Fairfax County
Internal Audit Office

Department of Tax Administration
BPOL Tax Assessment Audit
Final Report

May 2013

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Introduction

Fairfax County assesses a business, property and occupational license (BPOL) tax on businesses, professionals, trades, and occupations. The tax is based on gross receipts for the prior year without deductions on January 1st of each year. In fiscal year 2012, the county collected approximately $150M in BPOL tax revenue. The Department of Tax Administration (DTA) is responsible for the assessment and collection of BPOL taxes for Fairfax County. The Personal Property and Business Licenses Division within DTA is responsible for the assessment of personal property including vehicles and business equipment, business license taxes, and a variety of local license taxes such as transient occupancy tax, short-term daily rental tax and bank franchise tax. As of December 2012, the Personal Property and Business Licenses Division had ten business tax specialists (BTS), and six auditors. The revenue generated from discovering new businesses was approximately $2.5M for the period July through December 2012.

The current BPOL application system utilized by DTA is a mainframe system that was designed and developed during the 1980s and 1990s. Per discussion with DTA staff, the system uses outdated technology and programming languages. It is also limited in areas such as integration with other county and state systems, including the Virginia Department of Motor Vehicles and other DTA applications, and citizen interaction and self-service opportunities via web-based technologies. The integration is important for automation purposes. DTA is in the process of acquiring a new BPOL application system. Additionally, DTA used the TSOP system for revenue tracking purposes; however, during the audit, due to functionality issues, DTA decided to use different tracking systems such as Excel and Siebel.

This audit was mainly focused on the assessment, enforcement, and auditing of BPOL taxes. Additionally, we researched tools and techniques used by other jurisdictions to discover non-reporting businesses and increase BPOL tax revenue.

Executive Summary

We found that internal controls were in place to ensure adequate separation of duties for sensitive BPOL tax-related activities and field visits to discover unregistered businesses were effective. However, due to limited resources, the amount of time it took for DTA field auditors to provide full coverage of the entire county was extended. DTA has requested additional staff to shorten this time frame and maximize revenue; this staffing request funding has been included in the County Executive's FY 2014 Advertised Budget Plan. Additionally, BPOL appeals (exemptions, reclassifications, and exclusions) were reviewed found to have been and approved by appropriate levels of management. We did identify two areas within the audit that could be strengthened, as follows:

- DTA did not have finalized written departmental specific procedures covering appeal processes. Per discussions with DTA management, a draft was developed but had not been finalized.

- Confidential information on documentation such as BPOL tax records, Schedule C reports, Transient Occupancy Tax (TOT) applications, etc. was not being adequately safeguarded against unauthorized access. Sensitive information was left on staff desks or in unlocked cabinets at night.

Scope and Objectives

This audit was performed as part of our fiscal year 2012 Annual Audit Plan and was conducted 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. The objectives of the audit were to determine that:

- Comprehensive written policies and procedures governing BPOL processes were established and working effectively
- Controls over registering businesses for BPOL were effective and DTA utilized efficient and effective tools to discover non-compliant businesses
- Proper internal controls existed to ensure adequate separation of duties
- Field visits to discover unregistered businesses were effective, efficient, and timely
- Physical safeguarding of tax records was adequate and in compliance with management policies for retention of BPOL tax records

Methodology

Our audit approach included reviewing county and departmental policies and procedures governing BPOL functions. We conducted interviews with the DTA staff; performed walkthroughs of the different BPOL processes (i.e. tax assessment, approval processes, new businesses discovery, appeals, etc.); and benchmarked data from other jurisdictions to identify the tools and techniques utilized by these jurisdictions to aid in discovering non-reporting and increasing revenues.

We performed substantive testing to determine if appeals were processed accurately and complied with DTA tax requirements. We also reviewed supporting documentation for judgmentally selected samples from the discovered businesses list to ensure sufficient follow-up steps were taken to bring the businesses into compliance. Additionally, we performed on-site visits within DTA to ensure physical controls over tax records were adequate and sensitive information was safeguarded against unauthorized access. Our audit did not focus on controls over the revenue collection process, tax refund process, and calculations in the BPOL application system.

