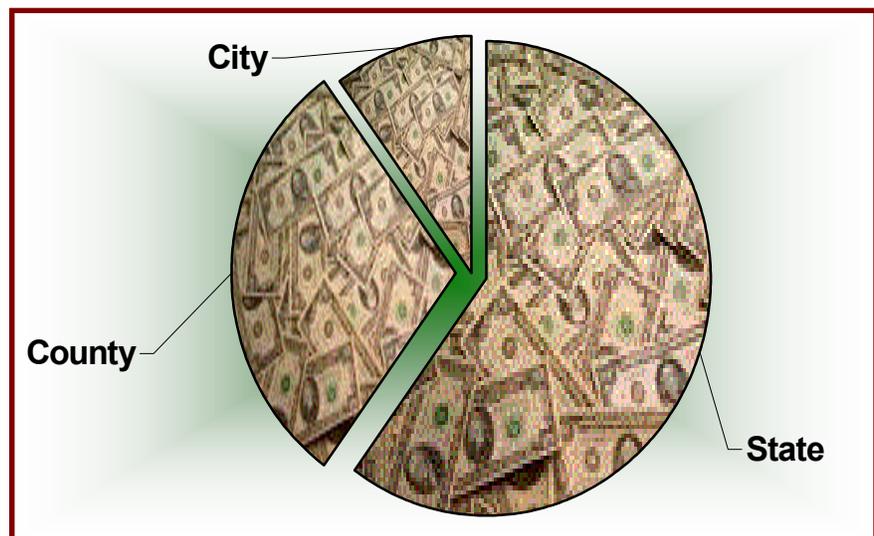




# Internal Audit Report

Sales Tax Revenue Sharing  
July 2002



## **Audit Team Members**

**Joe Seratte, Audit Manager**

**Patra Carroll, Associate Auditor**

**Tom Fraser, Associate Auditor**

**Lisa Scott, Audit Intern**

# Internal Audit Department

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301 W Jefferson • 10th Floor • Phx • AZ • 85003 • (602) 506-1585 • Fax (602) 506-8957



July 15, 2002

Don Stapley, Chairman, Board of Supervisors  
Fulton Brock, Supervisor, District I  
Andrew Kunasek, Supervisor, District III  
Max S. Wilson, Supervisor, District IV  
Mary Rose Wilcox, Supervisor, District V

We have completed our FY 2002 review of Sales Tax Revenue Sharing as part of our Countywide Revenue Audit. This audit was conducted in accordance with the Board approved audit plan. Our review focused primarily on the Arizona Department of Revenue's sales tax allocation methodology, and how efforts to identify non-compliance by County businesses could increase the County's sales tax revenue stream.

The highlights of this report include:

- The County's FY 2000-01 sales tax distribution from Arizona Department of Revenue (DOR) would have increased by approximately \$1 million, if the Arizona Department of Revenue had used the most current property tax valuations.
- The Department of Finance does not receive the information necessary to fully reconcile Maricopa's monthly sales tax distribution.
- The County could potentially increase sales tax revenue through activities in conjunction with the Arizona Department of Revenue's present audit measures.

Attached are the report summary, detailed findings, recommendations, and management responses. We have reviewed this information with the Department of Finance and appreciate the excellent cooperation of all County employees involved. If you have questions, or wish to discuss items presented in this report, please contact Joe Seratte at 506-6092.

Sincerely,

A handwritten signature in cursive script that reads "Ross L. Tate".

Ross L. Tate  
County Auditor

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# Executive Summary

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Maricopa County’s FY 2000-01 sales tax revenues would have been \$1.05 million greater if the Arizona Department of Revenue (DOR) had used the current, rather than the prior, year’s secondary property tax valuations to allocate sales tax revenue. County management should petition DOR to use current year data, available from county assessors, to calculate counties’ sales tax distributions.

