August 2005

The County Council and County Executive
of Prince George's County, Maryland

Re: Energy Tax Collections

INTRODUCTION AND SCOPE OF EXAMINATION

The Office of Audits and Investigations audited the financial records and reports submitted by energy companies that provide energy to the residents of Prince George's County to determine compliance with the energy tax reporting requirements, as set forth in Article 24 of the Annotated Code of Maryland.

Article 24 of the Annotated Code of Maryland authorizes the County to levy and collect energy taxes on the sale of electricity, natural gas, liquefied petroleum gas and fuel oil used or to be used in the County. Pursuant to Prince George's County Code, Section 10-205.01, the energy tax rates are established annually and collected quarterly, subject to the following exceptions: (1) fuels used by motor vehicles; and (2) fuels used in the production of other forms of energy that are subject to energy tax.

The sale of energy is deemed to have occurred at the time when evidence of sale is issued or employed by the energy vendor or company. The tax imposed under this section is a part of the actual charge for energy or fuel, however it is not considered operating revenue of the energy company. Every energy company making a sale, distribution or delivery of electricity, natural gas, liquefied petroleum gas or fuel oil to be used in the County is subject to the tax.

The energy tax is charged in terms of an amount per standard unit measurement, and is computed by multiplying the rate by the number of units of energy or fuel reflected on the energy or fuel bill. The tax rates to be applied are enacted by the Prince George's County Council for each fiscal year, by type of energy. The following are the enacted tax rates for fiscal years 2001 through 2003:

Fiscal Year	Electricity	Natural Gas	Fuel Oil	Propane
2001	0.0057380	0.0416100	0.0594330	0.0673220
2002	0.0056590	0.0465460	0.0746930	0.1058310
2003	0.0053050	0.0561750	0.0715650	0.0121882

Energy operators are required to remit the tax to the Treasury Division of the Office of Finance in quarterly installments for the periods ending September 30, December 31, March 31, and June 30. Taxes must be remitted within 30 days from the last day of the month in which the sale occurs. If an energy operator fails to remit the taxes due within the time prescribed for payment, interest of two thirds of a percent per month and a penalty of one percent per month are assessed until taxes are paid in full.

The County has collected an average of $45.6 million per year in energy taxes for fiscal years 2001 through 2003. Actual revenues collected in fiscal year 2001 were $44.2 million, and $43.3 million and $49.4 million, for fiscal years 2002 and 2003 respectively. It should be noted that all revenue from the energy taxes collected is earmarked for the Prince George's County Board of Education.

The objectives of the Energy Tax audit were to (1) determine that the correct rate of tax was being applied by energy operators; (2) ensure that the resultant collections were transmitted to the Treasury Division; and (3) verify that all bad debt expenses of the energy operators were accurate and that any subsequent bad debt recoveries were appropriately remitted to the Treasury Division. The scope of our review covered a thirty-six month period from July 2000 through June 2003. As of June 30, 2003, Prince George's had forty-seven (47) energy operators serving the needs of Prince George's County citizens. We reviewed the records of twenty-eight (28), or 60%, of these energy operators.

FINDINGS, COMMENTS, AND RECOMMENDATIONS

As part of our review we examined the vendor and delivery records of twenty-eight (28) of the forty-seven (47) energy operators. We reviewed the financial statements of the energy operators and compared them to the energy tax returns for the audited period. We verified information submitted to the Treasury Division with the records maintained by the energy operators. This included a verification of taxable energy units, energy tax rates, penalties and interest, bad debt write-offs, and any credits or adjustments. In cases where the financial statements and records of the energy operators were not automated, we examined delivery and sales tickets and other manual reports. Any and all exceptions were investigated and noted.

We determined that twenty-seven (27) of the twenty-eight (28) energy operators were in compliance with the energy tax reporting requirements. One energy operator, United Propane, was applying the incorrect tax factor, thereby under paying energy taxes for the quarters ending December 31, 2001, March 31, 2002, and March 31, 2003. The total amount of underpayment for the three quarters amounted to approximately $4,500. The tax was properly remitted to the Office of Finance's Treasury Division after notifying the energy operator of the deficiency.

During the course of business, bad debt is created as a result of non-collection of billings to consumers. The energy tax revenue associated with the uncollectible bad debt is recorded as a reduction on the energy tax return submitted to the Treasury Division. We reviewed material bad debt expenses reported on the energy tax returns for proper support for the deduction. We determined that there are no detailed records maintained by the energy operators to support subsequent bad debt collections.

Since bad debt is essentially revenue billed that was uncollected, if collection eventually occurs after the bad debt is written off, there is no process to submit the associated energy tax to the County's Treasury Division. If bad debts are claimed on the energy tax returns, a detailed write off should be available that supports the reduction in taxes due. This detail should include the client name, units sold, applicable taxes, and the uncollected total. If an eventual recovery is made, reconciliation data should be provided that clearly identifies the prior uncollected bad debt, and the corresponding collection. This process will help ensure that the energy tax associated with previously reported bad debts deducted on the energy tax returns and subsequently collected, are properly remitted to the Treasury Division. We therefore recommend:

1. **The Office of Finance's Treasury Division require energy operators to submit support for any bad debt deductions taken when submitting energy tax returns. Energy operators should also be required to immediately remit any energy tax related to bad debt reductions previously written off and subsequently collected and provide an adequate reconciliation.**

2. **The Office of Finance's Treasury Division reviews all energy tax returns for material bad debt deductions (materiality is subjective, but could be defined as those deductions that exceed 5% of total revenue). If bad debt expense deductions are material, an audit should be scheduled through the Office of Finance's Treasury Division or with the assistance of the Office of Audits and Investigations.**

3. **The Office of Finance's Treasury Division randomly audit energy operators for compliance with tax collection and remittance requirements. Particular attention should be given to those operators with material bad debt reductions.**

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