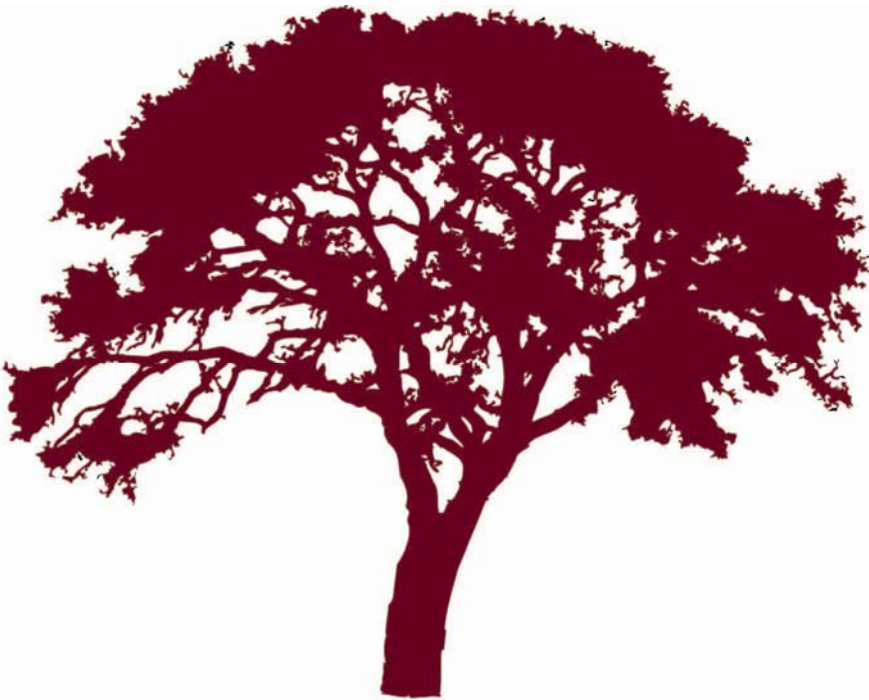


City of Oakland Office of the City Auditor

November 19, 2013

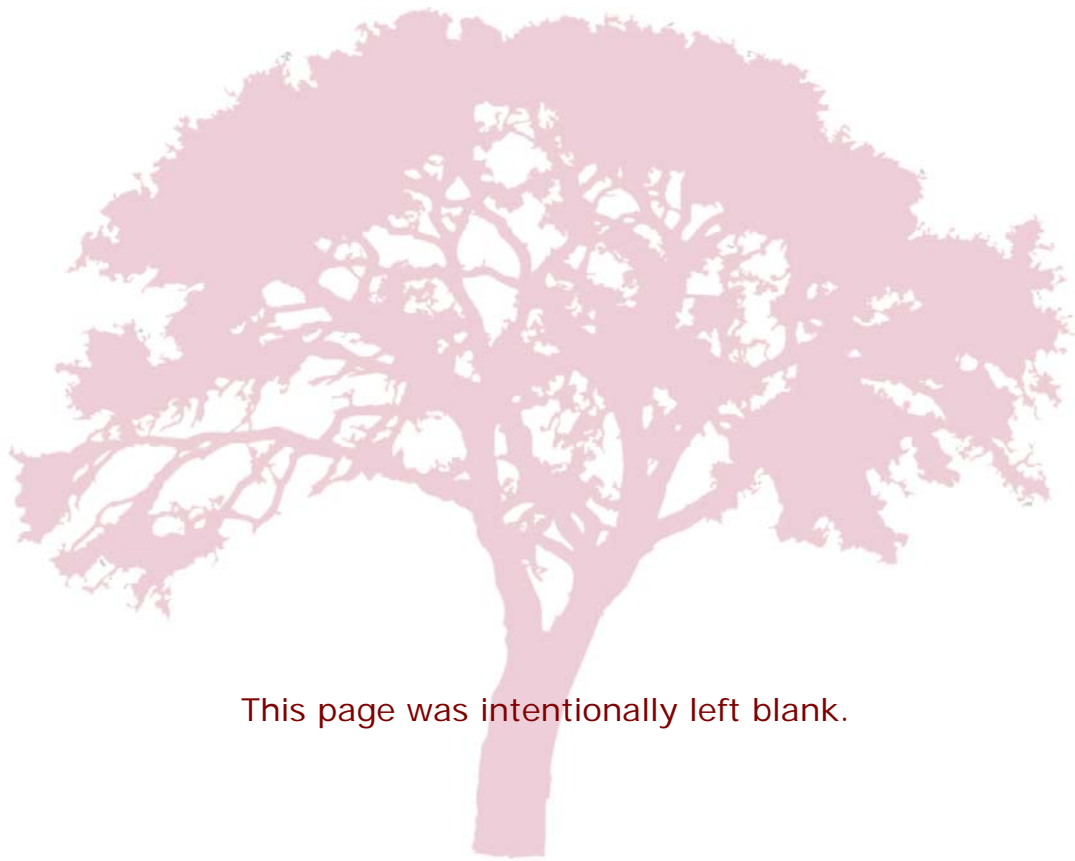
Business Tax Refund Audit 2009 – June 2013

The audit found that the City correctly calculated, appropriately processed, and approved business tax refunds; however, minor improvements to the refund process can be made.



City Auditor
Courtney A. Ruby, CPA, CFE

PERFORMANCE AUDIT



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November 19, 2013

OFFICE OF THE MAYOR
HONORABLE CITY COUNCIL
CITY ADMINISTRATOR
CITIZENS OF OAKLAND
OAKLAND, CALIFORNIA

RE: BUSINESS TAX REFUND AUDIT FOR 2009 – JUNE 2013

Dear Mayor Quan, President Kernighan, Members of the City Council, City Administrator Santana, and Oakland Citizens:

The City of Oakland Municipal Code Section 5.04.540 requires the Office of the City Auditor (Office) to annually audit the business tax refunds approved by the Director of Finance. However, due to resource limitations, our Office was not able to conduct this annual audit. Attached is the Business Tax Refund Audit, which reviewed business tax refunds processed in 2009 through June 2013.

