



Office of the City Auditor

INFORMATION CALENDAR
February 9, 2010

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: Business License Tax Program Audit Report Fiscal Year 2009

SUMMARY

The attached Business License Tax (BLT) Program Audit Report conveys the results of the Auditor’s Office BLT program audits during FY09. The Business License Tax audits initiated during FY09 were primarily Berkeley residential rental properties. Cases selected for audit appeared to be unlicensed, delinquent, and/or underreporting tax due the City.

CURRENT SITUATION AND ITS EFFECTS

Total payments collected during FY09 from Business License Tax audits totaled \$170,577.

The Business License Tax Program Audit had 91 open cases, which included 29 cases carried forward from the prior year. Twenty-two residential rental properties and two auto repair shops were billed a net total of \$138,223 for unpaid taxes, penalties, and interest. Nine cases were dropped or closed, and one case was provisionally billed \$2,829.

As of June 30, 2009, the BLT accounts receivable consisted of 17 cases totaling \$120,256. Seven of these audit cases, with unpaid billed amounts totaling \$40,625, have been charged to the owner’s property tax bills by the Finance Department.

Since inception of the audit program in 1982, auditors have billed tax, penalties, and interest totaling over \$5,000,000. Revenue identified is not a one-time windfall but becomes part of the future revenue stream in subsequent years. For each \$100,000 identified by audit, about \$22,333 in recurring tax can be expected for each future year. In addition, BLT audit work may act as a deterrent to those who might consider underreporting or neglect to obtain a license.

POSSIBLE FUTURE ACTION AND FISCAL IMPACTS

We will continue to allocate staff resources to identify underreporting, delinquent and/or unlicensed businesses. As a result, the City will receive tax revenue it may not otherwise receive.

In FY10, the Auditor's Office and Finance are planning a joint effort aimed at increasing Business License tax revenues by identifying unlicensed businesses and billing them for unpaid Business License tax, penalties, and interest.

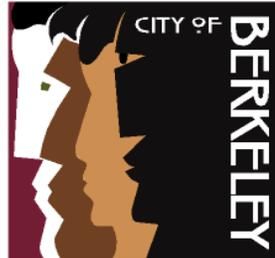
CONTACT PERSON

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Attachment

1: Business License Tax Program Audit Report Fiscal Year 2009

City of Berkeley



Business License Tax Program Audit Report

For Fiscal Year Ending June 30, 2009

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Presented to Council February 9, 2010

**Business License Tax Program Audit Report
For Fiscal Year Ending June 30, 2009**

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I. PURPOSE AND OBJECTIVE

The purpose of this report is to present the results of the City Auditor's Business License Tax (BLT) Audit Program for fiscal year 2009 (FY09).

The objective of the BLT Audit Program is to recover Business License revenues that the City might not otherwise receive because businesses or persons doing business in Berkeley did not procure a Business License, were delinquent in payment of tax, or under-paid the tax due.

II. SCOPE AND METHODOLOGY

The City Auditor's Office assesses compliance with the BLT ordinance by auditing entities and individuals engaged in business within Berkeley. The review period is based on compliance for the three most recent calendar years at time of audit selection¹. A fourth year may be incorporated into the review if the audit case has not been completed by March 1 (due date for business licenses), and we have identified the case as being unlicensed, delinquent, or underreporting gross receipts.

Ninety-one cases were under audit during FY09. Sixty-two of these cases were initiated in FY09: 58 residential rental properties and 4 businesses, which included 2 automotive repair businesses. The other 29 cases were carried over from FY08: 7 residential rental properties and 22 automotive repair business.

The Auditor's Office compared Rent Board data² to the City's Occupational License (OL) data using Audit Command Language (ACL) data extraction and analysis software to identify the residential rental property audit cases. Properties were selected for audit, if Rent Board data indicated a property owner could charge significantly higher total rents than the gross receipts taxpayers self-reported and used to calculate BLT due. Two of the rental properties audited had a business at their location, and these businesses were also audited.

¹ For audit cases initiated during July 1 through February 28, Business License years 2006, 2007, and 2008 were reviewed. For audit cases initiated during March 01 through June 30, Business License years 2007, 2008, and 2009 were reviewed.

² In November 2004 Berkeley voters passed Ballot Measure P authorizing the amendment of the "Rent Stabilization and Eviction for Good Cause Ordinance". The amendment permits the City to use Rent Board information to help enforce other City ordinances, such as the Berkeley BLT ordinance.

Automotive repair shops carried over from FY08 had been selected for audit by comparing OL data to Franchise Tax Board, telephone directory, and City search website information. The automotive repair shops selected appeared to be unlicensed or reporting much lower gross receipts than similar businesses in the same industry.

