



CITY AUDITOR'S OFFICE

Tax Audit Assessments and Collections

January 12, 2011

AUDIT REPORT NO. 1108

CITY COUNCIL

Mayor W.J. "Jim" Lane

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January 12, 2011

Honorable Mayor and Members of the City Council:

Enclosed is a report on the *Tax Audit Assessments and Collections*, Audit No. 1108. This audit was included on the Council-approved fiscal year 2010/11 audit plan.

The audit found the Administrative Services Division's Tax Audit department has established written policies, procedures and management controls to provide reasonable assurance of compliance with the applicable City Code. We identified opportunities to improve the program by reevaluating the mix and utilization of staff as well as the management-stated goals and performance measures. In addition, some extensive desk reviews should be conducted as audits, thereby ensuring taxpayers are offered the option for a joint audit and the accompanying reprieve from additional audits.

If you need additional information or have any questions, please contact me at (480) 312-7867.

Sincerely,

A handwritten signature in cursive script that reads "Sharron Walker".

Sharron Walker, CPA, CFE
City Auditor

Audit Team:

Lisa Gurtler, Assistant City Auditor
Joanna Munar, Senior Auditor

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EXECUTIVE SUMMARY

This audit of *Tax Audit Assessments and Collections* was included on the Council-approved fiscal year 2010/11 audit plan. The objective was to review the Tax Audit department's assessments and related collections for compliance with Scottsdale Revised Code (City Code), Appendix C - Privilege and Excise Taxes. Additionally, we evaluated program performance for opportunities to improve operations.

The City's Tax Audit department, part of the Administrative Services Division, is responsible for auditing businesses operating within Scottsdale to determine if they are accurately paying transaction privilege taxes. Transaction privilege taxes (commonly referred to as sales taxes) are the General Fund's largest single revenue source, accounting for 38% in fiscal year 2009/10.

The Tax Audit department's 9 full-time employees include a Manager, 4 Senior Tax Auditors, a Tax Auditor and 3 Audit Associates. During the last three years, the department completed 1,028 audits, ranging from 283 to 438 per year. These audits primarily focus on transaction privilege tax, but also include bed tax and franchise fee amounts owed to the City.

We found that written policies and procedures have been established along with management controls and performance objectives to facilitate compliance with City Code. The department's Tax Audit Manual provides staff with reference to tax history, regulatory guidance and work expectations. Audit work plans were properly approved, records and supporting documentation were well organized and industry-specific templates were consistently used.

Opportunities for improvement include reevaluating the mix and utilization of staff. Although the Tax Audit department is authorized for 8 Senior Tax Auditor positions, 4 of these positions have been filled at lower staff levels. While this provides salary savings, the practice results in a higher cost per audit and lower productivity.

Additionally, some Tax Audit performance measures have declined. A smaller percent of Scottsdale businesses are being audited, staff has not met audit completion goals and collection of tax assessments have continually declined, in part due to economic conditions.

Finally, some audits have been performed as extensive desk reviews rather than following established audit protocol and offering the taxpayer a joint audit. If the taxpayer chooses a joint audit, all cities would generally be prohibited from conducting another audit of the business for any portion of the 4-year time period covered by the audit.

BACKGROUND

The City's Tax Audit department, part of the Administrative Services Division, is responsible for auditing businesses operating within Scottsdale to determine if they are accurately paying transaction privilege taxes and other related taxes, such as transient occupancy and franchise taxes. The City imposes a 1.65% privilege tax on sale, lease or license transactions and a 1.45% use tax on storage or use of items within the City for which no privilege tax was paid. Together, these taxes are commonly referred to as sales tax.

In addition to completing audits, the Tax Audit staff annually conducts 2 to 3 educational seminars designed to promote accurate and timely tax payments. Also, during the past three years, Tax Audit assumed the additional responsibility of projecting transaction privilege tax revenues for budgeting and forecasting purposes.

