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August 23, 2018

OFFICE OF THE MAYOR
HONORABLE CITY COUNCILMEMBERS
CITY ADMINISTRATOR
CITY ATTORNEY
RESIDENTS OF OAKLAND
OAKLAND, CALIFORNIA

RE: Audit of Business Tax Refunds

Dear Mayor Schaaf, City Council President Reid, Members of City Council, City Administrator Landreth, City Attorney Parker, and Oakland residents:

The City has a responsibility to ensure tax overpayments or payments made in error are refunded to taxpayers accurately and timely.

Our audit reviewed fiscal years 2013-14 through 2016-17. The objectives were to 1) verify refunds were recorded and paid correctly, 2) confirm refunds were properly approved and processed in accordance with the Oakland Municipal Code (Code) and City procedures, and 3) determine whether internal control processes over business tax refunds, including taxpayer customer service, were in place and effective.

The audit found that overall, the Department of Finance processed business tax refunds in compliance with the Code and with City procedures. However, we identified opportunities for improvements to customer facing processes, processing tax refunds, and user access.

Management was responsive and promptly addressed our findings and took steps to implement our recommendations during the audit.

Audit of Business Tax Refunds - Fiscal Years 2012-13 through 2015-16
August 23, 2018

I want to express our appreciation to the Revenue and Tax Administrator, the Director of Finance, and their staff for their cooperation during this audit and their commitment to improving the practices in their department to enhance customer service, reduce processing time, and ensure consistency in processing refunds.

Respectfully submitted,



BRENDA D. ROBERTS
City Auditor

Enclosure

cc: Margaret O' Brien, Revenue and Tax Administrator
Katano Kasaine, Director of Finance
Kirsten LaCasse, Controller
Doryanna Moreno, Chief Assistant City Attorney



PERFORMANCE AUDIT



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Business Tax Refunds
Performance Audit
FY 2013-14 through FY 2016-17

August 23, 2018

The Office of the City Auditor independently investigates the areas of our City government most vulnerable to fraud, waste, and abuse. We communicate to the public the results of our investigations through audit reports containing recommendations for a more effective and efficient government. These recommendations are passed on to City Council and City Management so they can improve City operations and services provided to you.

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Executive Summary

Performance Audit Business Tax Refunds Audit FY 2013-14 through FY 2016-17

OVERVIEW

The City's Municipal Code (Municipal Code or Code) permits business owners to request a refund of taxes paid *"...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..."*

OBJECTIVE

The audit reviewed business tax refunds paid between and including fiscal years (FY) 2013-14 through FY 2016-17. The objectives were to 1) verify refunds were recorded and paid correctly, 2) confirm refunds were properly approved and processed in accordance with the Code and City procedures, and 3) determine whether internal control processes over business tax refunds, including taxpayer customer service, were in place and effective.

KEY FINDINGS

Overall, the Finance Department processed business tax refunds in compliance with the Code and with City procedures. However, the audit identified opportunities for improvements in the following areas:

1. Taxpayer facing information and guidance is needed to improve customer service and help reduce the time taken to process business tax refunds;
2. Finance Department procedures are outdated and do not include the details required to ensure staff are processing refunds consistently; and
3. Generic User Accounts for the City's taxpayer system are not linked to a specific individual, but shared among users. Transactions cannot be traced to staff responsible for the actions in the system, thus increasing the likelihood of unauthorized use and undetected transactions.

Executive Summary

RECOMMENDATIONS

1. Update the Business Tax Refund Request form and the website, including Frequently Asked Questions (FAQ) to provide clear instructions to taxpayers as to the requirements for claiming a tax refund.
2. Update and consolidate internal department procedures, checklists and the tracking spreadsheet to ensure all the necessary steps are documented clearly, the minimum documents required are included, and turnaround standards are established and monitored.
3. Management should disable all generic usernames. These should be created and used only when necessary, and as a temporary measure. If generic usernames are used during application testing, they should be restricted to the test environment, and deleted as soon as possible.