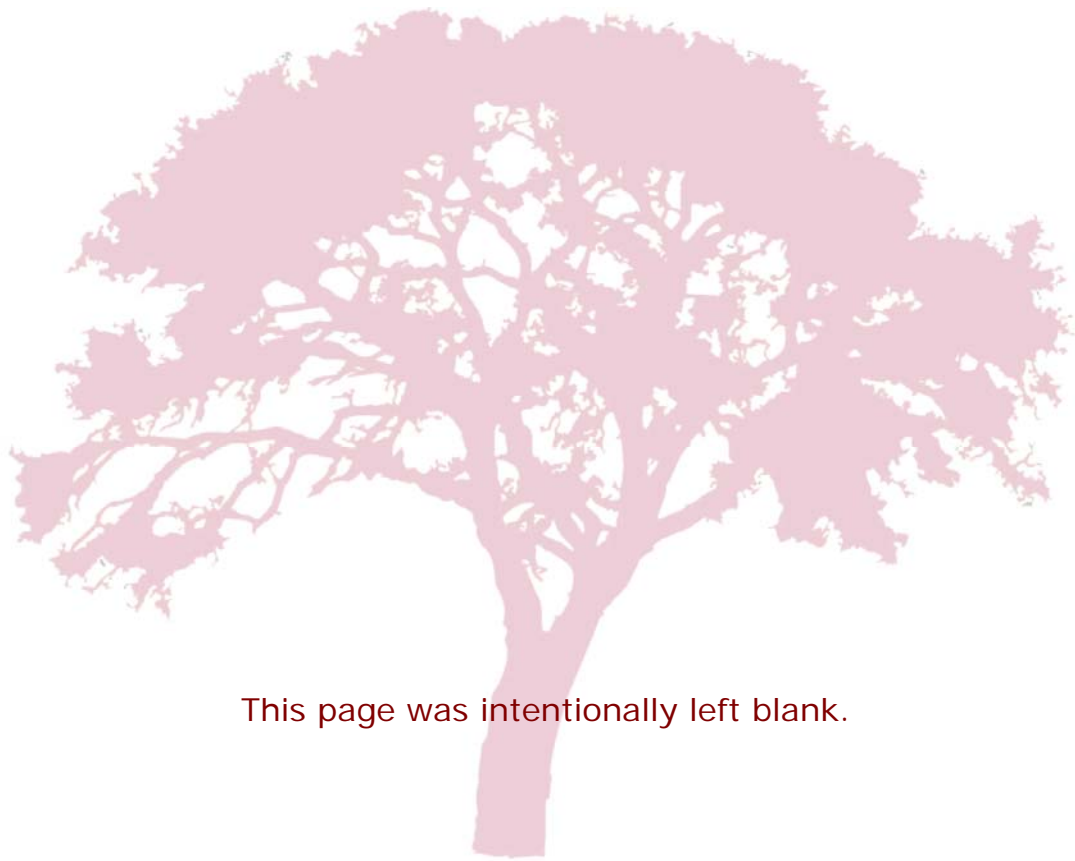
I am pleased to share that based on a sample of 50 business tax refunds equaling approximately 70 percent of the total \$1.4 million in refunds the City paid during the audit scope, the audit found that the City correctly calculated, appropriately processed, and approved its business tax refunds. The audit includes four recommendations to improve transparency.

I want to express our appreciation to the City Controller, the Revenue and Tax Administrator, and staff for their cooperation and commitment to addressing the recommendations presented in the audit.

Respectfully submitted,

A handwritten signature in black ink that reads "Courtney A. Ruby". The signature is written in a cursive, flowing style.