Scottsdale is one of 14 cities and towns in Arizona that collects its own sales tax. Alternatively, the City could participate in a state program that allows the Arizona Department of Revenue (ADOR) to collect city sales taxes. Sales tax revenue was approximately 38% of the General Fund in fiscal year 2009/10 and is the fund's single largest revenue source. As shown in Table 1, sales tax revenue has steadily declined during the economic downturn, from \$198.3 million in fiscal year 2006/07 to \$147.0 million in fiscal year 2009/10. The largest categorical declines have occurred in the construction and automotive industries.

Table 1. Sales and Related Tax Revenue Trend (in thousands)

	FY 2006/07	FY 2007/08	FY 2008/09	FY 2009/10
Sales & Use Tax	\$177,912	\$170,849	\$140,981	\$128,332
Other Tax*	20,362	21,195	19,014	18,694
Total	\$198,274	\$192,044	\$159,995	\$147,026
Change (%)	10%	-3%	-17%	-8%

* Includes Transient Occupancy (bed tax) and Franchise taxes subject to audit by the Tax Audit department.

SOURCE: City of Scottsdale Comprehensive Annual Financial Report, FY 2009/10.

Scottsdale Revised Code (City Code), Appendix C - Privilege and Excise Taxes, sets out the regulatory guidance for licenses, taxation and miscellaneous business regulations. Appendix C is based on the Model City Tax Code, a uniform sales and use tax act adopted by all Arizona cities that is allowed to be modified to fit each city's individual needs.¹ Arizona

¹ The Model City Tax Code originated in response to a legislatively created municipal sales tax study commission and was developed with input from city representatives, Arizona Chamber of Commerce representatives and a committee of sales tax attorneys representing major taxpayers. A city can modify provisions of the model code after holding a public hearing on the proposed change.

Revised Statutes (ARS) §42-6005 establishes the Unified Audit Committee (UAC), with the ADOR and various Arizona cities as members, to coordinate tax audit functions between municipalities and publish guidelines that interpret the Model City Tax Code.

Program Operations

The Tax Audit department's 9 full-time employees include a Manager, 4 Senior Tax Auditors, a Tax Auditor and 3 Audit Associates. During the last three years, the department completed 1,028 audits, ranging from 283 to 438 per year. These audits primarily focus on transaction privilege tax, but also include bed tax and franchise fee amounts owed to the City.

Initially, the department staff performs a compliance or cursory review using various resources, such as the City's GenTax system and Community Development permit database, a proprietary real property database, state and county property and tax records and information gathered from the Tax & License section within the Finance & Accounting Division. To ensure a cross section of businesses are audited, tax auditors are assigned to audits and accounts of various size, complexity and industry category such as construction, retail, rental and hotel.

The Tax Audit department categorizes its work as follows:

- **Desk reviews** are generally performed using information voluntarily supplied by the taxpayer as part of an educational compliance program or through general correspondence making inquiries as to the status of taxpayer reporting history.
- **Audits** are defined by the UAC as a systematic and comprehensive examination of the taxpayer's accounting books and records, involving analysis, tests, confirmations or verifications. The City can generally audit any taxpayer only once every four years.
- **Joint audits** are conducted when a taxpayer elects to have all municipal tax activity audited in conjunction with any city's audit. Per ARS §42-6005, a city deciding to audit a taxpayer must offer this option. As a result, the UAC created a Multi Jurisdictional Audit Coordinator (MJAC) to coordinate tax audits between various jurisdictions. These joint audits may be led by Scottsdale's or by other cities' Tax Audit staff.

Besides tax audits and reviews, the City's Tax Audit staff generates use tax billings for vehicles purchased out of state by Scottsdale residents. When a vehicle is registered, the Arizona Motor Vehicle Division assesses a state use tax and notifies the applicable city so it can bill the vehicle owner for city use tax. The resulting 300 to 600 billings a year generated \$139,000 to \$322,000 in each of the last three fiscal years. Because these revenues primarily result from an administrative task of the department rather than actual audit work, they are not included in the assessment amounts or related analysis discussed in this report.