Findings, Recommendations, and Management Response

1. Internal Policies and Procedures

While DTA follows the Virginia State BPOL Tax Rules for processing BPOL appeals, it did not have finalized written departmental specific procedures. The draft procedures were developed but not finalized. During the audit, we did observe evidence of departmental procedures through our substantive testing such as reviews, approval signatures, and documented audit results. At the exit meeting, a copy of the draft procedures was provided.

Written departmental specific procedures are needed to document processes specific to Fairfax County's DTA that are not included in the Virginia State BPOL Tax Rules. Examples include approval workflows for the different types of appeals (i.e. exclusions, exonerations, incorrect gross receipts, etc.), required supporting documentation, and peer review requirements.

Recommendation: DTA should finalize their department specific procedures for BPOL appeals. These procedures should include but not be limited to approval workflows for the different types of appeals, required supporting documentation, peer review requirements, etc. Once approved, management should distribute and communicate the finalized procedures to DTA staff.

Management Response: As noted in the audit, DTA uses and staff is well-trained on defined procedures for BPOL operations, but we concur in the recommendation to finalize formal documentation. The anticipated completion date is June 30, 2013.

2. Safeguarding Tax Records

Confidential information on documentation such as BPOL tax records, Schedule C reports, Transient Occupancy Tax (TOT) applications, omitted BPOL records, and Mixed Beverage License applications was not being adequately safeguarded against unauthorized access which presented confidentiality issues. The documentation was kept in file cabinets that did not have locks on them. In addition, DTA staff indicated that tax-related documentation being processed was not put away over night after the office was closed. Sensitive information was displayed on some of these applications. The DTA suite is accessible to cleaning personnel after hours, and they would have access to view unauthorized data.

Recommendation: DTA should safeguard the confidential tax documentation by utilizing locked file cabinets for storing the documentation when not in use. Access to these file cabinets should be limited to authorized staff.

Management Response: The entire agency handles numerous confidential documents (all divisions, not just the BPOL section). Replacing the file cabinets that do not have locks is estimated to cost at least $100,000. DTA will start phasing-in this replacement to upgrade our existing cabinets as necessary. All cash and checks not yet deposited are locked up each night in a secure vault. All

documents are secured behind locked suite doors at night, but separately locking up all documents each night could prove impractical. DTA is a high volume production shop. Each day staff may have thousands of documents to process. DTA is concerned that locking everything up each night and unlocking everything the next morning could significantly slow our processing time, our auditing time and our ability to be responsive to the public. DTA will conduct a test pilot to try to gauge the workload impact of this recommendation (but this would be further exacerbated during peak workload time periods). DTA will also coordinate with FMD to ensure all contract cleaning staff (and other FMD/DIT employees that might have night access to DTA suites) read and sign DTA's Confidentiality Oath Sheet that alerts the employee that violation of confidentiality is a criminal offense under state law punishable by termination and prosecution.

Other Observations

The Other Observations section includes suggestions for DTA to potentially increase revenue or change processes that might result in minimizing the number of unreported businesses and maximizing revenues. As part of our objectives for this audit, we researched other jurisdictions to identify the tools and techniques utilized to discover non-compliant businesses and generate revenue by bringing businesses into compliance, and we discussed potential areas of revenue enhancement with DTA staff.

1. Electronic Database Matching

DTA received several electronic files from Virginia state databases such as the Virginia State Sales Tax Report and the Schedule C Report. DTA staff used these resources to manually research tax issues and perform a limited amount of income verification. DTA had made several attempts to perform automated matches of their data against these databases; however, at the time of our audit, the automation had not been completed. DTA staff indicated that the State Sales Tax Report could not be run against the records in the BPOL application system due to lack of a unique identifier for each taxpayer. The State Sales Tax Report was sent to DTA by the Virginia Department of Taxation on a monthly basis. The report was downloaded into Excel and had the gross receipts for retailers only. The unique identifier in the State Sales Tax Report was the business' Virginia sales tax identification number, whereas in BPOL system businesses were identified with their Federal Tax ID or social security number of the owner. BPOL did capture some state sales tax ID numbers, but the population was not complete due to the fact that although the field was available on the BPOL tax application, businesses did not always fill in the information. DTA had entered the state sales tax identification number in BPOL for some accounts manually, but was not able to complete the whole population due to resource shortages. Although DTA may not have unique identifiers for their total BPOL populations, consideration should be given to developing a means to match reported incomes for the ones that it does have to determine if they are reasonably close to what has been reported to the state. This verification could decrease lost revenues due to under reporting.