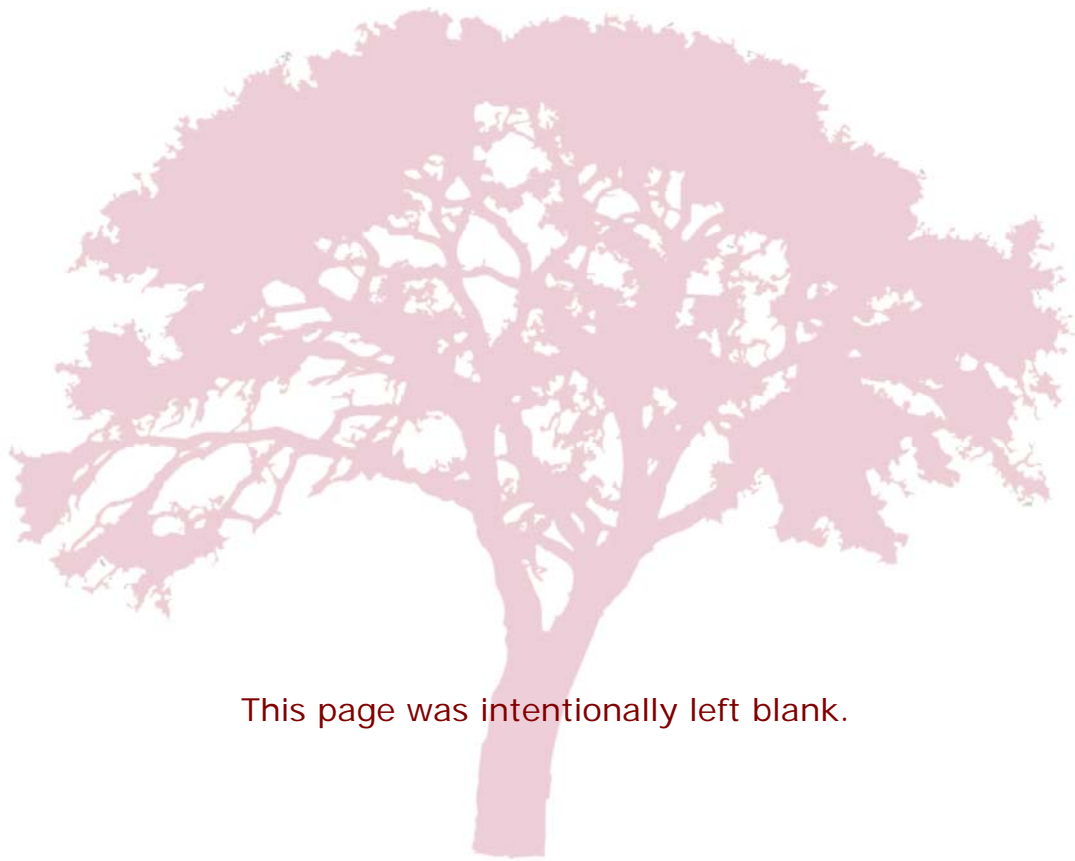
COURTNEY A. RUBY, CPA, CFE
City Auditor



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REPORT SUMMARY

Business Tax Refund Audit

OVERVIEW

The City correctly calculated, appropriately processed, and approved business tax refunds; however, minor improvements to the refund process can be made.

Objective

The Office of the City Auditor conducted a performance audit of the City's business tax refunds for years 2009 through June 2013. The objective of the audit was to determine if business tax refunds were correctly calculated and appropriately processed and approved.

Key Finding

The audit found that the sample of business tax refunds tested was correctly calculated and appropriately processed and approved; however, minor improvements to the refund process can be made.

Key Recommendations

To address the audit's finding, the report includes four recommendations.

The Administration should:

1. Update the business tax refund procedures to clarify types of allowable exceptions to the 15-month refund request deadline.
2. Determine if the two refunds identified in this audit with minor calculation errors are past the statute of limitations. If they are not past the statute of limitations, the City should determine if Jacobs Pineda is owed an additional refund and if Sincere Plumbing and Hardware Supply should be invoiced for a refund overpayment.
3. Update the business tax refund procedures to include guidance regarding additional documentation that should be retained for each type of refund, including but not limited to:
 - Printouts from the City's collection system to show that businesses had no outstanding debt with the City prior to the refund being approved
 - Copies of checks or credit card statements
 - Declaration forms
 - Documentation supporting reclassification analysis and approval
4. Consider increasing consistency and transparency by using a form, similar to the previous reclassification change form, to document any key changes that result in a refund.

Introduction

The City of Oakland's (City) Municipal Code section 5.04.540 states that businesses may request a refund "whenever the amount of any tax, penalty or interest has been, due solely to a clerical, accounting or mathematical error, erroneously paid to, collected or received by the City" and "whenever the amount of any tax, penalty or interest has been illegally paid to, collected, or received by the City." The Municipal Code requires that the Office of the City Auditor (Office) annually audit the business tax refunds approved by the Director of Finance.

Background

The Administrative Services Department's Revenue Management Division (Revenue Division) manages all aspects of business tax collections, including business tax refunds for the City. Businesses requesting a refund must submit a request in writing detailing the reason for the refund and supporting documentation to substantiate their claim for a refund. The Revenue Division reviews the refund request to determine if the refund is warranted.

Prior to approving a refund, the Revenue Division checks the City's legacy Automated Collection System to ensure that the business does not have any outstanding amounts due to the City. If the business owes outstanding amounts to the City, then the amount owed will be deducted from the refund. A Revenue Division supervisor reviews the refund request, supporting documents, and any analysis or calculations for the refund. All refunds require the Revenue and Tax Administrator's signature. Refunds over \$25,000 also require the Finance Director's signature. The approved refund file is then sent to the Controller's Office for processing.

Objectives, Scope & Methodology

Audit Scope and Objective

The objective and scope of this audit was to determine if business tax refunds were correctly calculated and appropriately processed and approved for 2009 through June 2013.

Audit Methodology

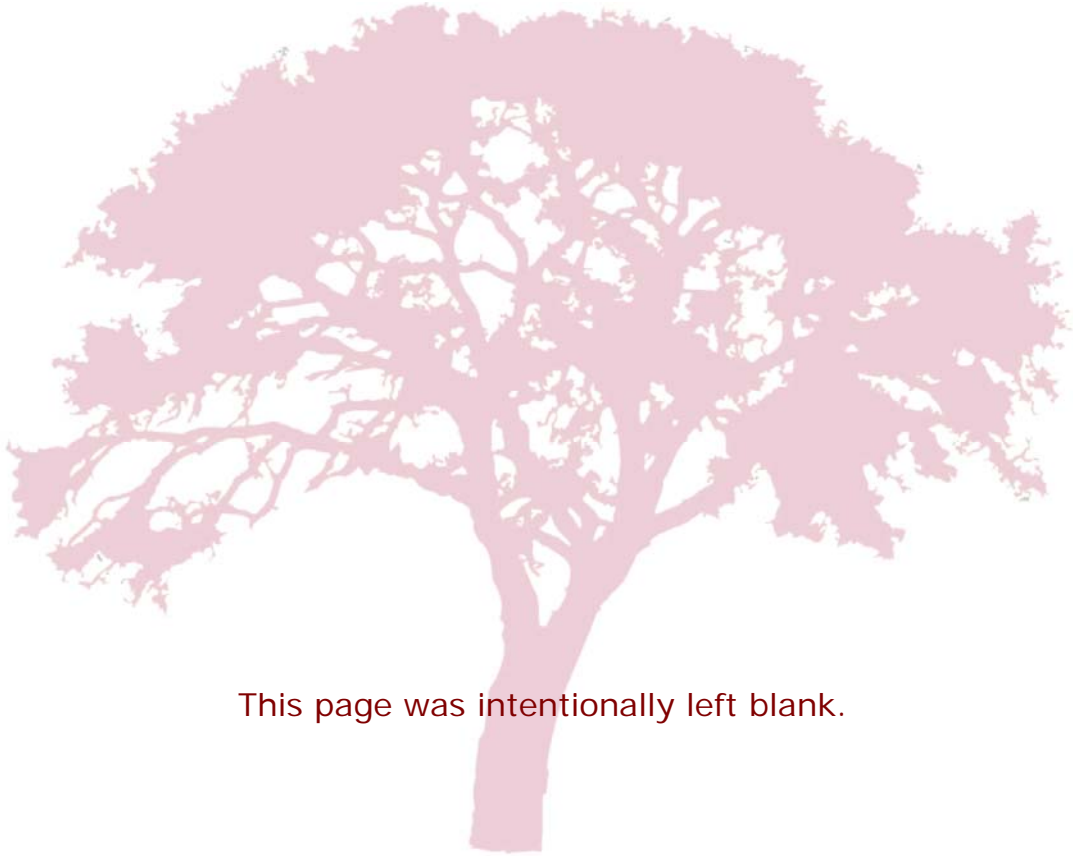
To conduct the audit, the Office:

- Reviewed the Revenue Division's business tax refund policies and procedures.
- Interviewed Revenue Division staff and management.
- Conducted a walkthrough of the business tax refund process which included a review of the City's LicenseTrack system.
- Selected a random and judgmental sample of 50 business tax refunds out of 604 total refunds. The sample totaled approximately \$1 million out of the \$1.4 million total business tax refunds paid during the audit scope. The judgmental portion of the sample included larger refunds and refunds to businesses receiving multiple refunds within a year.
- Verified that the sample refunds had appropriate approvals prior to the issuance of the refund check, appropriate supporting documentation to substantiate the refund, and that the refund calculation was correct.

- Verified that the Revenue Division reviewed the legacy Automated Collection System for outstanding debt prior to issuing a refund.
- Verified that refund payments were made to businesses registered with the City by reviewing printouts from the City's LicenseTrack system, which shows all businesses registered with the City.
- Reconciled addresses in LicenseTrack to addresses on the refund checks to ensure checks were mailed to the registered business address.

The City's Municipal Code requires that the Office annually audit the business tax refunds approved by the Director of Finance. Due to resource limitations, the Office was not able to audit business tax refunds annually. However, this audit brings the Office current on meeting this mandate.

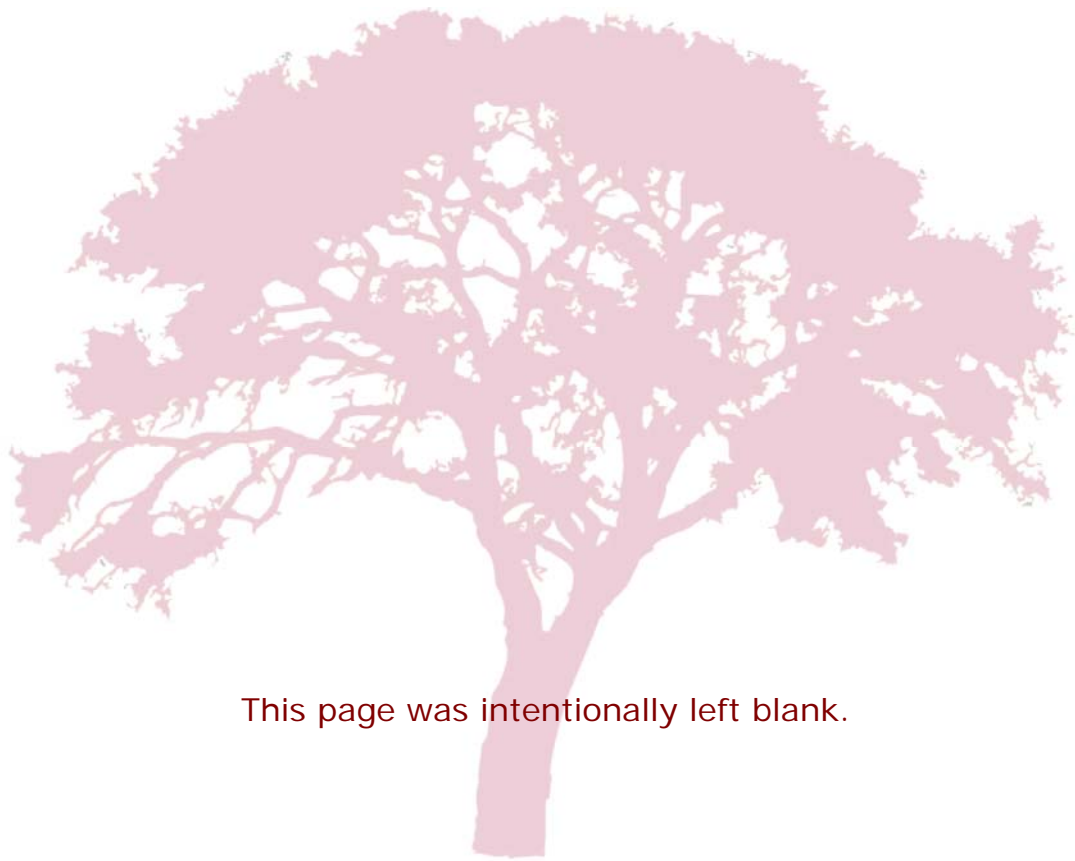
The Office conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). These standards require that the Office plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the audit's findings and conclusions based on the audit's objectives. The Office believes that the evidence obtained provides a reasonable basis for the audit's findings and conclusions based on the audit objectives.



