

Office of the City Auditor

INFORMATION CALENDAR
February 26, 2008

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Submitted by: Ann-Marie Hogan, City Auditor
Subject: Business License Tax Program Audit Report Fiscal Year 2007

SUMMARY

The attached Business License Tax Program Audit Report identifies the Business License Tax revenue identification efforts, challenges, and accomplishments of the Auditor's Office during fiscal year 2007 (FY07). The Business License Tax audits initiated during FY07 consisted of Berkeley residential rental properties and one professional service business. The work performed during FY07 involved auditing new cases and cases that had been initiated before FY07. Rent Board information, disclosed as authorized by Ballot Measure P, was used to determine the residential rental properties selected for audit. Properties selected appeared unlicensed or owners appeared to have underreported tax due to the City. In addition to the audit work performed, auditors invested staff time to improve automated systems tracking the Business License Tax Program audit activity.

CURRENT SITUATION AND ITS EFFECTS

During FY07 the Business License Tax Program Audit had 57 open cases, which included 34 cases carried forward from prior years. Audit work completed during FY07 resulted in 24 businesses being billed a total of \$128,460 for unpaid taxes, penalties, and interest. There were 17 dropped/closed cases, and 5 cases that were provisionally billed an additional \$20,743. Provisionally billed auditees had declined several requests for gross receipts documentation and were tentatively billed using Rent Board information. If City staffs' efforts to obtain rental gross receipts information for the 5 cases that were provisionally billed are not successful, the provisional billings will become final.

As of June 30, 2007, 13 Business License Tax Program audit cases totaling \$156,680 were past due and required collection efforts from the Finance Department. For 8 of these audit cases, the unpaid audit assessments were 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 \$4,868,810.

Revenue identified is not a one-time windfall but becomes part of the future revenue stream, assuming auditees pay the correct tax in years subsequent to their audit. For each \$100,000 identified by audit, about \$16,667 in recurring tax can be expected for each future year, as long as the audited businesses continue to generate consistent gross receipts.

POSSIBLE FUTURE ACTION AND FISCAL IMPACTS

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

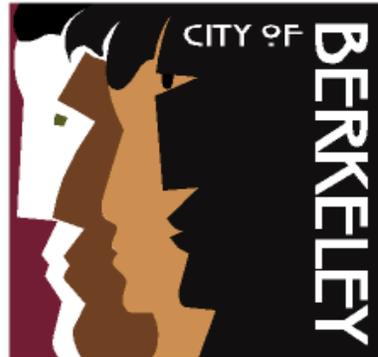
CONTACT PERSON

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Attachment

1: Business License Tax Program Audit Report Fiscal Year 2007

City of Berkeley



Business License Tax Program Audit Report

For Fiscal Year Ending June 30, 2007

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Presented to Council February 26, 2008

BUSINESS LICENSE TAX AUDIT PROGRAM REPORT

For Fiscal Year Ending June 30, 2007

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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 2007 (FY07).

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 BLT calendar years (January 1 to December 31) from time of audit selection. A four-year period may be incorporated into the review when the City has entered into a new reported BLT calendar year if the audit case has not been completed, and we have identified underreported gross receipts.

Fifty-seven cases were under audit during FY07. Twenty-three cases, comprised of twenty-two residential rental properties and one professional service business, were initiated in FY07. The other thirty-four cases were carried over from FY06. The auditors identified the residential rental properties cases by comparing the Rent Board data to the City's Occupational License (OL) data using Audit Command Language (ACL). Properties selected were those for which Rent Board data indicated a property owner could charge significantly higher total rents than the gross receipts used by taxpayers to calculate BLT due the City.

Rental property owners selected for an audit were requested to provide supporting documentation of their reported gross receipts. Rental property audits initiated in FY07 focused on gross receipts reported for BLT years 2004 to 2006. Review of audit cases carried over from FY06 and completed during FY07 focused on business license tax years 2003 to 2006. Based on the information provided and/or compiled, the auditors billed business owners for any unpaid BLT, plus penalties and interest, in accordance with Berkeley Municipal Code (BMC) Section 9.04.

BLT audit work was performed in accordance with Generally Accepted Government Auditing Standards for a performance audit. Audit work was limited to those areas specified in the scope and methodology section of this report.

III. BACKGROUND

A. General Information

The BLT ordinance was first enacted in 1977 and is codified under Berkeley Municipal Code (BMC) Chapter 9.04. It was established solely for revenue purposes and, as such, 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 \$11,292,446 during FY07.