WHY THIS AUDIT MATTERS

The City has a responsibility to ensure tax overpayments or payments made in error are refunded to taxpayers accurately and timely.

Objectives and Background

The City of Oakland's (City) Finance Department manages all aspects of business tax collections and refunds for the City businesses. The Finance and Tax Administrator (Tax Administrator) is the authorized City manager responsible for the approval of business tax refunds.

The City's Municipal Code¹ (Municipal Code or Code) permits business owners to request a refund of taxes paid "...*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...*"

Between 58 and 114 refund requests were processed per year during the 4-year period of the audit, totaling approximately \$712,000. Total business taxes collected during the 4-year period totaled approximately \$281 million.

Business tax refunds represent less than 1% of total business taxes collected, and are not a substantial component of the City's overall budget. However, refund payments may be significant to the business owners making the request.

The Municipal Code requires the Office of the City Auditor (City Auditor) to audit the business tax refunds for accuracy and appropriate approval.

Scope & Objectives

The audit reviewed business tax refunds paid between and including fiscal years (FY)² 2013-14 through FY 2016-17.

The objectives were to

- 1) verify business tax refunds were recorded and paid correctly,
- 2) confirm business tax refunds were properly approved and processed in accordance with the Code and City procedures, and
- 3) determine whether internal control processes over business tax refunds, including taxpayer customer service, were in place and effective.

Background

Business Taxes

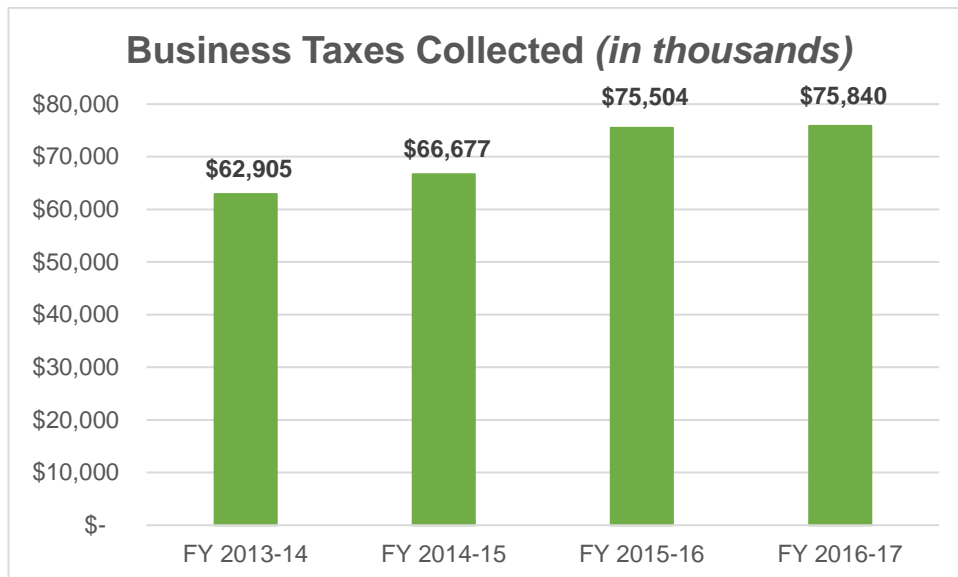
City business owners are required to pay business taxes based on gross income receipts. Tax rates are applied dependent upon business classification. Payments may be made online, through the mail, or in-person at City cashier locations. Taxes are paid annually, on or before March 1st. Late payments are subject to penalty and interest assessments.

¹ Oakland Municipal Code section 5.04.540

² The City's fiscal year is July 1st – July 30th.

Objectives and Background

Exhibit 1 shows City business tax collections for the 4-year period, FY 2013-14 through FY 2016-17.



Source: City of Oakland Comprehensive Annual Financial Reports – FY 2013-14 through FY 2016-17.

