TAX MANAGEMENT ASSOCIATES, INC.

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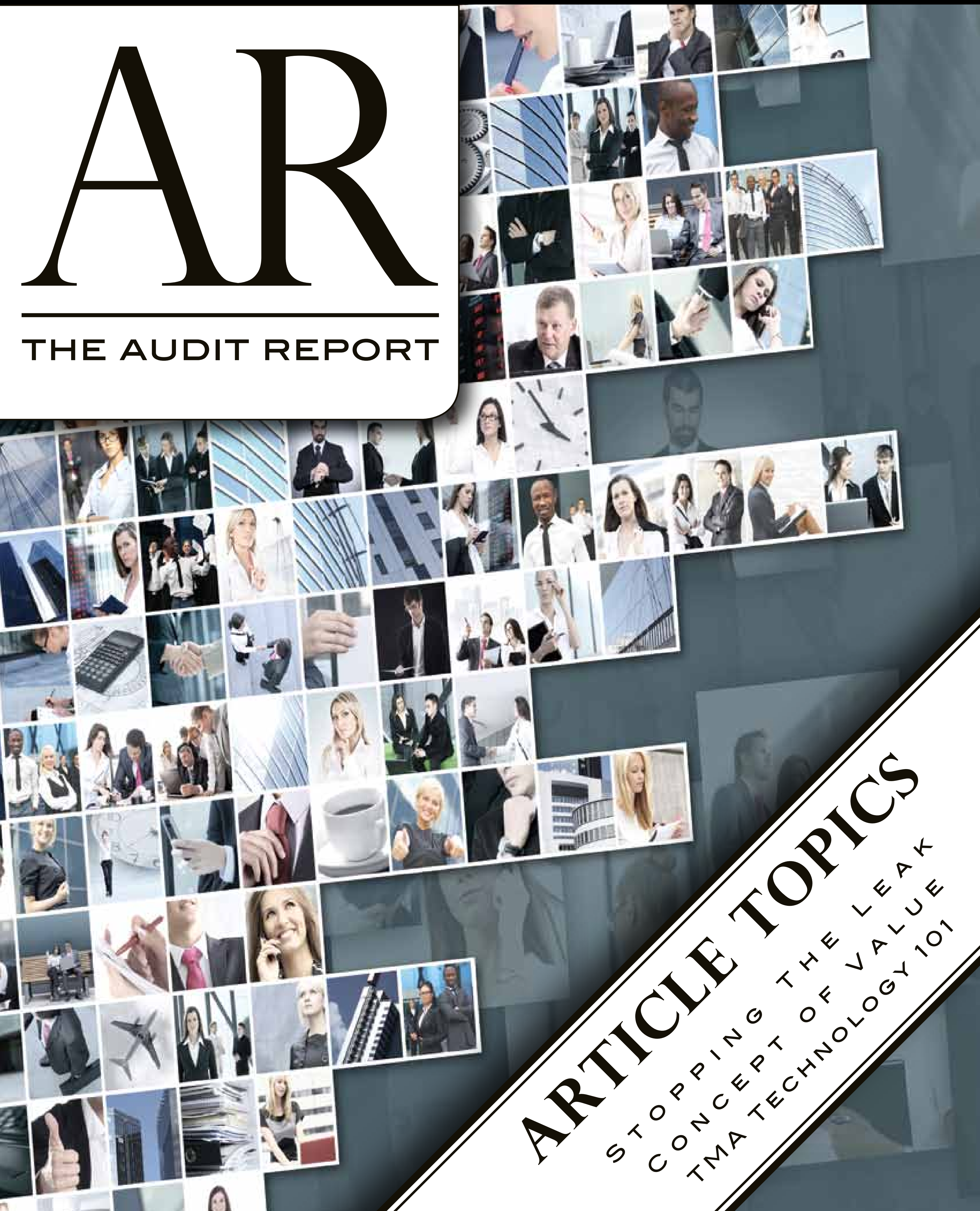
THE AUDIT REPORT



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Stopping the Leak

How TMA Can Assist in Eliminating Waste, Fraud, and Abuse | *by Chip Cooke*

If you have been paying attention to the news lately, you have certainly noticed that there seems to be a trend in story lines. Calls for reduced government spending in the wake of our faltering economy have been matched by calls for the elimination of waste in the system. Whether the issue lies within the tax system (revenue leakage) or the entitlement system (spending leakage), watchdog groups have massed under the banner of "enough is enough."