The audited business owners were requested to provide supporting documentation for their reported gross receipts. The audits initiated in FY09 focused on gross receipts reported for BLT years 2006 through 2008. Audit cases carried over from FY08 focused primarily on business license tax years 2005 to 2007. Based on the information provided and/or compiled, the auditors billed business owners for unpaid BLT, plus penalties and interest, in accordance with Berkeley Municipal Code (BMC) Section 9.04.

We conducted this performance 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 work was limited to those areas specified in the scope and methodology section of this report.

III. BACKGROUND

General Information

The BLT ordinance was enacted in 1977 and is codified under Berkeley Municipal Code (BMC) Chapter 9.04. It was established solely for revenue purposes and is not meant to be a regulatory function. The Finance Department is responsible for the administration and collection of BLT revenue. The City received revenue from BLT totaling \$13,843,360 during FY09.

Annual Licensing Procedure

The BMC requires all individuals and entities engaged in business within Berkeley to obtain a Berkeley business license and to pay an annual license fee. Each December the Finance Department sends a BLT renewal form (Tax Declaration) to licensed businesses listed in the City's OL database. Taxpayers are instructed to identify their gross receipts, calculate the tax due, and return the form to the Finance Department with payment. Newly established businesses are required to obtain a business license within 15 days of commencing business.

BLT is generally assessed on a business' prior year gross receipts generated within Berkeley. However, in some instances the tax is assessed based on gross payroll, value added (gross receipts less value of raw materials), or a flat fee. The applicable BLT rates for the FY09 audit sample were 1) Rental properties, taxed at a flat fee of \$77, or at the rate of \$10.81 for each \$1,000 of gross receipts, whichever is higher; and 2) Automotive repair shops (classified under business, personnel, and repair services), taxed at a flat fee of \$51, or at the rate of \$1.80 for each \$1,000 of gross receipts, whichever is higher.

All licenses are effective January 1 and expire December 31st. A business license is delinquent if not paid within thirty days after commencing business. A business license renewal is delinquent if payment is not received annually on or before February 28th. Delinquent businesses are assessed penalties. These businesses are also assessed interest at the rate of one percent each month on unpaid taxes and penalties. Interest continues to accrue until all taxes, penalties, and interest have been paid.

Penalty for Non-payment or Underpayment

Type of Business	Number of Days Delinquent or Delinquent Date	Penalty on Unpaid Tax
New	After 30 days	10%
New	After 60 days	50%
Renewal	After February 28	10%
Renewal	After April 1	50%

IV. SUMMARY OF FY09 PROGRAM RESULTS

A. Audits Initiated

The City Auditor's Office initiated 62 new audit cases consisting of 58 residential rental properties and 4 businesses, which included 2 auto repair shop cases. The majority of the cases selected were licensed business owners who appeared to have paid taxes based on underreported gross receipts (basis for tax). Four cases were unlicensed and 4 were delinquent. In addition to the 62 new audit cases, 29 cases were carried over from the previous year.

B. Audit Activities and Assessments

The Auditor's Office assessed a total of \$140,507 in unpaid taxes, penalties, and interest. However, \$2,284 in taxes, penalties, and interest assessments was waived due to a code-misclassification in the City's OL system. The code-misclassification affected one of the two auto repair shop cases. Twenty-two residential rental property owners and two auto repair shops were assessed a net amount of \$138,223 in unpaid taxes, penalties, and interest.

Summary of FY09 Audit Activity

Audit Activity (Residential Rental Properties, Auto Repair Shops, and Other Businesses)	Audit Cases Carried Over From FY08 (I)	FY09 Initiated Audit Cases (II)	FY09 Total Audit Cases (I)+(II)
Total Audit Activity	29	62	91
Less: Billed Audits	(8)	(16)	(24)
Closed/Dropped Audits	(9)	(0)	(9)
Audit Cases Carried Over to FY10	12	46	58*

**Fourteen of the 58 Audit Cases carried over to FY10 consist of Auto Repair Shops.*

FY09 Audit Assessment Composition

Audit Assessment Composition	Assessments for Cases Carried Over from FY08 Residential Rental Properties (I)	Assessments for Cases Carried Over from FY08 Auto Repair Shops (II)	Assessments for Cases Initiated in FY09 Residential Rental Properties (III)	FY09 Total Assessment (I)+(II)+(III)
Unpaid BLT	\$ 1,494	\$ 1,285	\$ 91,037	\$ 93,816
Penalty Assessments	\$ 747	\$ 642	\$ 29,177	\$ 30,566
Interest Charges	\$ 479	\$ 474	\$ 15,172	\$ 16,125
Adjustment		(\$ 2,284)**		(\$ 2,284)
TOTAL	\$ 2,720	\$ 117	\$ 135,386	\$ 138,223

** Waived

C. Provisional Audit Assessments

Provisional audit assessments are tentative billings based on Rent Stabilization Board data. If a residential rental property owner (auditee) declines several requests to provide the auditor with gross receipt documentation that support the BLT due, the auditee is provisionally billed. When a provisional bill is issued, the auditee is asked to pay the assessment and/or file an appeal, or provide the requested documentation. If the auditee continues to be non-responsive, the provisional bill becomes final. Because provisional assessments are subject to change prior to finalization, they are not included in the “Audit Assessment Composition” table above.