Audits and Assessments

Table 2 depicts the number of audits and reviews completed by the Tax Audit department along with the tax assessed during the past three fiscal years. While the number of audits performed in fiscal year 2009/10 declined 8% over the previous year, assessments increased 133% or \$2.9 million. According to the Tax Audit Manager, this is primarily due to completing several large audits that were started in fiscal year 2008/09.

Table 2. Tax Audits and Assessments*

	FY 2007/08		FY 2008/09		FY 2009/10	
	Count	Assessment	Count	Assessment	Count	Assessment
Desk Reviews	327	\$ 1,133,352	194	\$ 917,200	175	\$ 3,190,785
Audits	67	1,537,036	70	986,241	67	1,545,430
Joint Audits – COS**	3	91,982	3	17,573	16	32,042
Joint Audits – Other***	41	252,932	40	248,592	25	292,043
Total	438	\$ 3,015,303	307	\$2,169,606	283	\$5,060,300
Change from prior year (%)	13%	-20%	-30%	-28%	-8%	133%

* Excludes use tax billings for vehicles purchased out of state.

** Joint audit led by City of Scottsdale Tax Audit staff.

*** Joint audits led by other entity's tax auditors.

SOURCE: Auditor analysis of GenTax system reports.

Of the audits and reviews conducted in the last three years, 56% resulted in assessments caused by the business not being licensed, 28% were assessed due to underreported taxes, and 6% were assessed due to various other types of errors. The remaining 10% of audits were found to be in compliance with the City's sales tax requirements.

Program Assessment and Collection Ratios

The Tax Audit department's performance can be measured, in part, by comparing the dollars assessed and collected to program costs. As shown in Table 3, fiscal year 2009/10 assessments and collections were considerably higher than the two prior fiscal years. In fiscal year 2009/10, assessments totaled \$5.1 million and collections, regardless of the year the tax was assessed, totaled \$2.6 million. Compared to the department's \$691,397 cost, on average, \$7.32 was assessed and \$3.77 was subsequently collected for every \$1.00 of program cost.

Table 3. Tax Audit Assessment and Collection Ratios

	FY 2007/08	FY 2008/09	FY 2009/10
Tax Audit Department Costs	\$670,010	\$738,322	\$691,397
Assessments*	\$3,015,303	\$2,169,606	\$5,060,300
Collections**	\$2,183,557	\$2,077,620	\$2,608,089
Ratio of Assessments to Costs	\$4.50	\$2.94	\$7.32
Ratio of Collections to Costs	\$3.26	\$2.81	\$3.77

* Fiscal year 2009/10 assessments increased primarily due to completing large audits begun in fiscal year 2008/09. Assessment amounts do not include use tax billings for vehicles purchased out of state.

** Total collections during the fiscal year regardless of the year the tax was assessed.

SOURCE: Auditor analysis of SmartStream financial reports and data provided by Tax Audit management.

OBJECTIVES, SCOPE AND METHODOLOGY

This audit was conducted in accordance with the Council-approved fiscal year 2010/11 audit plan. The objective was to review the Tax Audit department's assessments and related collections for compliance with Scottsdale Revised Code (City Code), Appendix C - Privilege and Excise Taxes. Additionally, we evaluated program performance for opportunities to improve its operations. The audit scope primarily focused on assessment and collection activities during fiscal years 2008/09 through October 2010, with some analysis of prior years.

To gain an understanding of the Tax Audit department functions, policies and practices, we interviewed Administrative Services and Finance & Accounting personnel, including the Tax Audit Manager, Customer Service Director and Tax & License Manager. In addition, we interviewed tax audit staff and obtained tax assessment and collection data from other local municipalities. We also interviewed the current chairman of the Unified Audit Committee and coordinators of the Multi-Jurisdictional Audit Coordinator program.

We reviewed a related audit report, *Collection of Delinquent Funds*, issued by this office in May 2009. That audit focused on the City's Revenue Recovery programs, including collections of transaction privilege (sales) taxes. Relevant findings stated additional delinquent taxes might be collected if previously written off accounts were referred to a collection agency as allowed by City Code and formal evaluation of alternative service delivery for collection efforts was not performed as required by Council-approved financial policy. According to the City Auditor's September 2010 Quarterly Follow Up report, the implementation of these findings is still in progress.