TMA and our partner, LexisNexis, have seen our fair share of both examples. Under the first, revenue leakage, we have seen examples of decreased tax revenues through improper reporting, refusing to report at all, and just about everything in between. Under the second, spending leakage, we have seen numerous examples of improper payments, entitlement fraud, and other instances of unnecessary spending.

In the effort to maximize revenues and reduce excessive spending, there are a number of programs available to assist officials and administrators at the federal, state and local levels. On the revenue side, compliance efforts must be in place to ensure that the jurisdiction is receiving 100% of the

"Criminals have used both stolen identities and falsified documentation to receive hundreds of millions of dollars in false refund requests"

revenue level allowed by law. That means that the self-assessed taxes should be monitored for accuracy and completeness. Property and income taxes easily fall within this category. In the case of income tax, not only must we examine the form to ensure it is accurate, we must also prevent fraudulent refund requests from draining that revenue source. It is not uncommon to have refund requests filed by individuals with less than honorable intentions. Criminals have used both stolen identities and falsified documentation to receive hundreds of millions of dollars in false refund requests.

When looking at the effort to reduce leakage by eliminating payments to fraudsters, the jurisdiction must have in place a systematic approach for verification of identities and the ability to constantly monitor the outflow of funds. There are countless examples of improper payments through expenditures to the deceased, payments to individuals who do not deserve the assistance, and outright fraud to receive a benefit illegally.

The first step in combatting fraud, waste and abuse lies in understanding all of the elements surrounding the source

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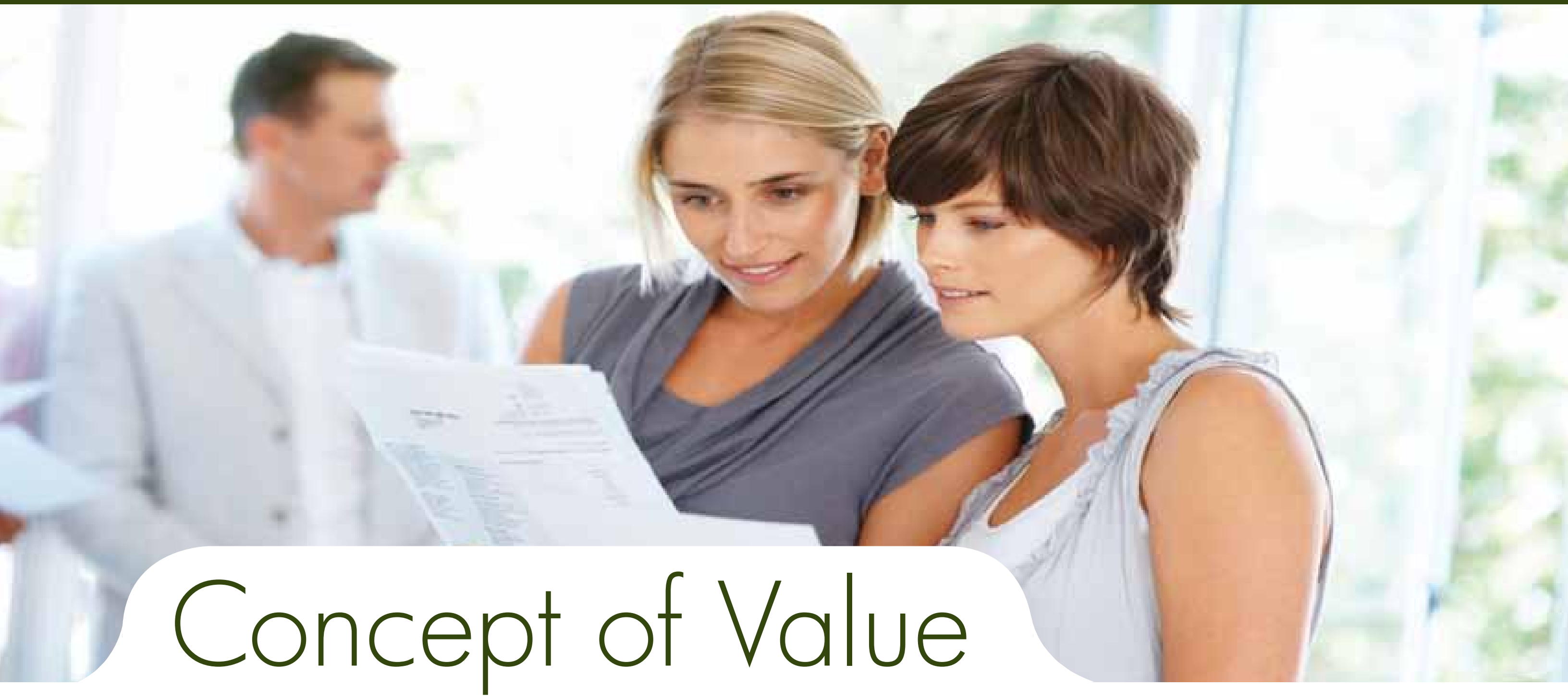
of revenue or intended benefit. Who needs to pay the tax, how much, how can we ensure that everything is being reported? TMA is currently providing these services to jurisdictions in sixteen (16) states and has been quite successful in assisting clients realize the full benefit of the tax in place. By understanding the laws associated with the revenue source and then implementing a compliance initiative, you satisfy the intent of the governing body that put the tax into effect in the first place.