**Controls and Reconciliation**  
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The County’s FY 2000-01 sales tax revenue distributions are correctly accounted for in the County’s financial reporting system and the Treasurer’s information system. Adjustments made to the County’s sales tax revenues were accurate. However, the Department of Finance (DOF) does not receive from DOR the information necessary to reconcile gross distributions to net cash. **DOF should obtain and reconcile DOR monthly distribution reports to County records.**

**Special Permit Compliance**  
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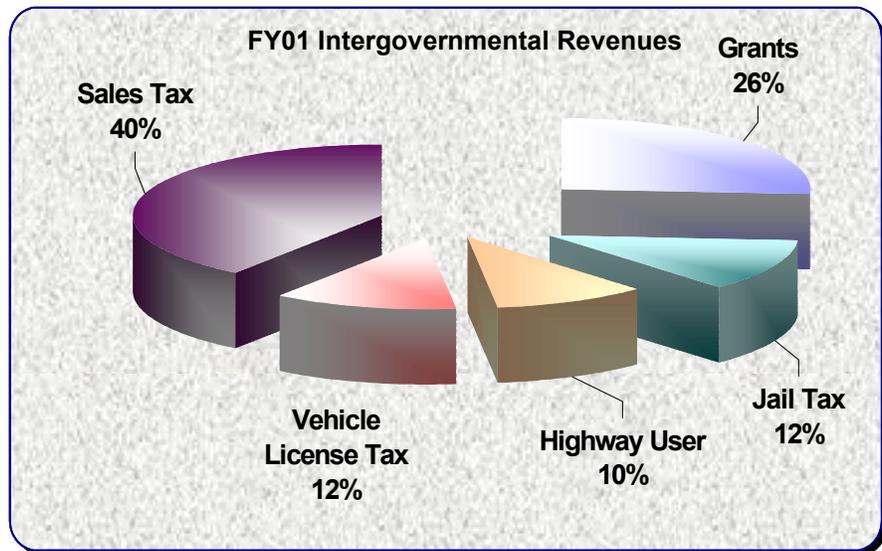
Our limited review of Special Event Permits found no unregistered or non-compliant businesses. However, additional County compliance review efforts, in cooperation with DOR, could boost future sales tax revenues.

# Introduction

## Background

Maricopa County General Fund, Special Revenue Funds, Debt Service Fund, and Capital Projects Funds revenues were reported in the Fiscal Year (FY) 2000-01 Comprehensive Annual Financial Report at approximately \$1.3 billion. The County's largest revenue source is Intergovernmental Revenue, which comprises 46 percent of the total. The largest portion of this revenue is sales tax.

The following pie chart depicts all sources of the County's FY 2000-01 Intergovernmental Revenues.

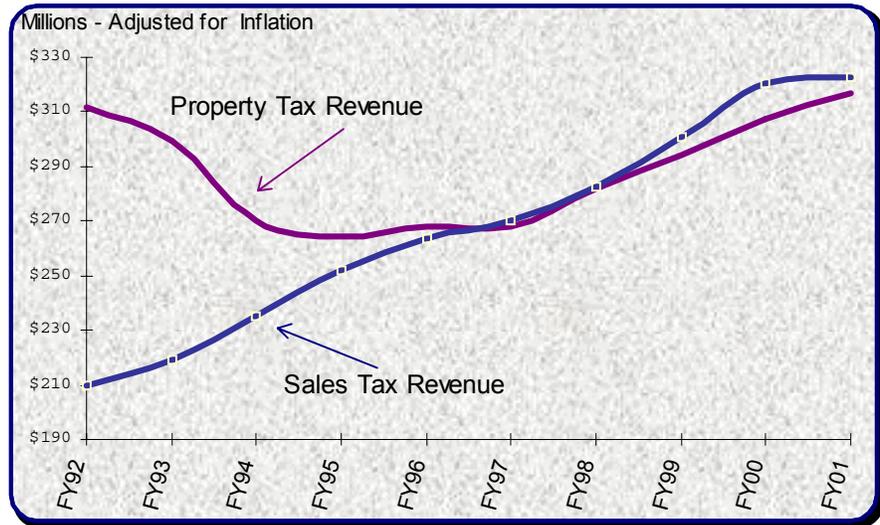


## Sales Tax Revenue

The County's sales tax revenue has increased steadily over the last ten years, surpassing property taxes in FY 1998-99 as the number one revenue source. During FY 2000-01, the County received \$310 million in allocated sales tax revenue. These taxes are collected and distributed through Arizona Department of Revenue (DOR) and, therefore, fall outside the County's immediate control.