B. Annual Licensing Procedure

BMC requires all individuals and entities engaged in business within Berkeley to obtain a Berkeley business license and to pay an annual license fee. In December of each year the Finance Department sends a BLT renewal form (Tax Declaration) to all licensed businesses listed in the City's OL database (if within the current statute of limitations). 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. Rental properties are taxed at a flat fee of \$77, or at the rate of \$1.081 for each \$100 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 1 percent each month on unpaid taxes and penalties. Interest continues to accrue until paid.

Penalty for Non-payment or Underpayment

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

C. Passage of Ballot Measure P

In November 2004 Berkeley voters passed Ballot Measure P, authorizing the amendment of the “Rent Stabilization and Eviction for Good Cause Ordinance”. The Measure P amendment permits the City to use Rent Board information to help enforce other City ordinances, such as the Berkeley BLT ordinance. The Auditor’s Office used this information to identify rental property owners who appeared not to have licensed their property or who appeared to have underreported the gross receipts used to calculate the BLT due.

IV. SUMMARY OF PROGRAM RESULTS

A. Audits Initiated

The City Auditor’s Office initiated 22 residential rental property cases and 1 professional service provider case. The rental property cases selected were those licensed properties whose owners appeared to have paid taxes based on underreported gross receipts (basis for tax).

B. Audit Activities and Assessments

The Auditor’s Office assessed 24 residential rental property owners a total of \$128,460 in unpaid taxes, penalties, and interest. Fifteen cases were assessed a total of \$120,219 (94%). These cases were carried over from FY06. Nine cases were assessed a total of \$8,241 (6%). These cases were initiated in FY07.

Summary of FY07 Audit Activity

Audit Activity	Audit Cases Carried Over From FY06 (I)	FY07 Initiated Audit Cases (II)	FY07 Total Audit Cases (I)+(II)
Total Audit Activity	34	23	57
Less: Billed Audits	(15)	(9)	(24)
Closed/Dropped Audits	(15)	(2)	(17)
Audit Cases Carried Over to FY08	4	12*	16

** Five of the FY07 initiated audit cases carried over to FY08 have been provisionally billed.*

FY07 Audit Assessment Composition

Audit Assessment Composition	Assessments for Cases Carried Over From FY06 (I)	Assessments for Cases Initiated in FY07 (II)	FY07 Total Assessment (I)+(II)
Unpaid BLT	\$ 59,772	\$ 4,459	\$ 64,231
Penalty Assessments	\$ 30,177	\$ 2,230	\$ 32,407
Interest Charges	\$ 30,270	\$ 1,552	\$ 31,822
TOTAL	\$120,219	\$ 8,241	\$128,460*
%	94%	6%	100%

*The auditors assessed \$1,164 in Business Improvement District taxes (BID) during the audit and included the revenue with Business License taxes and penalties. The unpaid BID taxes were \$582 and penalties were \$582.

C. Provisional Audit Assessments

Provisional audit assessments are interim billings based on Rent Stabilization Board data when a residential rental property owner declines several requests to provide gross receipt documentation that support the bases for which BLT taxes were calculated. When a provisional assessment is issued, the auditee is asked to pay the assessment, file an appeal, or provide requested documentation. If the auditee continues to be non-responsive, the issued provisional billing becomes a final invoice. Since provisional assessments were tentative and subject to changes, they were not included above in the "FY07 Audit Assessment Composition" table.

Three provisional audit assessments (originated in FY05) were carried over from FY06 to FY07. One of the three cases was dropped after the property owner presented adequate supporting documentation to substantiate their claim. The property owners of the other two cases did not respond; therefore, the status of the invoices changed from "provisional" to "final" and totaled \$21,662.

In addition, five audit cases initiated in FY07 were issued provisional assessments totaling \$20,744 (tax, penalties, and interest). These cases will be carried over to FY08.

D. Audits Dropped/Closed

Cases are "closed" if an auditee provides adequate documentation that supports compliance with the BLT Ordinance. Cases may be "dropped" in situations where the Statute of Limitation has been exceeded or if further research shows misinformation had been relied upon to select the case(s) for audit. Based on our review of submitted documentation and City records, seventeen cases were dropped or closed.

E. Issuance of Administrative Citations

In December 2006, Council granted all auditor job classifications the authority to issue administrative citations to auditees that are not in compliance with BMC 9.04.285 or 9.04.035. The issuance of an administrative citation serves as a means to address BMC violations and to promote a quick resolution of the violation. Three administrative citations were issued during FY07.

F. Business License Tax Appeals

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, within 30 calendar days from the date of a final or provisional invoice. No BLT audit assessments were appealed during FY07.

G. Audit Cases Referred to Finance

Auditees That Declined To Provide Auditors With Adequate Documentation

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

- Respond to audit letters and telephone calls,
- Provide the auditor with adequate documentation to perform an audit, or
- Pay the administrative citation issued by the auditor.