We reviewed the following authoritative policies and related documentation to gain an understanding of existing controls and practices:

- Arizona Revised Statutes, Sections §42-6005, Unified Audit Committee; Joint Audits and §42-6056, Municipal Tax Hearing Office
- City Code, Appendix C - Privilege and Excise Taxes
- Tax Audit Manual and related documents (i.e., form letters, audit work plans and checklists)
- Job descriptions, classifications and qualifications for the various Tax Audit positions

During the audit, we analyzed related financial data from the SmartStream accounting system and the Comprehensive Annual Financial Report as well as tax assessment, collection and write-off data from the GenTax System. These systems are maintained by the City's Finance & Accounting Division.

To verify compliance with state requirements, we compared the types of work performed by the Tax Audit department to the interpretations of the Unified Audit Committee's definition of an audit and to the interpretation and application by three other municipalities' tax audit groups. To verify reliability of information systems data, we tested selected elements of

GenTax report data, such as staff hours and number of business licenses issued, with audit file documentation and data provided by Customer Service management.

To analyze the overall efficiency and productivity of the Tax Audit program, we calculated various statistics for comparison to stated performance measures and other cities' results, including the:

- Number and types of audits or reviews conducted by Tax Audit staff.
- Percent and cross section of businesses audited or reviewed.
- Ratios of tax assessments and the accompanying collections to program costs.

To test the effectiveness of internal controls, we:

- Evaluated the reliability of published tax information by reviewing the City's website and other published documents, such as the Taxpayer's Bill of Rights and industry specific pamphlets to the City Code.
- Analyzed the audit files and supporting records of a randomly selected sample of 20 completed audits for timeliness, appropriate review and required elements, such as workplans and checklists.
- Reviewed the Tax Audit department promotion requirements as they relate to existing job descriptions.

Based on these audit procedures, we determined that documented policies have been established along with management controls and performance objectives to facilitate compliance with City Code, Appendix C - Privilege and Excise Taxes. Specifically, the department utilizes a Tax Audit Manual that provides staff with reference to tax history, regulatory guidance, procedure and methodology and work expectations. Additionally, the 20 tested audit files were complete, accurate and timely processed. Work plans were properly approved, and checklists, contact logs and industry-specific templates were consistently utilized. Records and supporting documentation were well organized, provided for ease in following the tax auditor's work, and showed no notable delays in administrative processes, which could otherwise result in additional interest or penalties imposed upon the taxpayer.

Efficiency and effectiveness can be improved by reevaluating the mix and utilization of staff. In addition, some performance measures, such as number of businesses audited, number of audits completed and collection of tax assessments, have declined, due in part to economic conditions. Finally, some audits have been performed as desk reviews rather than following established audit protocol which requires that a joint audit be offered to the taxpayer.

We conducted this audit in accordance with generally accepted government auditing standards as required by Article III, Scottsdale Revised Code, §2-117 et seq. 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 took place from October through December 2010, with Lisa Gurtler and Joanna Munar conducting the work.

FINDINGS AND ANALYSIS

1. Optimum productivity is not achieved with the current mix and use of staff.

Although the Tax Audit department is authorized for 8 Senior Tax Auditor positions, within the last two years, 4 of these positions have been filled at the Tax Auditor or Audit Associate level. While this provides salary savings, the practice results in a higher cost per audit and lower productivity.

A. Entry level positions have lower productivity goals and results.

Although Senior Tax Auditors comprise 55% of the staff, they complete 74% of the audits and desk reviews and generate 80% of assessments. As shown in Table 4, these senior auditors average 56 audits (including desk reviews, audits or joint audits) per full-time equivalent (FTE) per year, far exceeding the other positions' results of 24 and 28 audits respectively. In addition, the senior auditors average 10 hours per audit, less than half the time used by the other positions.