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AUDIT RESULTS



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Finding 1

The sample of business tax refunds tested was correctly calculated, appropriately processed, and approved; however, minor improvements to the refund process can be made.

Overall, the sample of business tax refunds was correctly calculated, appropriately processed, and approved according to the Revenue Division's business tax refund procedures. However, additional minor improvements to the refund process can be made. For example, the Revenue Division should provide guidance on additional types of documentation that should be retained to increase transparency. Ensuring that all refund files have consistent supporting documentation will help increase transparency and accountability.

In order to receive a refund, businesses must: 1) submit a request in writing, 2) submit a request prior to 15 months after the business tax payment was made, 3) submit supporting documentation, and 4) be a registered business with the City. The audit found that the sample of refunds reviewed complied with the City's refund criteria; however, the business tax refund procedures do not specify the supporting documentation that should be retained in the refund file. To process a refund request, the Revenue Division: 1) calculates the refund, 2) ensures that the business does not have any outstanding debt with the City, and 3) documents the appropriate approvals.

The audit found that the sample of business tax refunds tested was overall correctly calculated, with just two out of the 50 refunds having minor calculation errors resulting in minor refund discrepancies. The City's refund to Sincere Plumbing and Hardware Supply Inc. was overpaid by \$311 and the refund made to Jacobs Pineda Inc. was underpaid by \$108. According to the Revenue Division, these were clerical errors.

Out of 50 business tax refunds reviewed, all were appropriately approved by a Revenue Division supervisor and the Revenue and Tax Administrator, as required by the Revenue Division's policies and procedures. All refunds over \$25,000 were also appropriately approved by the Finance Director. Also, all business tax refunds were appropriately approved prior to the refund check being issued.

Forty-six out of 50 refunds reviewed were submitted in writing prior to the 15-month deadline. One refund request was not submitted in writing prior to the 15-month requirement; however, the taxpayer did contact the Revenue Division by phone prior to the deadline. According to the Revenue Division, staff was responsible for the error, therefore the Revenue and Tax Administrator approved an exception to the 15-month deadline. The 15-month requirement was not applicable to three of the refunds in the sample because the refunds were the result of a reclassification¹. Reclassification refunds can be made for payments up to three years prior. While these exceptions to the 15-month refund request deadline appeared appropriate and supported, the Office noted that the Revenue Division does not have any documented guidance on acceptable exceptions. Guidance regarding acceptable exceptions would likely increase consistency and transparency.

¹ Classifications are industry groups. Businesses are charged different tax rates based on the industry classification. Reclassifications are reassignments of industry groups that usually result in applying a different tax rate.

Overall, the majority of the business tax refunds sampled had sufficient supporting documentation to verify that the refunds were appropriate. However, the Office found two areas for improvement that would increase consistency and transparency:

- All refund files should include documentation that shows the City checked for outstanding debt prior to issuing a refund. Five out of 50 business tax refund files did not have evidence that the City verified whether the business had outstanding debt with the City prior to issuing a refund. According to the Revenue Division, the City's legacy collection system, the Automated Collection System, was reviewed at the time of the refund even though there is no evidence that this step was completed. According to the Revenue Division, business tax refund procedures do not require that a printout from the system be included in the refund files. Also according to the Revenue Division, as of 2011 debt is now tracked and managed in the City's CollectionTrack system. The Office reviewed the Automated Collection System and the CollectionTrack system to determine if debts were owed by these five businesses. As of October 2013, there was no debt owed by these five businesses.
- The City should provide additional guidance on the supporting documentation that should be kept in all refund files. The business tax refund procedures do not clearly define the supporting documentation that should be retained for each type of refund². The Office found that the documentation retained in each refund file differed. For example:
 - Copies of checks and credit card statements were not consistently retained in the refund files. According to the Revenue Division, staff were directed to obtain copies of checks or credit card statements from businesses. However, this is not documented in the business tax refund procedures.
 - Declaration forms, which are forms businesses use to report their gross receipts, were not consistently retained in the refund files. Declaration forms support gross receipt totals that the Revenue Division uses to calculate business taxes.
 - Documentation for reclassifications was inconsistent. Only some refund files included documentation showing the analysis and approvals supporting the reclassifications. According to the Revenue Division, it previously had a form to document the analysis for a reclassification change and that form increased transparency.

Clearer procedures would help to ensure that all refunds are consistently supported and that the supporting documentation is included in the business tax refund files.