Let's examine one area of fraud within the revenue side of the shop – homestead exemption fraud. In certain states, if a taxpayer meets specific guidelines (i.e., the home is the primary residence and not a vacation property or rental property), then the taxpayer may receive a substantial reduction in their annual property taxes on the home in question. In many cases this may decrease the tax burden by 50% to 75% of previous total. As school systems are the primary beneficiary of this tax, the effect of fraud in this area is felt here the most. We have found through programs in place in Indiana, Michigan, and South Carolina that around 5% of the homestead exemption applications filed have been filed in error or in some other way are not qualified to receive the exemption. Estimates suggest that even just 5% of the homes receiving this reduction in error creates hundreds of millions of dollars in revenue loss for the jurisdictions. As this directly affects the school system, tax rates must be increased to offset the loss in value, or services must be reduced – neither a pretty option in this economy.

Another example that has been in the news lately is the increase across the country in fraudulent income tax refund requests at both the federal and state levels. Through forged documents and stolen identities, criminals are flooding tax departments with requests for income tax refunds. If the refunds are in small amounts and stolen identities are used, many of these requests are inadvertently processed and paid. By the time someone can thoroughly review the request, the money has been deposited and the trail of the criminal goes cold.

By employing certain data filters and with a commitment to compliance initiatives, much of the waste, fraud, and abuse in the system can be mitigated. Currently, TMA is working with its counterparts at LexisNexis to develop and deploy these suggested fixes. LexisNexis is one of the leading companies in the world when it comes to identity verification and TMA is a national leader in investigation for self-reported taxes. Whether we are talking about revenue or spending, TMA and LexisNexis plan on reducing waste in the system.



Concept of Value

Why Original Historical Cost is Important in Ad Valorem Appraisal | *by Kirk Boone*

One of the first appraisal issues I encountered almost 20 years ago is still relevant today and is probably going on in your jurisdiction. It involves the accountant's concept of value versus the appraiser's concept of value.

This appraisal issue is addressed in most introductory personal property appraisal courses. However, it seems that many accounting professionals may overlook the concept, or it's not taught in depth. So let's review a couple of definitions and revisit why this is an important concept for both government and taxpayer.

Depreciation in appraising - A decrease in the upper limit of value due to physical wear and tear, functional obsolescence, and/or economic obsolescence. A loss in value from all causes.

Depreciation in accounting - The amount of annual expense taken as a reduction of income necessary to recapture the cost of an asset. Does not represent actual losses in value.

Quite simply, a property tax appraiser's initial target is to estimate fair market value (FMV) each year as of a specific date according to jurisdictional rules.