Business Tax Refund Process

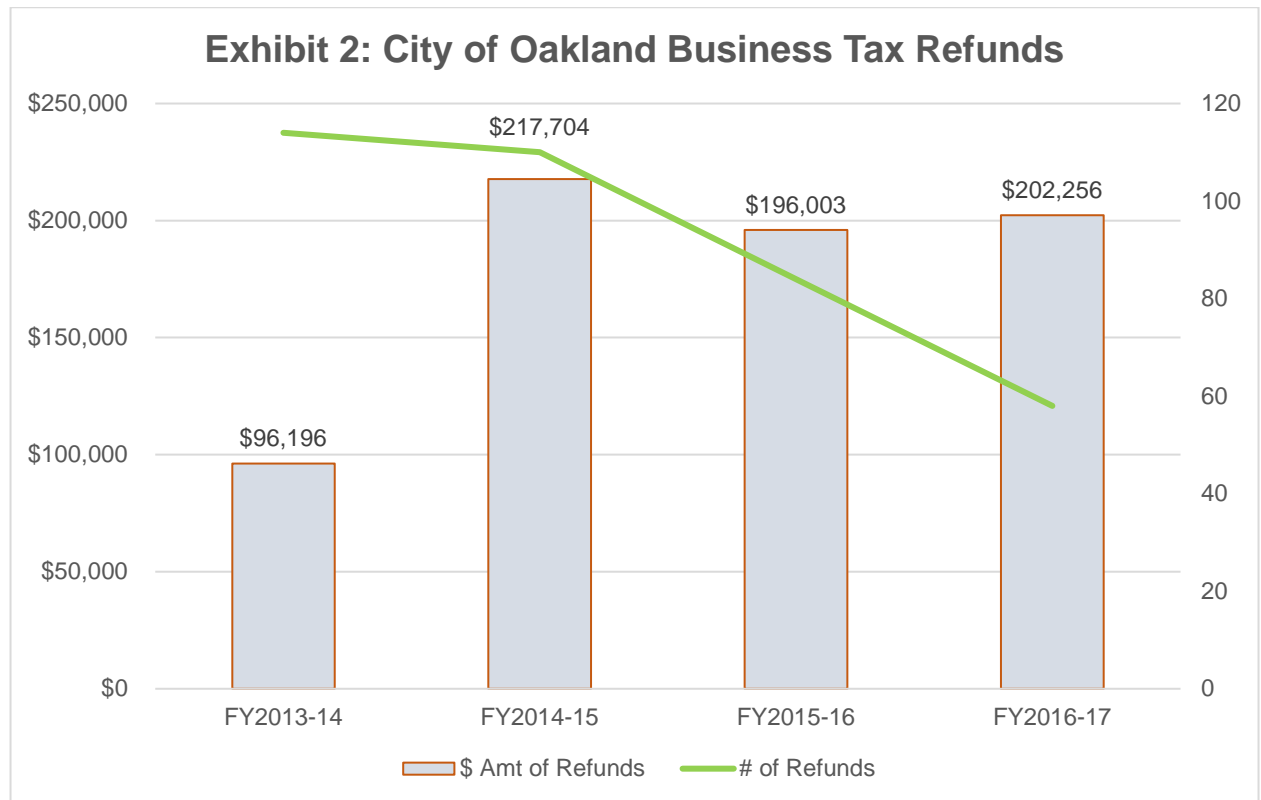
A taxpayer may request a refund if the request is made within 15 months from the date the business tax payment was made. Finance Department staff review the request, the documents, and calculations provided by the taxpayer to support the claim for refund. All refunds require the Tax Administrator’s signature, noting approval. Refund requests greater than \$25,000 also require the Finance Director or the Assistant City Administrator’s signature. Once the refund request is approved, it is processed and a refund check is issued to the taxpayer.

Although not a common occurrence, taxpayers may miscalculate business taxes owed, or inadvertently pay the tax twice, both resulting in an overpayment to the City. Tax refunds are most commonly requested due to miscalculated taxes resulting in overpayments of, in some cases, several thousands of dollars. Refunds are requested for other reasons, including duplicate payments, amended gross receipts, or a closed or relocated business from the City.