Management Response: DTA's IT staff and business staff have been working on the process to increase our matching capabilities despite system limitations. Staff will continue to explore this and will try to develop additional matching capabilities if possible. We will also survey other jurisdictions to see if they have any matching possibilities that we have not yet identified.

2. Utilizing Electronic Devices to Improve Efficiency

The business tax specialists did not have tablets or any kind of electronic hand-held devices to carry with them on their field visits. They had to contact the office using a phone if they needed to check the filing or payment status of a business in the system or wait until they returned to the office, prolonging the discovery process. Additionally, the discovery process was further prolonged because information on businesses had to be collected first manually and then entered into the TSOP system after staff returned to the office. Having access to the BPOL system while BTS' are in the field would allow them to resolve tax issues in minutes instead of days. Additionally, if staff could enter the business information in the system while on location, they could eliminate the need to do this back at the office. This would allow them more time to discover new businesses out in the field for increased revenue.

Management Response: DTA will review with DIT and DMB the cost/benefit of purchasing field tablets. DTA appreciates the use of added technology, but our perception is that the current process is not a significant limitation to productivity. DIT will also need to address data security in the use of tablets to access our confidential records in the field.

3. System Functionality Upgrades for Future BPOL Software Applications

During the audit, DTA staff notified Internal Audit that the department was looking into the possibility of upgrading their BPOL system, as the county is looking to remove the remaining systems from the mainframe. As mentioned in the Introduction, the BPOL system is an old mainframe system developed over 20 years ago with outdated technology. As part of our review, we noted current system deficiencies that could possibly be addressed in a system update, improving the efficiency and effectiveness of processing BPOL transactions and maximizing revenue.

a. Under the current system much of the BPOL reporting on taxpayer information verification is done manually. DTA should consider including functionality to export information to an Excel spreadsheet to perform enhanced financial analysis and import data from other systems in order to perform automated matches of taxpayer information for verification of reported income for any new BPOL application system.

b. The TSOP revenue tracking system was not a very user-friendly system. After the business tax specialist (BTS) discovered a business, they had to enter the same data for every year that the business had not filed taxes in

the past. For instance, if the business that was brought into compliance was non-compliant for five years, the BTS would have to enter the same data in the tracking system five times. It required a lot of manual data entry, including a summary of what they did to bring the business into compliance. The DTA auditors used Siebel, a different tracking system that was more efficient than TSOP; however, the reporting functionality needed improvement. For example, in order to get a report of all the appeal cases that were completed during a certain period, the auditor would have to manually copy the information from each account in Siebel. The system also was not capable of generating revenue reports. (During the audit, DTA started using Siebel to keep track of the discovered business and no longer used TSOP for tracking purposes. Additionally, DTA staff began using Excel for tracking BPOL revenue.) DTA should consider including tracking functionality for business discovery as a requirement for any new BPOL system. This could increase efficiency by centralizing BPOL data and eliminating duplicate entries.

c. Business owners' contact information history was not captured by the BPOL application system. The hard copies were kept in file cabinets. Per staff, the applications for the three prior years were stored in the Databank Online system; however, to obtain the name and address of the owner for applications older than three years, the staff had to pull the hard copies. (Due to system limitations, DTA had not been able to add a field that captures contact information history in BPOL.) This should be considered as a requirement for any new BPOL system being considered.

Management Response: DTA would like to add new functionality as it replaces the antiquated BPOL system. However, due to budget constraints, DIT is now looking at more economical solutions as it removes systems from the mainframe. Rather than purchasing a COTS package (or a custom build), DIT is presently exploring a translation solution whereby an IT vendor would simply program the existing functionality into a different software language/platform (in which case DTA will have limited opportunity to seek new functionality). Still, even with a translation, DTA might be better positioned to pursue future enhancements. We will provide these recommendations to DIT for future consideration.