In FY08, two audit cases were issued provisional assessments totaling \$8,869 (tax, penalties, and interest), and carried over to FY09. After reviewing the business owners’ submitted supporting documentations, the invoice status of these cases changed from provisional to final invoices totaling \$1,059.

One provisional audit assessment totaling \$2,829 was pending as of June 30, 2009. The property owner was requested to provide supporting documentation to substantiate their reported gross receipts. This case will be carried over to FY10.

D. Audits Dropped/Closed

A review of City records and documentation provided by the auditees resulted in nine cases being dropped or closed. Cases are “closed” if an auditee provides documentation that substantiates they are in compliance with the BLT Ordinance. Cases may be “dropped” if the statute of limitations has been exceeded. Cases may also be “dropped” if the auditors determine that the information relied on at the time of sample selection was inaccurate.

E. Issuance of Administrative Citations

Two administrative citations were issued during FY09. In December 2006 Council granted the auditor job classifications the authority to issue administrative citations to auditees who are not in compliance with BMC 9.04.285 or 9.04.035³. The issuance of an administrative citation serves as a means to address BMC violations and to promote quick resolution.

³ BMC Section 9.04.285 Examination of books, records, witnesses—Information confidential—Penalty. “The Director of Finance or any authorized employee, is authorized to examine the books, papers and records of any person subject to this chapter for the purpose of verifying the accuracy of any return made or, if no return was made, to ascertain the license fees due under this chapter.”

BMC Section 9.04.035 License required. “It shall be unlawful for any person, either for himself/herself or for any other person, to commence or carry on any business specified in this chapter, in the City, without first having procured a license from the City to do so, or without complying with any and all regulations of such business contained in this chapter.”

F. Business License Tax Appeals

Three rental property owners requested an appeal for their BLT audit assessment. In all three cases, the Hearing Examiner found no grounds for waiving taxes and/or penalties and interest. Auditees have the opportunity to appeal BLT audit assessments to the Hearing Officer in the City Manager’s Office by submitting a written appeal request, generally within 30 calendar days from the date of a final or provisional invoice.

G. Audit Cases Referred to Finance

Adequate Documentation Not Provided

Cases are referred to the Finance-Revenue Collection Division for follow-up when the auditee fails to:

- Respond to audit letters and telephone calls, or
- Provide the auditor with adequate documentation to perform an audit.

Unpaid Audit Assessments

As of June 30, 2009, the BLT accounts receivable consisted of 17 cases totaling \$120,256. Seven of the 17 cases, with unpaid billed amounts totaling \$40,625, have been charged to the owner’s property tax bills by the Finance Department.

The Auditor’s Office provides the Finance-Revenue Collections Division with accounts receivable reports identifying the audit cases that have been assessed by the auditors and for which payments have not been received. Finance staff use various means to collect BLT due, including adding the unpaid audit assessments to the property owners tax bill.

H. Projected Business License Tax Revenue

Business License Tax revenue from compliance audits has historically been projected at \$125,000 to \$150,000 annually per full-time equivalent (FTE) employee assigned. There was 0.79 FTE assigned to the program during FY09, including supervisory time. For every dollar spent on salaries, fringe benefits, and BLT Program administration, the auditors identified and billed approximately \$1.46 in BLT penalties and interest.

FY09 Total Billed	FY09 Auditor Salaries*	Ratio
\$140,507	\$96,146	1.46: 1

* Auditor Salaries = auditor salaries + supervisory salaries + fringe benefits divided by .80 to account for vacation, sick leave, training, and other administrative time.

Business License Tax Program Audit For FY 2009

I. Collections

BLT audit collections totaled \$170,577 during FY09. Of this, \$56,818 was collected from prior year billings, including a total of \$7,771, collected by the County Assessor's Office through the owner's property tax bills.

