considered **Medium** because of the increased financial and legal risk of contractor/employee misclassification. Improper classification between independent contractors and employees may lead to IRS fines and penalties.

### Management Response:

*Disbursement Services currently reviews and approves Independent Contractor payments processed by departments in collaboration with the Payroll Office. The current policies and processes related to independent contractors is under review by a committee composed of representatives from Disbursement Services, Payroll, Human Resources, Purchasing, Research and Internal Audit. The goal of the committee is to automate the current paper driven process and strengthen the checks and balances against employee versus independent contractor.*

*Disbursement Services will utilize its payment tracking system to identify and report to the Purchasing Office the non-PO payments processed for independent contractors that are not following regulated purchasing processes.*

**Responsible Party:**

*Mark McGurk, Vice President for Business Affairs*

**Implementation Date:**

*May 31, 2020*

**B. Employee Classification and Withholding**

We tested a sample of 10 U.S. citizen and permanent resident employees to determine if:

- Employee classification is consistent with tax reporting type.
- Earnings and withholdings are accurately reported to IRS and employee.

No exceptions noted.

**C. Policies and Procedures**

We obtained UTEP’s tax related policies and procedures to confirm a tax compliance program is in place, and used the tested sample of employees and vendors to verify the program is monitored for proper classification and tax reporting.

No exceptions noted.

**D. Other Observations**

The IRS issues publications and guidance regarding taxation and reporting for non-resident alien (NRA) employees, including student scholars, and applies U.S. tax treaties with countries to exempt certain income earned in the U.S. Additionally, certain visa holders are temporarily exempt from FICA and OASDI<sup>3</sup> taxation. The agreement with federal criteria, is outlined on Payroll’s website.

The University uses Glacier, a non-resident alien tax compliance system, to collect an individual’s immigration status and determine appropriate employee tax treatment.

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<sup>3</sup> Federal Insurance Contributions Act (FICA) and Old Age, Survivors and Disability Insurance (OASDI) tax is paid by both employee and employer for Social Security and Medicare benefits.

NRAs are required to complete a Glacier profile prior to the first day of employment and annually update required tax forms in this system.

### **D.1. Withholdings and reporting of Non-resident Alien taxes do not always follow UTEP policies or IRS regulations.**

Payroll does not have a fully automated process to identify NRA employees and efficiently assess the correct tax withholdings for those exempt from FICA taxation. The timely completion of Glacier is beyond the control of Payroll; however, we found the following based on our test work:

- employees did not always complete their Glacier profile. However, Payroll did withhold taxes and report based on resident tax status.
- some new hires began work up to a month prior to completing their Glacier profile.
- three student employees had FICA taxes incorrectly withheld, resulting in an additional overpayment to the IRS by UTEP.

Payroll properly applied U.S. tax treaties and reported wages to the IRS for the tested sample. At this time, NRA employees are made aware of the tax implications when asked to complete a Glacier profile during the hiring process. Upon employee request, manual adjustments may be made to correct withholdings, but are dependent upon timing.

#### **We recommend:**

- New employees should not begin work without completed Glacier profiles and paperwork relating to both Human Resources and Payroll functions.
- Payroll should work with Human Resources to establish a review process to identify NRA employees who do not complete a required Glacier tax profile.
- Complete and timely communication between departments may reduce manual payroll corrections and improve the accuracy of IRS reporting.

## **CONCLUSION**

Based on the results of audit procedures performed, we conclude that Payroll and Disbursement Services have detailed departmental policies and procedures to assist with the required tax reporting.

However, Payroll and UTEP could improve tax reporting by:

- automating all tax payment processes,
- offering tax training for involved parties,
- monitoring payments, and
- creating a centralized tax department.

We wish to thank the management and staff of Payroll and Disbursement Services for their assistance and cooperation provided throughout the audit.