

**REVENUE BUREAU
LICENSE AND TAX DIVISION:**

Program makes significant progress
since last audit

A REPORT FROM THE CITY AUDITOR
November 2006



Office of the City Auditor
Portland, Oregon



CITY OF
PORTLAND, OREGON

OFFICE OF THE CITY AUDITOR
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November 28, 2006

TO: Tom Potter, Mayor
Sam Adams, Commissioner
Randy Leonard, Commissioner
Dan Saltzman, Commissioner
Erik Sten, Commissioner
Ken Rust, Interim Chief Administrative Officer, Office of Management & Finance
Sue Klobertanz, Director, Portland Revenue Bureau

SUBJECT: *Audit – Revenue Bureau License and Tax Division: Program makes significant progress since last audit, Report #337*

Attached is Report #337 containing the results of our follow-up audit of Portland's Revenue Bureau License and Tax Division. This audit was requested by the Director of the Revenue Bureau, and was included on our annual audit schedule. It was a follow-up to our audit (#305), which we published in April of 2004.

We make additional recommendations in this new report. A response from the Director of the Revenue Bureau is at the end of the report. As a follow-up to our new recommendations,, we ask the Director of the Revenue Bureau to provide a status report in one year, detailing steps taken to address the recommendations. This status report should be submitted to the Audit Services Division and coordinated through the Commissioner in Charge of the Revenue Bureau.

We appreciate the cooperation and assistance we received from personnel in the Revenue Bureau in conducting this audit.


GARY BLACKMER
City Auditor

Audit Team: Drummond Kahn
Ken Gavette
Sherry Wu

Attachment

REVENUE BUREAU

LICENSE AND TAX DIVISION:

Program makes significant progress since last audit

Summary Our April 2004 audit of the License and Tax Division found the Division (then the Bureau of Licenses) had established generally sound administrative practices to carry out the requirements of the City and County code, successfully addressed a series of new and complicated collection responsibilities, and implemented a new management information system. A large uncollected tax liability (“tax gap”) and a number of internal control weaknesses caused us to make several recommendations. Among these recommendations were to improve collection practices and identify non-complying businesses, to use automation to improve customer service, to improve internal controls over cash, checks and deposits, and to improve employee accountability and managerial communication.

This audit follow-up found that the Revenue Bureau has implemented most of the recommendations of our 2004 audit. Specifically, we found the Division has made significant strides in utilizing automated data resources to improve revenue collection practices, measure and monitor individual and organizational performance, enhance its internal auditing procedures, and make it easier for businesses to apply for licenses and pay fees. In addition, employee satisfaction on some key internal communication issues has improved.

However, we recommend the Bureau continue work on a Strategic Plan so the organization has clear direction, and that the Bureau continue its regular employee satisfaction surveys with an emphasis on involving employees in making organizational improvements.

Introduction

The City of Portland’s License and Tax Division (now a part of the Revenue Bureau) provides revenue collection and regulatory oversight for the City of Portland and Multnomah County. The taxes collected on behalf of the City constitute 14 percent of the City’s annual General Fund revenue. A series of significant declines in the amount collected prompted the original audit of collection practices. We made several recommendations intended to improve taxpayer compliance and revenue collection, strengthen internal controls, and improve employee job satisfaction. The recommendations are listed in the table on page 3.

The Director of the newly formed Revenue Bureau requested we conduct a follow-up review addressing the same issues as the 2004 audit.

Audit scope, objectives and methodology

The primary objective of this report was to determine the extent to which the License and Tax Division of the Revenue Bureau implemented the recommendations of our 2004 audit.

In order to determine the extent to which recommendations were implemented, we interviewed numerous Bureau staff both in senior management positions and among the staff. We collected and reviewed policies and procedures adopted by the Division in response to the audit. We also reviewed electronic documents to verify separation of duties concerning certain financial transactions. In addition, we conducted an evening desk audit in the Operations section to determine if checks, cash, or confidential information were left unsecured.

We conducted our work in accordance with generally accepted government auditing standards.

Audit Results

Our review of the implementation of prior recommendations found the following:

	Recommendation	Mgmt agreed	Status
1	Expand/ improve revenue collection practices	yes	implemented
2	Strengthen audit program	yes	in-process
3	Increase tax return documentation requirements	yes	implemented
4	Increase automated monitoring tools	yes	implemented
5	Measure and monitor collection performance	yes	implemented
6	Implement additional controls over revenue processing	*	implemented
7	Develop written policies and better documentation for settlements	yes	implemented
8	Improve bureau-wide control environment	*	implemented
9	Improve informal and formal communication with staff	yes	implemented

* Not specifically addressed in the Management's printed response letter. See Report # 305 "Responses to the Audit".