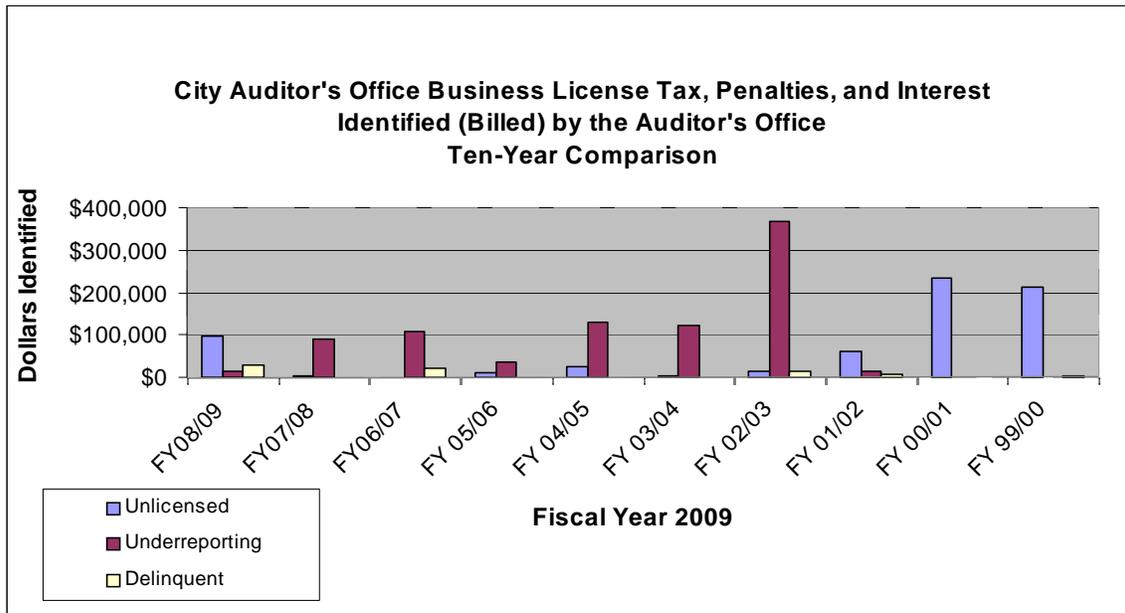
J. Cumulative Statistical Information

During the last ten years, the City Auditor's BLT Audit Program has identified 463 businesses and residential rental property owners that owed the City \$1,618,869 in tax, penalties, and interest. During this same ten-year period, payments totaling \$1,546,088 were received. Since the inception of the program in 1982, unpaid tax, penalties, and interest identified by the City Auditor's Office BLT Audit Program have totaled \$5,104,977.

**Business License Tax, Penalties and Interest
Identified (Billed) By The Auditor's Office
Ten-Year Comparison**

Fiscal Year	Unlicensed Businesses		Under-reporting of Gross Receipts		Delinquent Licenses		Total	Number of Hours Spent	% of FTE @ 80% Productive Time*
								(A)	(A)/0.8/2,080
08/09	3	\$ 96,903	19	\$ 15,693	2	\$ 27,911	\$ 140,507	1,322	0.79
07/08	1	\$ 4,987	32	\$ 90,673	0	\$ 0	\$ 95,660	1,398	0.84
06/07	0	\$0	22	\$106,919	2	\$ 21,541	\$128,460	1,515	0.91
05/06	5	\$ 9,584	6	\$ 34,418	0	\$ 0	\$ 44,002	973	0.58
04/05	5	\$ 25,281	7	\$130,160	1	\$ 1,421	\$156,862	1,918	1.15
03/04	1	\$ 2,770	15	\$121,766	1	\$ 534	\$125,070	1,806	1.09
02/03	8	\$ 15,162	31	\$366,680	8	\$ 13,351	\$395,193	3,457	2.08
01/02	54	\$ 59,701	8	\$ 15,020	1	\$ 7,653	\$ 82,374	2,236	1.34
00/01	115	\$233,571	2	\$ 934	0	\$ 0	\$234,505	1,915	1.15
99/00	112	\$214,361	0	\$ 0	2	\$ 1,875	\$216,236	1,553	0.93
TOTAL	304	\$676,758	143	\$887,656	16	\$ 54,455	\$1,618,869	18,093	

** Productive Time is calculated based on 2,080 work hours per year @ 80%. The 80% figure is used so that the cost of the hours spent includes an allowance for sick leave, vacation days, holidays, training, and other administrative uses of time.*



V. CONCLUSION

BLT audit work has historically been cost-effective in generating revenue by identifying unlicensed and underreporting businesses. The audit work may also act as a deterrent to those who might consider underreporting or neglect to obtain a license.

The BLT revenue identified during our audits is generally not a one-time windfall, but becomes a part of the future revenue stream. In FY09, 67% of our BLT billings were comprised of unpaid tax, and the remaining 33% were penalties and interest. The BLT audit generally includes unpaid tax for a three-year period. Accordingly, for each \$100,000 in tax identified by audit, about \$22,333 (\$67,000 / 3 years) in tax for each succeeding year can be expected, as long as the audited businesses are generating consistent gross receipts.