Table 4. Productivity by Job Classification
July 2008 – October 2010

	Audit Associate*	% of Total	Tax Auditor*	% of Total	Senior Tax Auditor	% of Total	Total
FTE	6.7	40%	0.8	5%	9.3	55%	16.8
Audits	157	22%	23	3%	522	74%	702
Audits per FTE	24		28		56		42
Total Assessments	\$1,479,355	19%	\$86,694	1%	\$6,342,249	80%	\$7,908,298
Total Audit Hours	3,727	37%	764	8%	5,463	55%	9,954
Hours per Audit	24		33		10		14

* An Audit Associate retired in September 2009, and a Tax Auditor was hired in December 2009.

SOURCE: Auditor analysis of GenTax system reports.

Tax audit groups in nearby cities (Mesa, Tempe, and Chandler) do not have audit associate positions. Instead, they indicated they generally only hire experienced tax auditors to maximize productivity and lower training time and costs.

Furthermore, based on each job classification's salary range average and review/audit completion goals, the Audit Associate cost per audit would average \$1,943. As shown in Table 5, this is 42% higher than the Senior Tax Auditor average cost per audit of \$1,368.

Table 5. Average Salary Cost per Audit by Job Classification

	Salary Range Average	Annual Audit Goal	Average Cost per Audit	% Compared to Senior Tax Auditor
Audit Associate	\$44,679	23	\$1,943	142%
Tax Auditor	\$55,796	45	\$1,240	91%
Senior Tax Auditor	\$61,579	45	\$1,368	-

SOURCE: Auditor analysis of Human Resources Division website information and Tax Audit Manager-provided audit goals.

B. Different staff levels perform similar assignments despite differing qualifications.

All levels of staff in the Tax Audit department perform similar types of assignments, including desk reviews, audits and joint audits within a cross section of industries. Of these assignments, audits are generally the most complex and desk reviews the least complex. However, the distinguishing workload factor is a lower review/audit completion goal, with the Audit Associate goal (23) at about half that of a Senior Tax Auditor (45).

During the 28-month period from July 2008 through October 2010, audits comprised 23% of the Senior Tax Auditors' work compared to 22% of the Audit Associate workload, as shown in Table 6.

**Table 6. Types of Audits Completed by Job Classification
July 2008 – October 2010**

Types of Audits	Audit Associate	% of Total	Tax Auditor	% of Total	Sr Tax Auditor	% of Total	Total Audits	% of Total
Desk Reviews	111	71%	2	9%	324	62%	437	62%
Audits	34	22%	18	78%	118	23%	170	24%
Joint Audit-Other*	2	1%	0	0%	67	13%	69	10%
Joint Audit-COS**	10	6%	3	13%	13	2%	26	4%
Total	157	100%	23	100%	522	100%	702	100%

* Joint audits led by other entity's tax auditors.

** Joint audits led by City of Scottsdale Tax Audit staff.

SOURCE: Auditor analysis of GenTax system reports and data provided by the Tax Audit Manager.

Due to the advanced skills of a Senior Tax Auditor, this classification's workload would be expected to emphasize the more complex types of work with the Audit Associate performing the less complex. The Tax Auditor and Senior Tax Auditor positions require a Bachelor's degree in Accounting, Business Administration or related field, but the Audit Associate position is required to have a Bachelor's degree in a related field or equivalent years of education and experience as determined by

the Tax Audit Manager. This difference in required job qualifications makes it less likely an Audit Associate will progress into the Tax Auditor classification with the associated higher productivity goals.

Optimal department cost efficiency and productivity may not be achieved with the current staffing mix and utilization. Although management collects and maintains comprehensive statistical information, a productivity analysis and review of job requirements has not been performed recently.

Recommendation:

The Tax Audit Manager should consider directing future recruitment efforts towards experienced tax auditors. Alternately, the Audit Associate job qualifications could be strengthened to require a business-related bachelor's degree so that staff can transition to the higher level positions and productivity requirements as they gain experience. In addition, the Tax Audit Manager should reevaluate the number and type of audits or reviews to be completed by each level based on the qualifications and experience required.