Finance staff uses various means to license these auditees and collect BLT due, including adding the unpaid audit assessment billings to the property owners tax bill.

Unpaid Audit Assessments

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. As of June 30, 2007, the BLT accounts receivable balance was \$159,763. Finance was asked to perform collection efforts on unpaid audit assessments that were outstanding for over 60 days. Thirteen cases totaling \$156,680 required collection efforts. Eight properties had the unpaid audit assessments charged to the owner's property tax bills by the Finance Department.

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 0.91 FTE assigned to the program during FY07, including supervisory time. For every dollar spent on salaries, fringe benefits, and BLT Program administration, the auditors identified and billed approximately \$1.24 in BLT penalties and interest.

FY07 Total Revenue	FY07 Auditor Salaries*	Ratio
\$128,460	\$103,206	1.24: 1

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

I. Collections

BLT audit collections totaled \$55,369 during FY07. Of this, \$50,211 was collected from prior year billings.

J. Business License Tax Program Database Improved

The Auditor's Office maintains its BLT program audits in a Microsoft Access database. During FY07, the auditors continued to invest staff time enhancing the current system to facilitate data entry, reporting, and information retrieval that helps manage the revenue audit work more efficiently. These continued improvements are expected to reduce the amount of time the auditors spend verifying and reconciling BLT information.

K. Cumulative Statistical Information

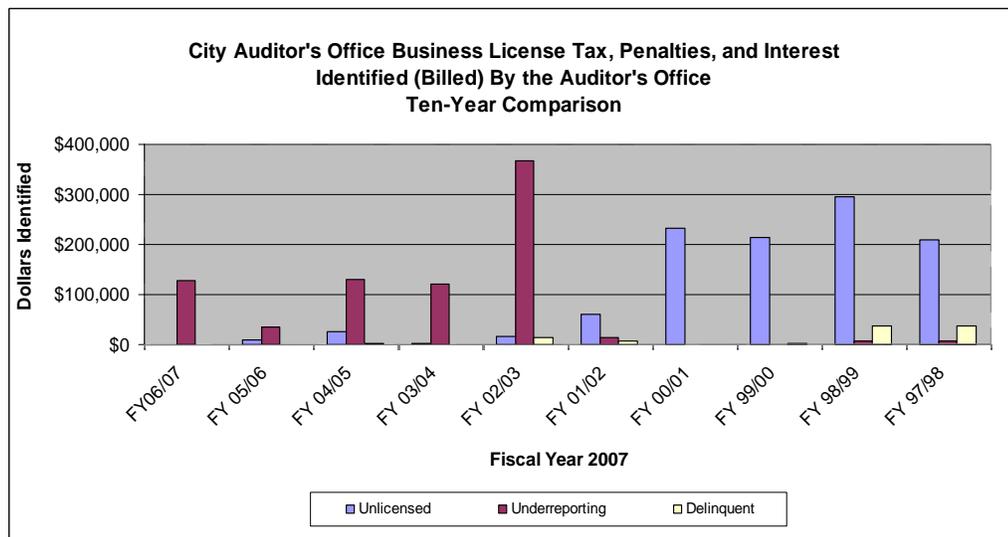
During the last ten years, the City Auditor's BLT Audit Program has identified 775 businesses and residential rental property owners that owed the City \$1,974,263 in tax, penalties, and interest. During this same ten-year period, payments totaling \$1,973,431 were received. Payments exceed billings because a settlement payment of \$205,000 from a billing issued outside this period was received. Since the inception of the program in 1982 unpaid tax, penalties, and interest identified by the City Auditor's Office BLT audits total \$4,868,810.

Business License Tax Program Audit For FY 2007

**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 (A)	% of FTE @ 80% Productive Time* (A)/0.8/2,080
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
98/99	186	\$295,323	5	\$ 7,283	3	\$ 36,591	\$339,197	2,536	1.52
97/98	152	\$209,723	9	\$ 6,466	14	\$ 36,175	\$252,364	835	0.50
TOTAL	638	\$1,065,476	105	\$789,646	32	\$ 119,141	\$1,974,263	18,744	

** 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 also acts as a deterrent to those who might consider under-reporting or neglect to obtain a license.

The BLT revenue identified during our audits is not a one-time windfall, but becomes a part of the future revenue stream. In FY07, 50% of our BLT billings were comprised of unpaid tax, and the remaining 50% 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 \$16,667 ($\$50,000 / 3$ years) in tax for each succeeding year can be expected, as long as the audited businesses are generating consistent gross receipts.