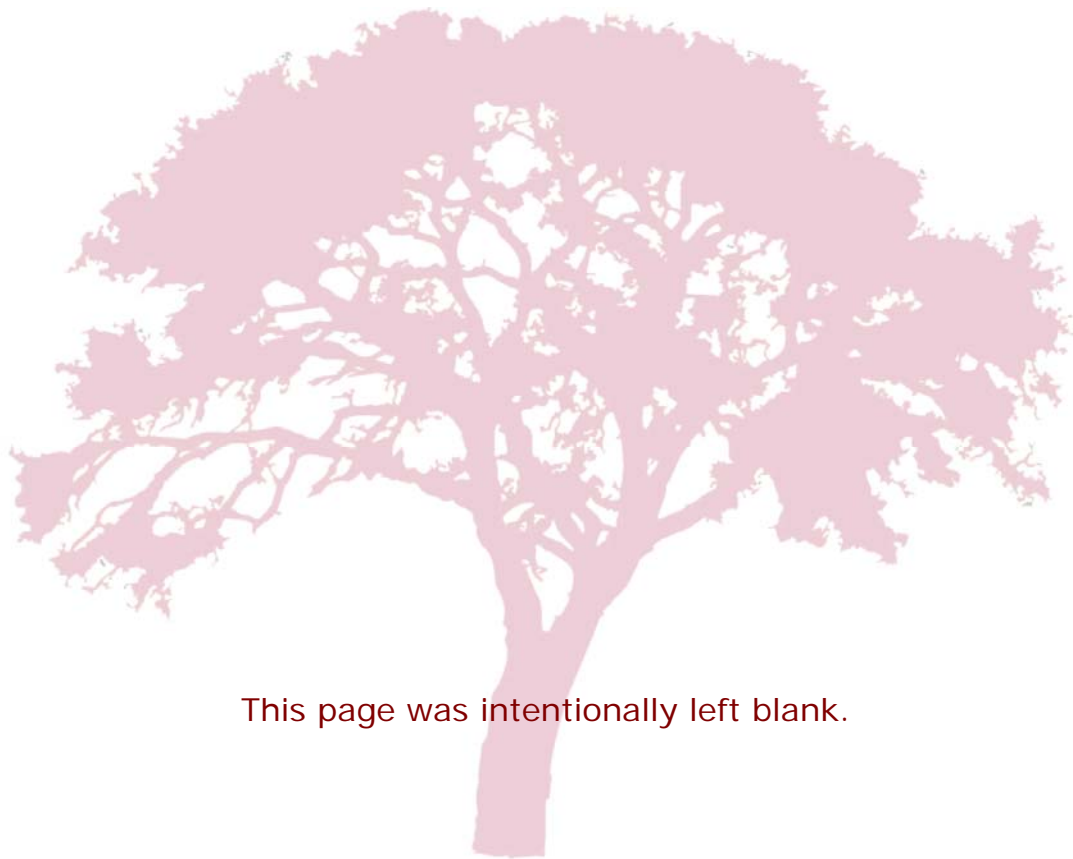
Recommendations

The Administration should:

1. Update the business tax refund procedures to clarify types of allowable exceptions to the 15-month refund request deadline.
2. Determine if the two refunds identified in this audit with minor calculation errors are past the statute of limitations. If they are not past the statute of limitations, the City should determine if Jacobs Pineda is owed an additional refund and if Sincere Plumbing and Hardware Supply should be invoiced for a refund overpayment.

² Types of refunds include, but are not limited to: duplicate payments, business taxes charged in error, overpayments based on a revision of gross receipts, and refunds approved based on a business tax reclassification.

3. Update the business tax refund procedures to include guidance regarding additional documentation that should be retained for each type of refund, including but not limited to:
 - Printouts from the City's collection system to show that businesses had no outstanding debt with the City prior to the refund being approved
 - Copies of checks or credit card statements
 - Declaration forms
 - Documentation supporting reclassification analysis and approval
4. Consider increasing consistency and transparency by using a form, similar to the previous reclassification change form, to document any key changes that result in a refund.



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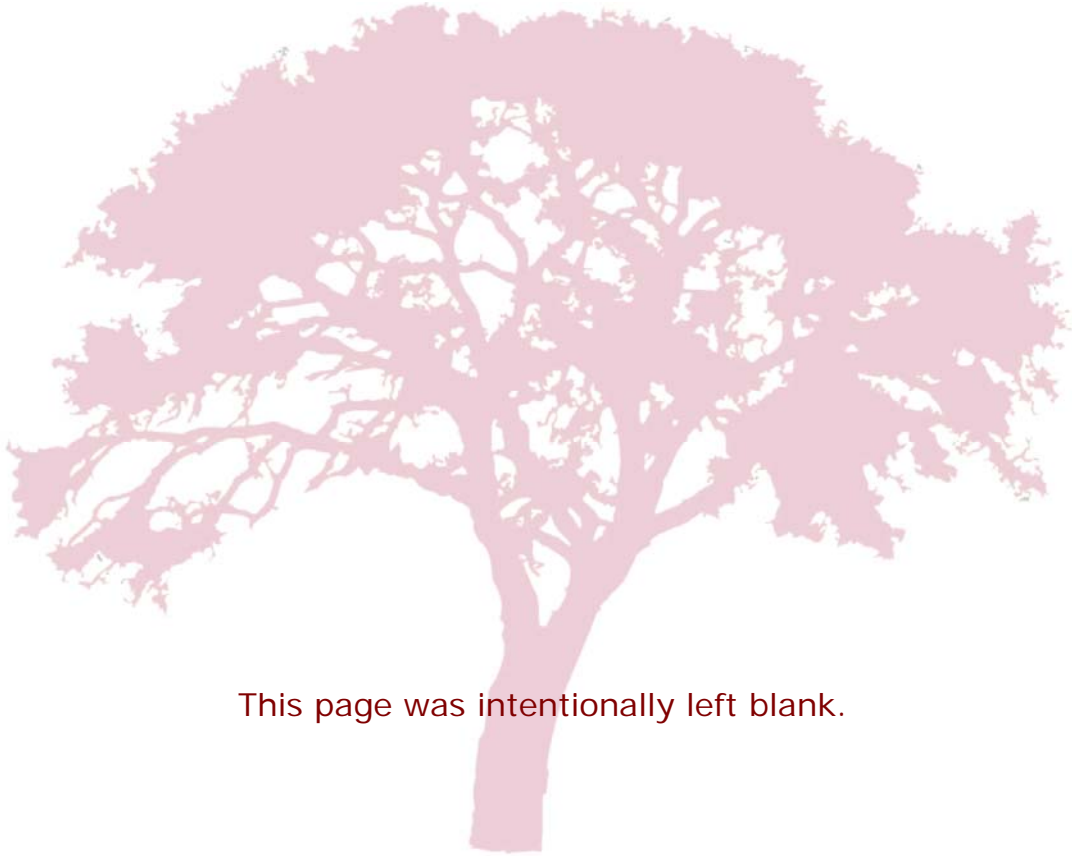
FINDING

The audit found that the sample of business tax refunds tested was correctly calculated and appropriately processed and approved; however, minor improvements to the refund process can be made.