2. Some Tax Audit department and staff performance measures have declined.

During the past three years, the percent of businesses audited, number of audits completed and the ratio of total assessments collected have continually declined.

A. A smaller percentage of Scottsdale businesses are being audited.

The Tax Audit department has a stated goal to audit at least 2% of Scottsdale's businesses annually. During the last three fiscal years, the proportion of businesses audited has declined from 1.7% to 1.4% as illustrated in Table 7.

Table 7. Business Licenses Audited

	FY 2007/08	FY 2008/09	FY 2009/10
Audits & Desk Reviews*	467	363	351
New Licenses	3,830	3,171	3,156
Active Licenses	17,964	18,256	18,203
Licenses Inactive < 4 years	4,967	4,661	4,264
Total	26,761	26,088	25,623
Percent Audited or Reviewed	1.7%	1.4%	1.4%

* Includes compliance or cursory reviews.

SOURCE: Auditor analysis of GenTax System reports.

Historically, Tax Audit has calculated the percentage of business licenses audited based only on new and active licenses, determining that the percentage of licenses audited was between 2.1% and 1.6%. However, in Table 7, auditors have calculated the percentage based on businesses eligible to be audited according to City Code §550. Thus, the total also includes licenses that have been inactive for less than four years, and the percentage reflects a lower productivity measure.

For comparison purposes, these Tax Audit statistics are within the range of other available performance statistics. The tax audit staff of two Valley area cities indicated they audited 1.9% and .78% of their businesses during fiscal year 2009/10.

B. Staff have not been meeting audit goals in recent years.

Audit completion goals require that the Tax Auditor and Senior Tax Auditor positions complete 45 audits (including desk review, audits or joint audits) annually, while an Audit Associate is to complete at least 23 audits. When a new staff member is hired, the audit completion goal is prorated during the first year.

After taking the training period into account, at least one staff member did not meet the annual performance expectations in fiscal years 2008/09 and 2009/10. In addition, based on the first four months of activity in the current fiscal year, it appears two staff members may not meet the annual goals. Conversely, Senior Tax Auditors routinely exceed their goal by almost 25%. During July 2008 through October 2010, Senior Tax Auditors have exceeded the goal of 45 completed audits by 11, completing an average of 56 audits annually.

According to the Tax Audit Manager, the department's ability to achieve some performance measure goals has been impacted by staff's additional responsibilities. For example, all staff members assist with ongoing privilege tax revenue forecasting and one Senior Tax Auditor works for up to six weeks assisting with the City's Comprehensive Annual Financial Report (CAFR).

The tax audit staff of three Valley cities indicated an audit completion goal has not been established for their Tax Auditors. Two of these cities indicated their Senior Auditors typically conduct 40 to 70 audits per year.

It is necessary to monitor management developed performance goals to determine whether they are realistic, attainable and appropriate to encourage a high level of program performance. The reasons for not attaining program or individual goals can help identify issues to be addressed, such as a need for specific additional training.

C. Collection of tax assessments have continually declined, at least partly due to the general economic condition.

The collection percentage for Tax Audit assessments has declined over the last three years from 65% in fiscal year 2007/08 to 47% in fiscal year 2009/10 as shown in Table 8.

Table 8. Tax Collection Rate

	FY 2007/08	FY 2008/09	FY 2009/10
Assessments	\$3,015,303	\$2,169,606	\$5,060,300
Collections*	\$1,973,345	\$1,270,205	\$2,367,905
Collection Rate	65%	59%	47%

* The collection amounts in this table are presented in the year the related assessment was made.

SOURCE: Auditor analysis of GenTax system reports.

Comparatively, the tax audit staff in two Valley cities stated their tax collection rates were 64% and 90%.

Section 517 of the City Code does not allow an employee to be evaluated based on the amount of tax assessed or collected. For this reason, according to Tax Audit and Customer Service management, performance goals have not been established for tax assessment or collections. However, a tax collection goal could be monitored as a measure of operational effectiveness and for signs of potential issues, such as timeliness of audit activity.