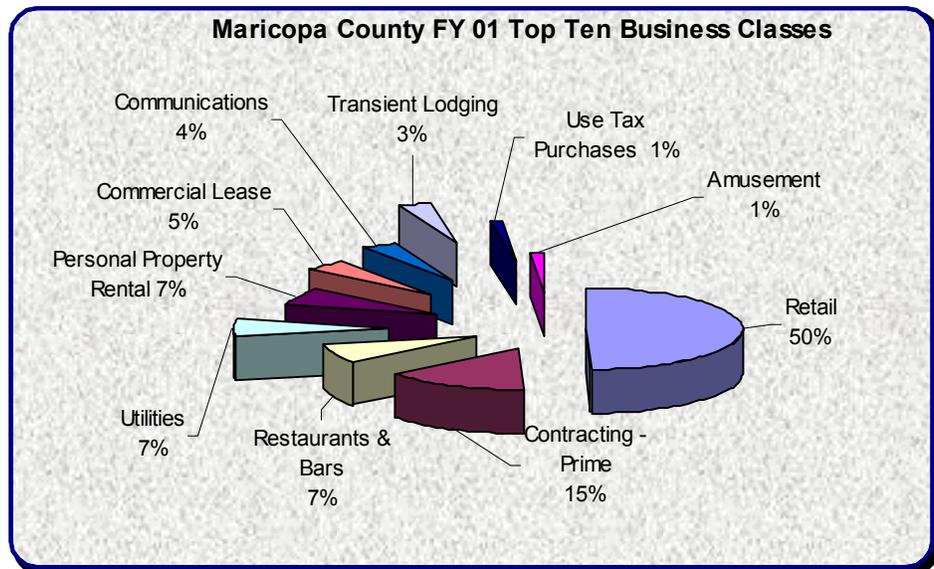
Statutory allocation formulas directly impact the County's share of state sales tax revenues. Because sales tax revenues are becoming an increasingly important part of the County's budget, ensuring that DOR provides the County its full revenue share is very important. The chart on the following page shows a comparative ten-year trend of sales and property tax revenues.

## Property and Sales Tax Growth Trend (FY92 - FY01)



### Allocation Process

DOR is directed by ARS §42-5029 to allocate sales tax revenue to Arizona's counties and cities. The portion of total collections distributed is known as the distribution base and varies by merchandise type or business category. For example, retail sales have a distribution base of 40 percent. Jurisdictions are credited for taxable transactions within its jurisdiction when computing the distribution base of each commodity group. The graph below shows the relative size of the County's FY 2000-01 business categories.



**Confidential  
Records**

DOR's interpretation of Arizona's confidential records statute (ARS 42-2003) precludes the release of certain information (e.g., taxpayer ID numbers, gross sales activity, industry specific data for utilities and mining sectors). This lack of confidential information did not limit our audit testing. However, if given access to additional DOR data the County could proactively identify non-compliant businesses and increase sales tax revenue.

**Scope and  
Methodology**

Our audit objectives were to determine if:

- DOR provides the County with all sales tax revenue due.
- The County has established effective controls over the receipt and recording of sales tax revenues.
- Non-compliant businesses within Maricopa County can be identified through County databases, such as Special Event Permits.

This audit was performed in accordance with Government Auditing Standards.

# Issue 1 Sales Tax Allocation

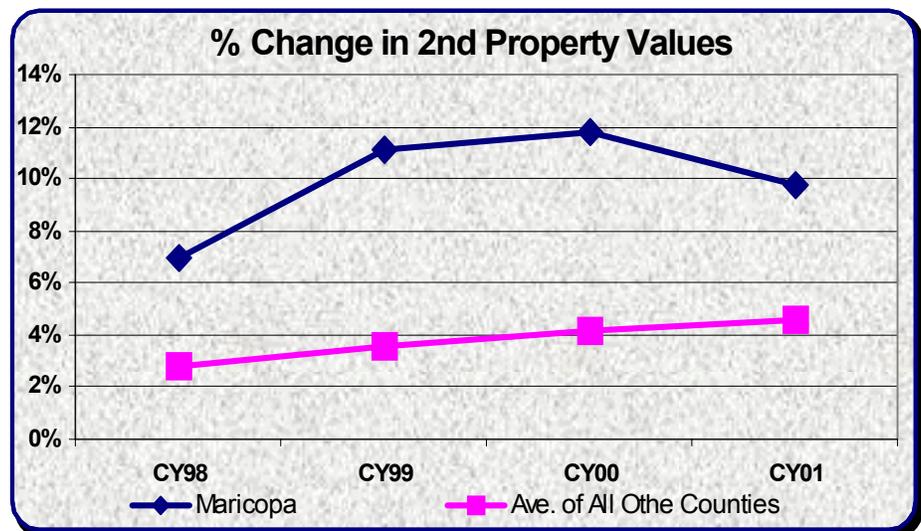
## Summary

Maricopa County's FY 2000-01 sales tax revenues would have been \$1.05 million greater if the Arizona Department of Revenue had used the current, rather than the prior, year's secondary property tax valuations to allocate sales tax revenue. County management should petition DOR to use current year data, available from county assessors, to calculate counties sales tax distributions.