RECOMMENDATIONS:

We recommend that the Administration:

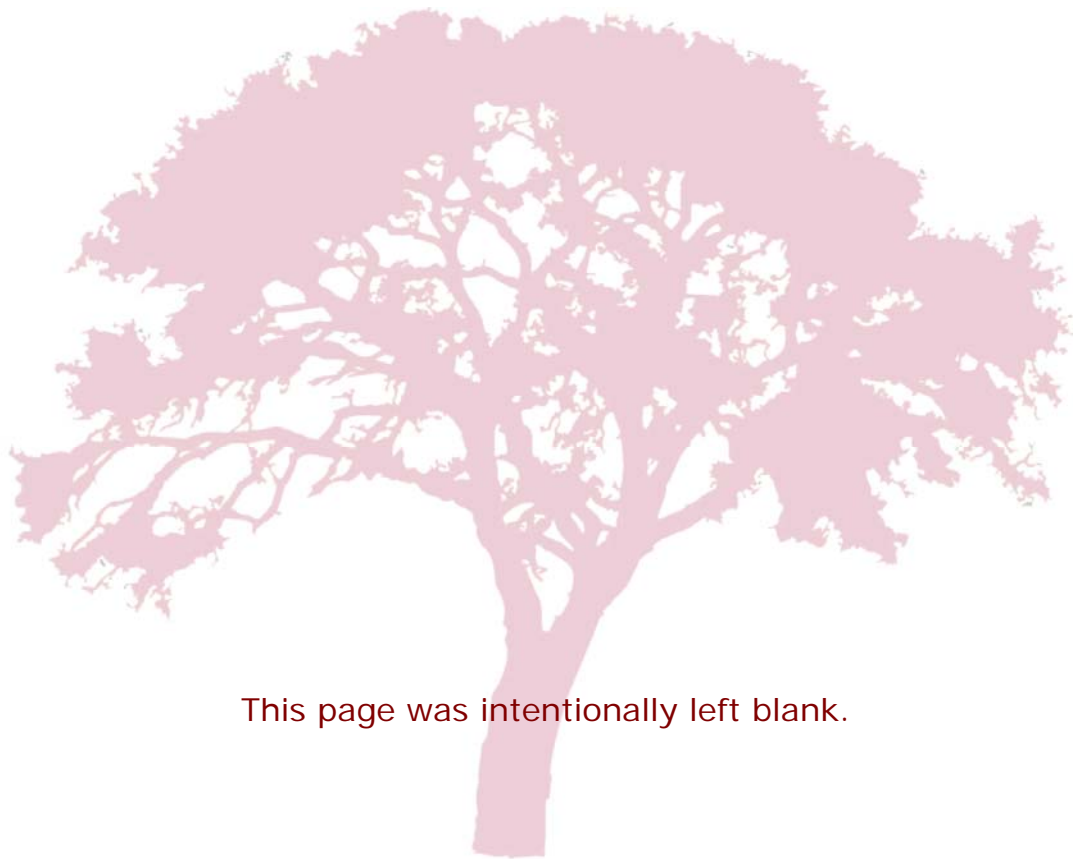
Recommendation #1	Update the business tax refund procedures to clarify types of allowable exceptions to the 15-month refund request deadline.
Recommendation #2	Determine if the two refunds identified in this audit with minor calculation errors are past the statute of limitations. If they are not past the statute of limitations, the City should determine if Jacobs Pineda is owed an additional refund and if Sincere Plumbing and Hardware Supply should be invoiced for a refund overpayment.
Recommendation #3	Update the business tax refund procedures to include guidance regarding additional documentation that should be retained for each type of refund, including but not limited to: <ul style="list-style-type: none">• Printouts from the City's collection system to show that businesses had no outstanding debt with the City prior to the refund being approved• Copies of checks or credit card statements• Declaration forms• Documentation supporting reclassification analysis and approval
Recommendation #4	Consider increasing consistency and transparency by using a form, similar to the previous reclassification change form, to document any key changes that result in a refund.



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**ADMINISTRATION'S
RESPONSE**

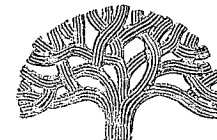


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CITY OF OAKLAND



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November 5, 2013

The Honorable Courtney Ruby,
Oakland City Auditor
City of Oakland, California
Frank Ogawa Plaza, 4th Floor
Oakland, California 94612

RE: Business Tax Refund Audit

Dear City Auditor Ruby:

I am pleased to provide you with the City Administrator's response to the Business Tax Refund Audit. We welcome performance audits conducted cooperatively to improve the efficiency and friendliness of City Government. The City's municipal code requires that the Office of the City Auditor conduct an annual audit of business tax refunds approved by the Director of Finance. However, due to limited resources in the City Auditor's Office, this audit has not been conducted for several years. Thus, in order to bring the City Auditor's Office current in accordance with the municipal code, the time period selected for audit was calendar years, 2009, 2010, 2011, 2012 and through July 2013.

The net findings of error in the audit, which stretched over four and one-half years, were \$203. As is evidenced in the audit findings, the Business Tax refund process is well managed and operating in a manner consistent with City laws and policies.

Attached to this cover letter is the Administration's detailed response (attachment A) on audit findings, recommendations, and other content.

I look forward to working with your office to target key issues identified in the audit process that could result in ways to improve Business Tax procedures.

Sincerely,

A handwritten signature in black ink, appearing to read "Deanna Santana".