Recommendation:

The Tax Audit Manager should include all eligible businesses in calculating the audit percentage performance measure. In addition, quarterly performance results should be shared with staff members to monitor and encourage their progress toward the annual audit goals. The Tax Audit Manager should also work with Customer Service management to develop an annual collection goal that can be used to monitor the collectability of audit assessments.

3. Certain audits have been performed as desk reviews without going through the process that provides the taxpayer reprieve from additional audits.

Recently, the Tax Audit department has requested extensive documentation from certain taxpayers without formally conducting an audit. As a result, the taxpayer was not offered the opportunity to choose to have a joint audit by all applicable jurisdictions rather than being subject to separate audits.

Tax audit departments commonly perform desk reviews as well as formal audits. Desk reviews generally rely on voluntarily self-reported information from the taxpayer, such as a tax reporting form that is filed with a payment. In contrast, a tax audit is defined as a systematic and comprehensive examination of the taxpayer's accounting books and records, involving analyses, tests, confirmations or verifications.

During the last two years, the City's Tax Audit department has requested extensive information in conjunction with desk reviews of about 140 speculative builders. Requested

information, such as documentation of the gross income attributable to the actual direct costs, statement of occupancy, purchasing agreement, billing invoices or contracts, is more than what is typical for a desk review. The Tax Audit department then verifies this information to other sources, such as County Assessor records and the City Planning department's certificates of occupancy. Although this level of work is more consistent with an audit, the department was not obtaining Multi Jurisdictional Audit Coordinator (MJAC) approval for an audit or offering the taxpayer a joint audit.

Arizona Revised Statute (ARS) §42-6005 requires that a joint audit be offered to the taxpayer with certain restrictions. If the taxpayer chooses a joint audit, all cities would generally be prohibited from conducting another audit of the business for any portion of the 4-year time period covered by the audit. The current chairman of the Unified Audit Committee concluded this level of work could be viewed as an audit rather than a desk review. To ensure compliance, proposed audits must be preapproved and coordinated through the MJAC under the direction of the Unified Audit Committee.

Recommendation:

The Tax Audit Manager should ensure that desk reviews are limited to readily available sources of information, with only limited requests for additional documentation from the taxpayer. However, the taxpayer should still be allowed to voluntarily offer any additional documentation. When the department needs more extensive taxpayer documents, the Tax Audit Manager should ensure the audit approval process is followed and the taxpayer is given the opportunity to choose a joint audit.

ACTION PLAN

1. Optimum productivity is not achieved with the current mix and use of staff.

Recommendation: The Tax Audit Manager should consider directing future recruitment efforts towards experienced tax auditors. Alternately, the Audit Associate job qualifications could be strengthened to require a business-related bachelor's degree so that staff can transition to the higher level positions and productivity requirements as they gain experience. In addition, the Tax Audit Manager should reevaluate the number and type of audits or reviews to be completed by each level based on the qualifications and experience required.

MANAGEMENT RESPONSE:

Management concurs that some improvements can be made.

PROPOSED RESOLUTION:

Management, in recent years, has focused on recruitments for either Audit Associates, which are entry level positions, or Tax Auditors that have one to two years of privilege/use tax auditing experience. The philosophy behind this approach has been for the possible promotion of Audit Associates to Tax Auditors or Tax Auditors to Senior Tax Auditors as experience is gained and achievement of expectations is met. However, as pointed-out by the audit, the productivity regarding the number of audits is less for Audit Associates than for Tax Auditors and Senior Tax Auditors. In the future, Senior Tax Auditors will be included in the recruitments to allow for the possibility of hiring more experienced auditors. At times in the past, management has opened recruitments to fill one position with an Audit Associate, Tax Auditor, or a Senior Tax Auditor. The challenge has been attracting Senior Tax Auditors from other jurisdictions given their salaries earned due to the many years such auditors have worked for other jurisdictions, especially municipalities.

Management agrees that requiring a business-related bachelor degree for Audit Associates be required and will discuss this possible requirement on a prospective basis with Human Resources.