The number of business tax refund requests has declined over the prior four years, as shown in Exhibit 2; although the total dollar amount of refund payments made has remained relatively unchanged over the past three years.

During our audit, we noted certain high dollar refunds went **primarily to four taxpayers** who miscalculated their business taxes. These small businesses paid far more than what was owed to the City; each refund exceeded \$25,000.

Objectives and Background



Source: Prepared by City Auditor Staff using financial reports in Oracle, the City's Financial Reporting System.

In December 2016, the Finance Department implemented a new taxpayer system, HdL³, allowing Oakland business taxpayers the option of paying their business taxes online. Previously, tax payments were submitted through the mail, or in person only, to the cashiers at City Center during regular business hours.

The system automatically computes taxes owed based on input from the taxpayer, thus reducing calculation errors. As the number of taxpayers using HdL increases over time, the number of business tax refunds, due to calculation errors, should decline.

Recently, the Finance Department initiated a pilot program, using the HdL system, to identify potential or possible tax overpayments. These payments are 'flagged' for staff to conduct a follow up to verify the correct tax is paid. This program is still in a test phase and the official roll-out date has not been determined.

³ <https://www.hdlcompanies.com>

Audit Results

The Finance Department processed business tax refunds in compliance with the Code and with City procedures. Business tax refunds tested, as a part of our audit procedures, were recorded correctly and paid accurately.

The audit identified opportunities for internal control improvements and efficiencies in the following areas:

1. Taxpayer facing information and guidance is needed to improve customer service and help reduce the time taken to process business tax refunds;
2. Department Procedures are outdated and do not include the details required to ensure staff are processing refunds consistently; and
3. Generic User Accounts for the City's taxpayer system are not linked to a specific individual, but shared among users. Transactions cannot be traced to staff responsible for the actions in the system to confirm the transaction was correctly applied. The use of generic user accounts increases the likelihood of undetected transactions or unauthorized use.

Finding 1: The Finance Department does not provide enough information and guidance for taxpayers to easily file requests for business tax overpayment refunds

TAXPAYER COMPLAINTS

"...when a business taxpayer underpays...the tax office notifies the taxpayer and assesses delinquent fees...[However] the office was silent when [taxpayer] was overpaying by ten times the amount."—excerpted from a taxpayer refund request letter.

"I've left numerous messages on [office number] starting on March 20th to March 29th and not one return call."—excerpted from a taxpayer refund request letter.

"I am following up on the voicemail ...regarding a duplicate payment...I originally notified the city in April 2017."—Taxpayer email dated May 2018.

Without adequate guidance or instruction, the process to refund the overpayment of taxes is lengthy; **on average, it takes 3 – 6 months for the Finance Department to process business tax refunds.** Seven refund requests out of 42 tested (17%) **took one year or longer** to refund monies owed to the taxpayer.

The Finance Department's website and Frequently Asked Questions (FAQ) page provides little information for a taxpayer to use when requesting refunds. Additionally, taxpayers cannot submit a request for refund online. Rather, they must manually complete and mail a *Request for Refund* form, or submit it in person to the City's offices during regular business hours. The form does not clearly state the required supporting documentation, or an expectation of timing to obtain a refund.

Audit Results

Recommendations:

1. Finance management should update its Business Tax Refund Request form to provide clear instructions to taxpayers explaining, in detail, the requirements for claiming a tax refund. Proper guidance will minimize the time it takes to process refunds.
2. Finance management should update the Business Tax website and FAQs, by providing clearer instructions and making the website easier to navigate.

Finding 2: The City does not have a uniform and comprehensive procedures manual for processing business tax refunds

The Finance Department has not documented its internal procedures into one comprehensive manual. Rather, procedures for processing tax refund requests are a compilation of documents and memos, some of which are vague, without specific instructions.

All refund requests require the same basic information to process, including a refund application form, proof of payment, and supporting documentation, such as Internal Revenue Service tax returns, business profit and loss statements, financial statements and sales tax returns. These documents should be included in all refund request case files. A uniform, comprehensive manual will ensure consistent application of the tax refund process.