## Department of Revenue Allocation

Arizona counties' share of sales tax revenue is determined by their size relative to all other counties. "Size" is measured by population or secondary property values. The Arizona Department of Revenue (DOR) calculates sales tax revenue distributions using both methods and applies the method most beneficial to each individual county.

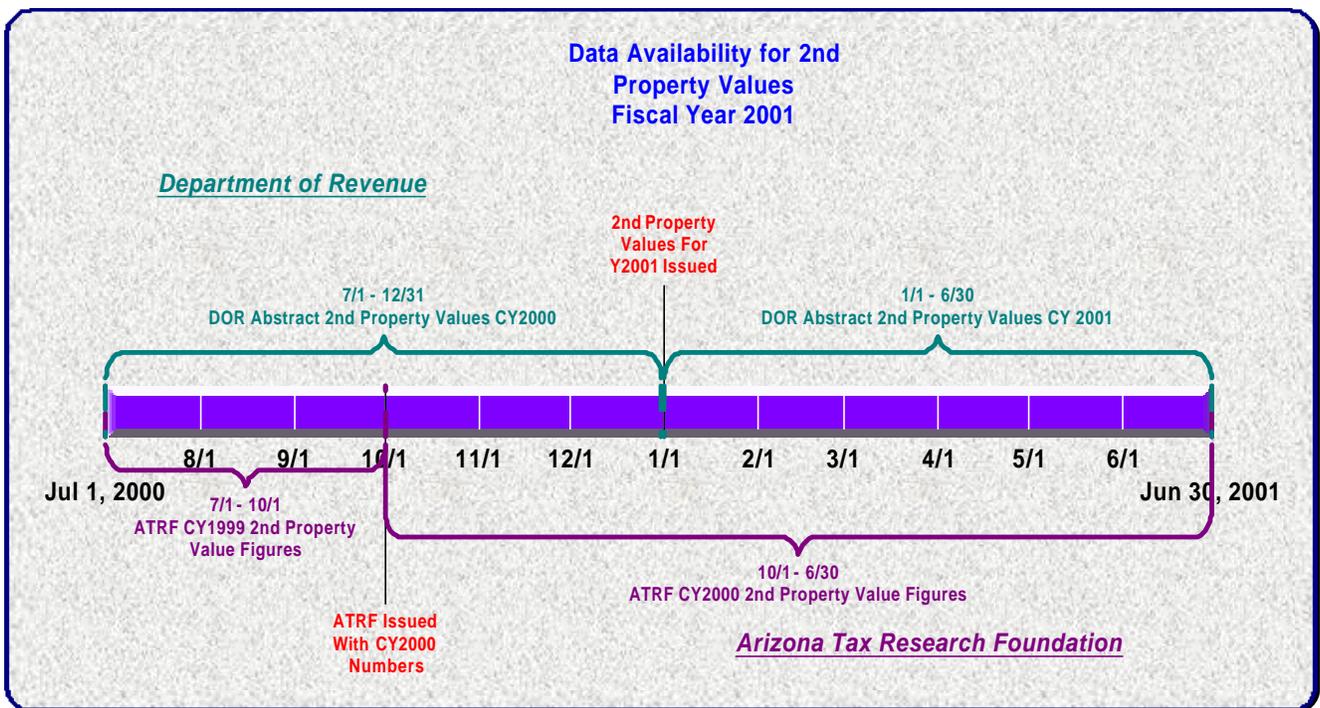
We reviewed the County's FY 2000-01 sales tax revenue allocations (more than \$300 million) using both distribution methods. We found no material differences in the formula results. However, DOR bases its allocation on prior year data. As one of the fastest growing areas in the country, Maricopa County outpaces other Arizona counties in secondary property values. Therefore, the County's interests are best served if DOR uses accurate and current secondary property value when calculating sales tax distributions. The relative growth rates of Arizona counties, over the past four years, are shown below.



**Data Sources**

DOR uses the Arizona Tax Research Foundation (ATRF) Property Tax book to calculate sales tax revenues distributable to Arizona counties. The timing of the ATRF publication means that allocations made by DOR are based on data up to 20 months old.

All Arizona county assessors submit secondary property values to the DOR Property Tax Division each December for the upcoming calendar year. DOR has current property tax data available each January. If the more current property values were utilized, the County would have received an additional \$1.05 million in sales tax revenue in FY 2000-01. The timing differences of data availability are illustrated below:



**Recommendation**

County management should consider petitioning DOR to use current secondary property valuations when calculating sales tax revenue distributions.