"TMA can help your jurisdiction recover reportable costs that are likely not being listed in your jusridiction"

In the mass appraisal of machinery and equipment and other taxable business personal property, we typically rely on the cost approach. However the market approach and income approaches are certainly valid and should be considered. The correct method of using the cost approach in mass appraisal is to begin with original historical installed cost, convert it to replacement or reproduction cost new (RCN) as appropriate, and then calculate depreciation to estimate the loss in value. The most common method to arrive at RCN is trending. The most common method of estimating deprecation is the age/life method. Original historical installed cost is the original cost to the original owner.

All of these terms aren't terribly important to grasp right now. For the moment, let's focus on the differences.

An accountant's target, usually, is net book value (NBV) as of the end of the business' fiscal year. To arrive at NBV, the historical cost of an asset or group of assets is allocated over an assigned life. The historical cost might be the cost new (original historical cost to the original owner) if the entity is the original owner. Or historical cost might be the current cost to the current

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owner, either actual or allocated from a larger purchase price of a business. Accountants usually use the straight line method of depreciation and usually fully depreciate an asset, down to a target of zero. Each year's result is called net book value (NBV).

Statements of Financial Accounting Standards (SFAS) is a formal document issued by the Financial Accounting Standards Board (FASB), which details accounting standards and guidance on selected accounting policies set out by the FASB. These statements of financial accounting standards are issued, with the expectation that all reporting companies listed on American stock exchanges will adhere to them. The standards are created to ensure a higher level of corporate transparency. (Investopedia online definition.)

SFAS 141, which details the standards on the accounting treatment of business combinations, has led to an acceptance of using NBV as evidence of Fair Market Value. That might be okay for accounting, but it's certainly incorrect for appraisal. I guess I should clarify that it's certainly wrong for appraisal. It may be fine for accounting.

Let's add these ingredients together and see what we get:

1. Accountants typically fully depreciate assets, down to a NBV of zero.

2. The accountant's annual target and overall target is not fair market value.

3. There is an acceptance of NBV being evidence of fair market value.

4. When businesses merge or business A takes control of business B, the acquiring company might consider their new historical cost as being the previous company's net book value.

These ingredients make a mess for appraisers who rely on the taxpayer to submit original historical installed cost, or the original cost to the original owner. The main reason it's a mess is because the trend factors or index factors used to convert original historical cost to replacement cost new are developed using data very specific to the year of original acquisition – typically the year of manufacture. If an acquiring company books NBV as their historical cost, they will reflect acquisition dates corresponding with the business acquisition, not the year of original acquisition.

Look at this example:

Taxpayer A has a 500 KW Diesel Generator that cost $100,000 new. It is now 8 years old and is fully depreciated for accounting purposes with a net book value of zero. For property tax purposes it is at residual value of $25,000 and will remain at that value until it is disposed.

In the same county, Taxpayer B has an identical generator but purchased it this year as part of a business acquisition. The allocated cost could have been net book value of zero, which could have totally eliminated the value of the generator for property taxes, but taxpayer B used an allocation of the overall purchase price and recorded the generator as a current year acquisition at $15,000.

Unless the tax office is aware, through an audit or detailed review, the generator owned by Taxpayer B will be recorded as a new asset acquired at $15,000 and will be depreciated downward towards another residual value, eventually around $4,000. The identical generator owned by Taxpayer A will continue to be appraised at it's fair market value, $25,000. Duplicate this enough, throw some zero's in there, and a lot of property tax value is lost.

This is just one example of how not using original historical installed cost creates inequity. Although that original historical cost may not always be available, it certainly helps to have experts review the taxpayer's records to help determine the best course of action. TMA has those experts and can help your jurisdiction recover reportable costs that are likely not being listed in your jurisdiction.

APPRAISAL VALUE
Target is Fair Market Value
Estimates appreciation via RCN
Begins with original historical cost
Depreciation is loss in actual value
Asset in use would rarely have a zero market value
Original historical cost is a standard

ACCOUNTING VALUE
Target is Net Book Value
Ignores the concept of inflation
Begins with current historical cost
Depreciation is an allocation of historical cost
Zero value only means all cost was allocated
Historical cost may be previous owner's NBV, an allocated cost from a purchase of a larger group of assets or business acquisition, or a lease buyout price.