1. Procedures lack detailed steps necessary for staff to apply the process consistently to all refund requests. For example, the eligibility requirements for different types of refunds are not addressed in these procedures.
2. The spreadsheet used to track and monitor all business tax refund requests does not include a step confirming the taxpayer is in good standing, with no outstanding taxes owed to the City.
3. Procedures have not been updated to reflect the current practices adopted with the implementation of the new taxpayer system, HdL.
4. There are no established refund processing turn-around standards and the timelines for processing tax refund requests cannot be measured.

A similar finding was identified in the City Auditor's Business Tax Refund Audit Report issued November 2013.

Audit Results

Recommendations:

Finance management should:

1. Create a checklist with the minimum documents required from taxpayers for a business tax refund claim.
2. Update the current tracking spreadsheet, to note whether the information received from the taxpayer is adequate, noting the date information received, and whether the taxpayer's account was in good standing.
3. Update and consolidate department procedures into one manual outlining criteria and the detailed steps necessary for processing business tax refunds, including updated processes for the newly implemented taxpayer system, HdL.
4. Establish a processing turnaround standard, and set guidelines to monitor the achievement of these goals. Such metrics and milestones met and those not met should be published on City Administrator's Finance webpage.

Finding 3: Use of Generic Usernames

Generic usernames created during the new taxpayer system implementation in late 2016 were never deleted. The Information Audit and Controls Association⁴ cautions about using generic logins because they increase the risk of unauthorized system use. Transactions made using a generic login cannot be linked to a specific individual and allow employees to create a transaction within the system while remaining anonymous. Supervisors cannot review these transactions for accuracy and authorization.

Recommendation:

Management should disable all current generic usernames. Generic usernames should only be created and used when necessary, and as a temporary measure. If they are, for example, used during application testing, as new components are added to the new taxpayer system, HdL, they should be restricted to the test environment, and deleted once the component is released.

Conclusion

The audit recommends the Finance Department clarify tax refund process instructions to reduce process time and improve customer service; update and consolidate department procedures to ensure consistent refund processing; and eliminate the use of generic usernames to reduce the risk of untraceable, unauthorized transactions.

We acknowledge the Finance Department has recognized these recommendations and has initiated plans to implement procedural improvements.

⁴ The Information Audit and Controls Association (ISACA) is an independent, nonprofit, global association that engages in the development, adoption and use of globally accepted, industry-leading knowledge and practices for information systems. See <https://www.isaca.org> for more information.

Audit Results

Other Areas for Consideration

The City Auditor often offers other suggestions for process and internal control improvements. These include the following:

Business tax refund materials are English-only

Taxpayers who have low proficiency in English or have a recognized disability under the Americans with Disabilities Act (ADA) may be less likely to request a refund as they may not be able to access the materials and requirements. We suggest updating taxpayer materials as required under ADA guidelines to meet the City's equal access and ADA requirements.

Business tax refund request form is not available online

Although business taxes can be paid online, business tax refund requests must be submitted in person or by mail. We suggest providing taxpayers with the option to request refunds online. This will make the process more efficient for the public, as well as for the Finance Department staff.

Business tax requests are tracked manually

Business Tax Refunds are manually tracked on an electronic spreadsheet. This increases the risk of manual errors, as it relies on manual input of each refund request. Part of this process could be automated if the business tax refund request form was available online and set-up to populate an internal database of refund requests.

Business tax refund request acknowledgement

Currently, an acknowledgement of a refund request filing is not provided to taxpayers. As a good customer service practice, the Finance Department should consider providing notices of receipt to all taxpayers, with expected dates to complete the request.

Business tax declaration statement is difficult to follow

For those not filing their business taxes online, a taxpayer must manually complete a Business Tax Declaration Statement. The instructions on this statement are complicated, which results in taxpayer errors, overpayments, and subsequent refund requests.

The Finance Department should consider updating its Business Tax Declaration form to provide clear instructions to the taxpayer on how to calculate business taxes. This will reduce the likelihood of overpayments that result in business tax refunds. Currently, it takes three to six months to process a tax refund.