Deanna Santana,
City Administrator

Cc: ^{OSBORN} Osborne Solitei, City Controller
David McPherson, Revenue & Tax Administrator

Attachments: Attachment A - Detailed Response

Recommendations	Response
<p>Recommendation #1 Update the business tax refund procedures to clarify types of allowable exceptions to the 15-month refund request deadline.</p>	<p>Agree/In Progress ~ The taxpayer has 15 months to establish "date of knowledge" with the City regarding overpayments and/or request a refund. If the taxpayer has submitted timely and the City does not respond, the City will honor the refund request in excess of 15-months. The City is in the process of amending <i>Revenue Division Credit Balance and Refund Policy</i> (issued September 22, 2008), to reflect the procedures regarding allowable exceptions to the 15-month refund request deadline.</p>
<p>Recommendation #2 Determine if the two refunds identified in this audit with minor calculation errors are past the statute of limitations. If they are not past the statute of limitations, the City should determine if Jacobs Pineda is owed additional refund and if Sincere Plumbing and Hardware Supply should be invoiced for overpayment.</p>	<p>Agree/In Progress ~ The City will contact Jacobs Pineda Inc. and provide a credit of \$108 on the business tax account that will be used toward payment of the 2014 business tax. The refund to Sincere Plumbing and Hardware Supply was issued on 3/30/2011, thus, it is beyond the statute of limitations and the City will not be pursuing the overpayment.</p>
<p>Recommendation #3 Update the business tax refund procedures to include guidance regarding additional documentation that should be retained for each type of refund, including but not limited to:</p> <ul style="list-style-type: none"> • Printouts from the Automated Collection System to show that businesses had no outstanding debt with the City prior to the refund being approved. • Copies of checks or credit card statements • Revised declaration forms • Documentation supporting reclassification analysis and approval 	<p>Agree/In Progress ~ The City is in the process of creating a checklist to ensure uniformity of the documentation required, reviewed, and maintained for the business tax refund process.</p>
<p>Recommendation #4 Consider increasing consistency and transparency by using a form, similar to the previous reclassification change form, to document any key changes that result in a refund.</p>	<p>Agree/In Progress ~ The City is in the process of creating a checklist to ensure uniformity of the documentation required, reviewed, and maintained for the business tax refund process. Furthermore, staff will receive training concerning <i>Revenue Division Reclassification Policy</i> issued on October 15, 2007.</p>

SUMMARY OF ACTIONS NECESSARY TO CLOSE THE REPORT

The "Summary of Actions Necessary to Close the Report" provides the Office of the City Auditor's (Office) analysis of the City Administration's (Administration) proposed actions required to close the report. At the time of the Administration's response, four recommendations are resolved. There are no unresolved recommendations. **The Administration has agreed to implement 100 percent of the recommendations in the report.**

Recommendation #1

Update the business tax refund procedures to clarify types of allowable exceptions to the 15-month refund request deadline.

Resolved - The Administration agrees with this recommendation and stated that it will amend the Revenue Division Credit Balance and Refund Policy to clarify allowable exceptions to the 15-month refund request deadline.

To close this recommendation, the Administration should provide evidence that it has implemented policies and procedures that clarify types of allowable exceptions to the 15-month refund request deadline. This documentation should be provided to the Office by May 19, 2014.

Recommendation #2

Determine if the two refunds identified in this audit with minor calculation errors are past the statute of limitations. If they are not past the statute of limitations, the City should determine if Jacobs Pineda is owed an additional refund and if Sincere Plumbing and Hardware Supply should be invoiced for a refund overpayment.

Resolved - The Administration agrees with this recommendation and stated that it will contact Jacobs Pineda Inc. and provide a credit that will be used toward the 2014 business tax payment. The Administration also stated that the overpayment to Sincere Plumbing and Hardware Supply is beyond the statute of limitations.

To close this recommendation, the Administration should provide evidence that it credited the business tax account of Jacobs Pineda Inc. The Administration should also provide evidence supporting the determination that the overpayment to Sincere Plumbing and Hardware Supply is beyond the statute of limitations. This documentation should be provided to the Office by May 19, 2014.

Recommendation #3

Update the business tax refund procedures to include guidance regarding additional documentation that should be retained for each type of refund, including but not limited to:

- Printouts from the City's collection system to show that businesses had no outstanding debt with the City prior to the refund being approved
- Copies of checks or credit card statements
- Declaration forms
- Documentation supporting reclassification analysis and approval

Resolved - The Administration agrees with this recommendation and stated that it is in the process of creating a checklist to ensure uniformity of the documentation required, reviewed, and maintained for the business tax refund process.

To close this recommendation, the Administration should provide evidence that it has implemented procedures that specify the documentation that should be retained for each type of business tax refund. This documentation should be provided to the Office by May 19, 2014.

<p><u>Recommendation #4</u></p> <p>Consider increasing consistency and transparency by using a form, similar to the previous reclassification change form, to document any key changes that result in a refund.</p>	<p>Resolved - The Administration agrees with this recommendation and stated that it is in the process of creating a checklist to ensure uniformity of documentation required, reviewed, and maintained for the business tax refund process. The Administration also stated that it will provide staff training concerning the Revenue Division Reclassification.</p> <p>To close this recommendation, the Administration should provide evidence that it has implemented procedures to document key changes that result in a business tax refund. This documentation should be provided to the Office by May 19, 2014.</p>
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Unresolved status indicates no agreement on the recommendation or the proposed corrective action. Implementation of proposed corrective action is directed in the City Auditor's Analysis and Summary of Actions Necessary to Close the Report.

Partially Resolved status indicates partial agreement on the recommendation or the proposed corrective action. Implementation of the proposed corrective action is clarified in the Analysis and Summary of Actions Necessary to Close the Report.

Resolved status indicates agreement on the recommendation and the proposed corrective action. Implementation of the proposed corrective action forthcoming from the auditee.