**Recommendations
1 and 4**

(1) Expand and improve revenue collection practices, and (4) Increase the use of automated monitoring tools. (These two are related enough in practice that we will combine them for discussion purposes. That is, increased use of automation has supported collection practice improvements.)

The main purpose of these two recommendations was primarily to improve the efficiency and effectiveness of collection practices by standardizing the work flow of the collection staff, making reports easier for the collection staff to use, and increasing the use of the BLIS system to flag non-complying businesses and other compliance

issues. We also recommended more use of the automated features of BLIS to generate useful information and to help collection personnel successfully resolve delinquent accounts.

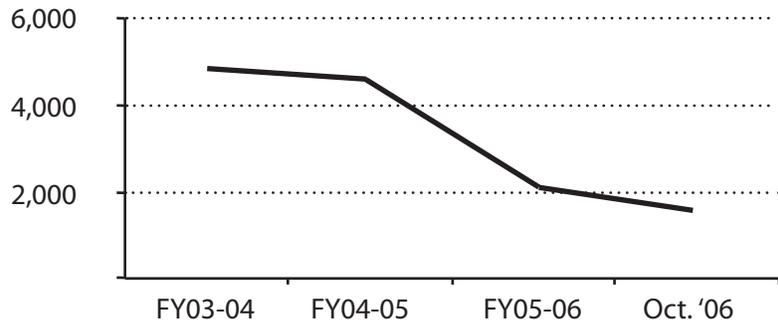
Status: Implemented

In response to recommendations, the entire collections process has been organized into a "Collections Pipeline" that details a highly structured system for identifying non-complying businesses and obtaining payments. Notably, the process includes a presumptive billing element that assigns an amount due, and an automatic legal notice when a bill is more than 150 days past due. Among the major improvements are:

1. The creation of an Unlicensed Compliance Team (UCT) in 2004. The UCT has a staff of two persons whose main job is to identify businesses that do not have required business licenses. UCT staff use various methods to identify unlicensed businesses including automated data matching of state department of revenue records, and fire bureau inspection records. They also review trade journals, newspapers, telephone listings and internet sources to identify businesses. In addition, they use information gathered from the annual "tax gap" survey (see recommendation #5) and from on-line citizen reports and city vendor lists. Businesses identified by the UCT are put into the "collection pipeline". According to the Division, the estimated number of unlicensed businesses has steadily declined since 2004 (see Figure 1). As of October 2006, the Division estimated there were about 1,571 unlicensed businesses. By May 2006, identified non-complying businesses had paid about \$1.9 million in owed fees (\$1.3 million to the City and \$600,000 to the County).
2. Major collections staff reports have been consolidated into a single weekly "collection call list" of businesses for field staff to contact. The list contains important information such as business name, phone number, days past due, remaining balance, and number of attempts to reach. Each week the collections staff receive these reports and are expected to make a number of contacts.

3. City staff can use a web-based system to look up businesses to verify compliance. The Division reports that as of May 22, 2006, 708 vendors were reported through the system resulting in almost \$900,000 of additional taxes collected to date. Residents and businesses also have access to this on-line information.
4. Collection notices are now generated automatically by BLIS.
5. The process now includes participation by the City Attorney's Office for final collection. Legal notices are automatically generated and sent to delinquent businesses.

Figure 1 Unlicensed Businesses



Source: As reported by Revenue Bureau

**Recommendation 2:
Strengthen the
auditing program**

Specifically, we suggested developing a more systematic approach to audit selection that would include methods to identify consistent patterns of compliance problems.

Status: In-process

The Audit Manager has developed a comprehensive approach to identifying audit candidates. It incorporates a system of auditing totally random accounts as well as those meeting certain risk-based criteria. Examples of risk-based criteria include auditing all businesses with the top 300 largest tax liabilities, and also those who in the past reported certain types of income but no longer do. We believe these

methods will enable auditors to maximize their efforts to identify businesses with large potential recoveries and to identify consistent problems with compliance that might be solved by improving instructions or amending rules.

We consider this to be in-process because Division auditors have not completed an audit cycle using these techniques. We feel it is important to include these practices as a part of office policies and procedures so they are assured to be followed in future years despite new staff or management. Shortly following the end of our fieldwork this policy was adopted by the Bureau.