Statement of Compliance with Auditing Standards

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.

Methodology

In conducting this audit, we:

- Reviewed Finance Department policies and procedures and the relevant Oakland Municipal Code section (O.M.C. 5.04.540).
- Interviewed the Finance Department staff and management.
- Conducted a walkthrough of the business tax refund process, which included a review of the City's taxpayer system, HdL.
- Selected a judgmental sample of 42 refunds (approximately 10 per fiscal year for the four-year period covered by this audit) focusing on high dollar amount refunds and multiple refunds to the same vendor or taxpayer.
- Verified the refunds sampled were approved prior to the issuance of the refund check, supporting documentation to substantiate the refund was provided, and that the refund calculation was accurate.
- Confirmed refund requests were submitted within 15 months of the taxpayer's payment date.
- Verified the refund amount paid in the City system of record agreed to the amount listed on the supporting documentation.
- Verified the refund amount paid was calculated correctly, based on business tax classification table and rates.



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August 17, 2018

The Honorable Brenda Roberts
Oakland City Auditor
1 Frank Ogawa Plaza, 4th Floor
Oakland, CA 94612

Dear City Auditor Roberts:

The City Administration and Finance Department appreciate the work performed by your team on the Business Tax Refunds Audit. The City has a responsibility to ensure tax overpayments or payments made in error are refunded to taxpayers accurately and timely.

City Administration appreciates the City Auditor's recommendations which are listed in the attached matrix and includes our comments and responsibility assignments. We welcome this report as an important management tool for ensuring effective processes.

I want to thank the City Auditor and her staff for their open communication. Management was kept up to date on all progress and presented with findings of process and control improvements as they were identified.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Sabrina B. Landreth', with a long horizontal stroke extending to the left.

Sabrina B. Landreth
City Administrator

Cc: Katano Kasaine, Director of Finance
Margaret O' Brien, Revenue and Tax Administrator
Doryanna Moreno, Chief Assistant City Attorney

Attachment: Audit Matrix

**Business Tax Refunds Audit
Management's Response to City Auditor's Report**



	City Auditor's Recommendations	Management Response	Responsible Party	Target Date to Complete
1	<p><u>Taxpayer-facing documentation</u></p> <ol style="list-style-type: none"> 1. Finance should update its Business Tax Refund Request form to provide clear instructions to taxpayers as to the requirements for claiming a tax refund. Good guidance will minimize the time it takes to process refunds. 2. Finance should update the website and FAQs, to make it easier to use and provide clear instructions to the taxpayer. 	<p>The administration appreciates this process recommendation.</p> <ol style="list-style-type: none"> 1. Finance has updated the Business Tax Refund Request form with examples of supporting documentation needed from the taxpayer. This updated form is available online, in the HdL system, and can easily email to taxpayer's email on file for log purposes. 2. Finance has updated its website and provided a point of contact person on the Business Tax Refund Request Form for clearer instructions and more efficient providing refund status. 	<p>Finance-Audit unit</p> <p>Finance-Audit unit</p>	<p>Completed 5/29/2018</p> <p>Completed 5/29/2018</p>
2	<p><u>Department Procedures</u></p> <ol style="list-style-type: none"> 1. Create a checklist of the minimum documents required from taxpayers for a business tax refund claim. 2. Update and consolidate department procedures into one manual outlining criteria and detailed steps necessary for processing business tax refunds, to include updated processes for the newly implemented taxpayer system, HdL. 	<p>The administration appreciates this process recommendation.</p> <ol style="list-style-type: none"> 1. Finance will update/implement the internal refund checklist for minimum documents required from taxpayer to qualify for business tax refund claim. 2. Finance will update and consolidate existing department procedures into one manual to include criteria and detailed steps necessary for processing business tax refunds, including updated processes reflecting the newly implemented taxpayer system. 	<p>Finance-Audit unit</p> <p>Finance-Audit unit</p>	<p>Sept 2018</p> <p>Nov 2018</p>