TMA Technology 101

Technology as Revenue Enhancement | *by Britt Hunter*

Technology can be daunting. As I write this now, there are undoubtedly thousands of new technology products being conceived and designed. In fact, it may not be long before the notions in this article become laughable, much the same way an old computer or a 1980s cell phone is laughable to us today.

The speed at which technology evolves can be intimidating even for the savviest of us, but eventually we adapt – sometimes because we have to, other times because we know the technology will make our lives easier and more efficient. This is why TMA always stays on the cutting edge of technology. Being on that edge ensures that we not only make our own business more efficient, but that we also enhance the tax offices we serve.

Technology is at the core of all of TMA's service offerings, from our Business Personal Property Audit and Discovery Programs, to our Homestead Exemption Audit and Online Listing Services. This is because, throughout the past 32 years, we've developed a deep understanding of how our clients use and need data.

The purpose of many of TMA's programs is to investigate, discover, and maximize sources of revenue for our clients. To do this, TMA needs to gather as much data as possible. For our Homestead Exemption Audit Program, this means collecting information to expose improperly claimed exemptions. As we announced in June, TMA's partnership with LexisNexis helps us do just that. In a nutshell, LexisNexis DAS (Data Analytics Supercomputer) contains billions of public records. From this public records database, LexisNexis is able to draw connections and show how businesses and individuals are related, which allows TMA to investigate and unearth nearly every exemption that is being mistakenly or fraudulently claimed, and ultimately return lost revenue to your jurisdiction.

> *"What makes TMA special is what we do with the data. Data is static. What brings it to life are people."*

Similarly, TMA's Discovery Program uses a combination of paid services and an in-house developed Internet search utility that scours the web to create a list of nearly every business within the jurisdiction. Together these resources help us determine the most comprehensive list of non-filing businesses within a jurisdiction – a list that 10-15 years ago would have been impossible to create without having an army of people physically canvassing businesses and painstakingly comparing a phone book to a jurisdiction tax roll.

If you have any questions or comments about this article, please contact Britt Hunter at 1-800-951-5350

Two of TMA's other technology products also offer this expediency to our clients. As you may know, TMA also offers a few software as a service (SaaS) products – TAXscribe and CAVS (Cost Analysis Valuation System).

TAXscribe is TMA's business personal property online listing system, first released in North Carolina. TMA took the concept of e-filing taxes and brought it to business personal property tax by allowing taxpayers to e-file and manage their business personal property listings for multiple counties in North Carolina. TMA understands that people are increasingly looking for ways to complete important tasks online. More importantly, TMA understands the huge benefit services like these bring to our clients. Products like TAXscribe save localities time from having to key in forms. Additionally, because taxpayers enter their information directly into the system, there is no chance of transcription errors on the part of the jurisdiction.

The CAVS service is another way TMA uses cutting edge technology to make a difference in our clients' lives. The CAVS system is an online tool that allows jurisdictions to create fair and defensible personal property estimates for those businesses that do not voluntarily file a business personal property form. TMA has compiled its knowledge from years of audits and research of cost data to create ready-made valuations for over 350 business types. These valuations contain the average cost new for each asset and are easily customizable. The best part is that in only takes a few minutes to generate these valuations that may bring in thousands or millions of taxable value into a jurisdiction.

However, it's not just technology and data that are important to TMA's programs. While TMA has the resources to gather large amounts of data, this is only one part of the picture. What makes TMA special is what we're able to do with the data. Data is static. What brings it to life are people. This is why TMA employs data management experts and data analysts who can examine the data to determine special cases and exceptions to the rule. It's our people who explain requirements, exhibit understanding, and calm the frustrated taxpayer. As of yet, these are skills computers and technology have not mastered.

Great technology is important, but TMA understands that technology is nothing without the human element to go along with it. We know technology can be daunting and that's why TMA ensures that behind all of our products, there are customer service representatives to help along the way. Please give us a call at 1 (800) 951-5350 and one of our representatives will be happy to offer you a tour or walkthrough of any of our services.

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