Management has and will continue to evaluate the number and types of audits or reviews to be completed by Audit Associates, Tax Auditors, and Senior Tax Auditors. One of the recent challenges experienced by the Tax Audit Department is the loss of an Administrative Secretary due to budget constraints. This has required the Audit Associates to perform administrative tasks such as processing and disseminating mail, providing documents to Revenue Recovery staff, securing the workplace, ordering supplies, updating research databases, cataloging and shipping records to off-site storage, etc. These administrative tasks can affect the output of this particular position. To alleviate this challenge, possibilities to be explored will be requesting administrative assistance from other City departments or consider the hiring of a part-time Administrative Secretary.

RESPONSIBLE PARTY: Tax Audit Manager

COMPLETED BY: JULY 1, 2011

2. Some Tax Audit department and staff performance measures have declined.

Recommendation: The Tax Audit Manager should include all eligible businesses in calculating the audit percentage performance measure. In addition, quarterly performance results should be shared with staff members to monitor and encourage their progress toward the annual audit goals. The Tax Audit Manager should also work with Customer Service management to develop an annual collection goal that can be used to monitor the collectability of audit assessments.

MANAGEMENT RESPONSE:

Management agrees with this finding.

PROPOSED RESOLUTION:

As shown in Tables 2 and 7, the number of assessments and compliance reviews has decreased somewhat for fiscal years 2008/09 and 2009/10 vs. fiscal year 2007/08. One of the reasons 2007/08 reflected a significantly higher number of assessments is due to a residential rental voluntary compliance project that was being completed. The number of assessments from this project alone was 185 of the 438 assessments shown in Table 2 for such fiscal year. Netting-out these assessments from this special project would have resulted in 253 assessments. Adding in approximately 50 audit assessments that otherwise would have been accomplished during such time period would have resulted in approximately 303 assessments. This amount would be comparable to the 307 assessments in 2008/09 and 283 assessments in 2009/10.

Other factors that contributed to fewer assessments by both the Department and individual auditors in 2008/09 and 2009/10 were the assignments of revenue forecasting by Budget staff and upper management and also a Senior Tax Auditor assisting the Finance and Auditing Department for six to eight weeks in both fiscal years for completion of the Annual Financial Comprehensive Report (CAFR). While drawing upon the Tax Audit Department's expertise in analyzing privilege tax collections and trends has proven to be very helpful for Budget staff and upper management, this assignment has taken considerable time and has impacted the output of assessments.

Although assessments have decreased in 2008/09 and 2009/10, the Tax Audit Department still exceeded the performance measure goal of a 2:1 ratio of collections vs. cost of the program as shown in Table 3.

To address the decline in the number of businesses audited, management will discuss with upper management the possibility of hiring another auditor and/or a part-time Administrative Secretary. Management will also consider adding a new performance measure of a tax collection rate as illustrated in Table 8. This item will be discussed with the Revenue Recovery Manager to determine an optimal collection percentage rate and also requesting that at least one Collector be solely focused on the collection of assessments.

RESPONSIBLE PARTY: Tax Audit Manager

COMPLETED BY: JULY 1, 2011

3. Certain audits have been performed as desk reviews without going through the process that provides the taxpayer reprieve from additional audits.

Recommendation: The Tax Audit Manager should ensure that desk reviews are limited to readily available sources of information, with only limited requests for additional documentation from the taxpayer. However, the taxpayer should still be allowed to voluntarily offer any additional documentation. When the department needs more extensive taxpayer documents, the Tax Audit Manager should ensure the audit approval process is followed and the taxpayer is given the opportunity to choose a joint audit.

MANAGEMENT RESPONSE:

Management agrees that recently the Tax Audit Department has requested documentation from certain taxpayers without formally conducting an audit.

PROPOSED RESOLUTION:

Management will review the current process for these desk review assessments and will curtail record requests. Preliminary assessments will be based on the use of available records, while taxpayers will continue to be allowed to voluntarily offer additional documentation.

RESPONSIBLE PARTY: Tax Audit Manager

COMPLETED BY: JULY 1, 2011

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