# Issue 2 Controls and Reconciliation

## Summary

The County's FY 2000-01 sales tax revenue distributions are correctly accounted for in County's financial reporting system and the Treasurer's information system. Adjustments made to the County's sales tax revenues were accurate. However, the Department of Finance (DOF) does not receive from DOR the information necessary to reconcile gross distributions to net cash. DOF should obtain and reconcile DOR monthly distribution reports to County records.

## Sales Tax Revenue Process

DOR collects sales tax revenues directly from Arizona businesses and remits the County's share monthly to the Maricopa County Treasurer via electronic funds transfer. The Treasurer's Office records the monthly distribution into its Treasurer's Information System (TIS) system. A copy of the transmittal is entered into the County's financial system (Advantage) by DOF. The graphic below depicts the primary components of Maricopa's Sales Tax Revenue cycle.

## Revenue Sharing Cycle



DOR routinely deducts ALTCS and Disproportionate Share (DSH) State reimbursements from the County's monthly sales tax revenues. DOF uses the annual notices from AHCCCS and the Governor's Office of Strategic Planning and Budgeting to verify the accuracy of these monthly deductions.

Monthly, the State Treasurer sends an electronic funds transmittal to the County Treasurer (copy to DOF) for the County's monthly sales tax amount, net of deductions. DOF maintains a reconciliation showing the monthly cash amount and the appropriate DSH and ALTCS deductions. However, DOR does not provide enough information to allow a complete reconciliation of the electronic funds transmittal amount (net of deductions) to the actual monthly sales tax revenue distribution.

**Review Results**

We obtained copies of DOR's monthly Sales Tax Distribution Report and were able to successfully reconcile the FY 2000-01 distributions. These reports would be useful to DOF in reconciling sales tax dollars received. During the fiscal year, DOR made a manual adjustment to all Arizona County's sales tax distribution based on a change in the Mining Severance Statute. These adjustments were not reflected on the DOR Monthly Distribution Reports and did not impact our audit results, since the adjustment was correctly applied. However, DOF would be in a position to identify and validate such adjustments if they were aware of them through the report.

**Recommendation**

DOF should obtain DOR Monthly Distribution Reports and use the reports to verify gross sales tax allocated against net cash received.

# Issue 3 Special Event Permit Compliance

**Summary**

Our limited review of Special Event Permits found no unregistered or non-compliant businesses. However, additional County compliance review efforts in cooperation with DOR could boost future sales tax revenues.

**DOR Audit Activities**

DOR’s Audit division has 60 sales tax auditors state wide that perform 2,500 audits annually. Approximately 60 percent of the audits statewide are performed on businesses in Maricopa County. DOR’s current audit emphasis is on Use Tax, from which the County derives no financial benefit.

Potentially, many businesses in the County underreport revenue and underpay sales tax, or fail to file a return with DOR. The County’s sales tax revenue could potentially be increased through Maricopa County Internal Audit involvement in the sale tax audit process.

**Database Matching**

We compared the businesses within the Environmental Services Special Event Permit database to taxpayer detail received from DOR. The Special Events Program issues "temporary food service" permits for food and beverage concessions at special events. Temporary events include parades, street fairs, festivals, and similar events that operate for no more than 14 consecutive days within any permit year.

We contacted 34 businesses not initially matched to DOR data to determine if Special Event Permit holders, not appearing on the DOR database, should have filed a sales tax return for the questioned period. All contacts with potential non-compliant or unregistered taxpayers were made by telephone. No exceptions were noted. IA’s sample results are depicted below:

Results	Number	Percentage of Sample
Failed to contact (incorrect telephone numbers)	15	44%
Confirmed Licensing Info.	12	35%
No Sales Tax Liability	7	21%
<b>Total</b>	<b>34</b>	

**Proactive Options for Future Growth**

The DOR Audit Division works with agencies throughout the state to increase compliance efforts. The office also works with the Multi-Jurisdictional Audit Committee, a group of state sales tax authorities that share audit resources to increase sales tax revenue to their jurisdictions. The County has several databases (building permits, commercial property records, and others) that could be systemically compared to the DOR taxpayer detail to identify non-compliant taxpayers. Further, the County may wish to partner with cities that have other appropriate databases.



**Mobile Food Peddlers are required to have Special Event Permits.**

**Recommendation**

None, for information and future consideration only.