**Recommendation 3:
Increase tax return
documentation**

We found that auditing could be done faster on sole proprietor returns if filers were required to submit their federal returns as attachments to their regular city license tax forms. It was also a federal “good practice” to make returns as simple and easy to complete as possible for filers.

Status: Implemented

In response to this recommendation, the Division now requires sole proprietors to attach copies of their federal return to their annual license tax form.

In addition, to make filing easier, the Division now has an on-line tax filing system.

**Recommendation 5:
Measure and monitor
collection performance**

Specifically, we suggested that developing a consistent approach to estimating the “tax gap” would enable the Bureau to assess its collection success over time.

Status: Implemented

The Division calculates the “tax gap” by adding an amount assumed due from unlicensed business (i.e., the estimated number of unlicensed businesses times the average dollar value due from all businesses), plus the known accounts receivable, plus the amount

assumed due from non-filers (i.e., the number of non-filers times the average dollar value due from all businesses).

Perhaps the most difficult part of this estimate is determining the number of unlicensed businesses. The Division has developed a two pronged method of determining this element. While the UCT constantly searches for unlicensed businesses, an annual field survey method has been developed to randomly sample geographic areas, identify unlicensed businesses, and apply that unlicensed rate city-wide.

The Division is in the process of verifying results from prior surveys and adjusting the methodology.

In addition, the "tax gap" calculation is reported annually in the City budget.

**Recommendation 6:
Initiate additional
controls over revenue
processing**

Specifically, we recommended a separation of duties between account entry information and processing of the Treasury deposits, tighter controls over receipt books (including staff initials on receipts, and legible entries), and physical security (locking drawers) for confidential returns.

Status: Implemented

Managers and staff we interviewed told us that staff who enter account information into the BLIS system do not prepare Treasury deposits. We reviewed several days of electronic sign-offs to verify the separation of duties. In addition, we were assured that individuals who cashier do not reconcile their own cash drawers, that an individual who prepares a bank deposit slip does not make the deposit, and that two staff members carry the deposit to the bank each day. These procedures have been adopted into office policies and procedures. In addition, the main office floor is secured through a set of locking doors, and is under video surveillance. Bureau employees with access to the floor must sign confidentiality oaths.

However, an area we feel needs more attention is the physical security of confidential license (return) information and payment checks. We performed an after-hours desk review in the Operations section of the Division and found that most desks had both personal checks and confidential tax information laying out in plain view and unsecured. While we understand it is not always possible to fully secure areas where work is constantly underway, the Bureau should continue to look for ways to improve security of open cubicle areas.

Most areas have access to locking drawers that could possibly be used to secure sensitive information.

**Recommendation 7:
Develop written
policies and better
documentation of
settlements**

Specifically we recommended the Division develop clearly written policies concerning the criteria for granting settlements and the authority for granting the settlements.

Status: Implemented

The Division has substantially improved requirements for settlements through an update of the old policy. The new policy clarifies under which circumstances settlements are allowable and who is authorized to grant them.

**Recommendation 8:
Improve Bureau-wide
control environment**

Specifically, we recommended that clear goals and objectives be defined for the organization, that individual performance expectations be clearly communicated, that individual performance evaluations be done, and that confidentiality oaths be retained on file.

Status: Implemented

The Division is in the process of crafting a strategic plan. It is on hold as the Bureau of Licenses has been absorbed by the larger, and newly formed, Revenue Bureau.

Individual work expectations for the collections staff are now well defined. Clear targets and collections goals are communicated to staff on a regular basis.

The Revenue Bureau has updated policies and procedures regarding the confidentiality of sensitive information. Employees are required to review and agree to these policies.

**Recommendation 9:
Establish more frequent
opportunities to
communicate formally
and informally with staff**

Specifically, we recommended that management improve the communication of performance expectations, and be more visible to the staff.

Status: Implemented

The recommendation to improve employee/management communications was based primarily on an employee satisfaction survey we administered and on staff interviews. We found significant dissatisfaction with the organization as a “learning environment”. Employees felt that management was not doing a good job of listening to and acting on their concerns. They did not feel that managers were attuned to their everyday problems. We also believed a key aspect was to improve the communication of performance expectations.

Recent management efforts include strategic planning sessions with participation from the labor-management committee, work with the DCTU on developing an annual performance evaluation system, and the institution of weekly performance reports for collection staff.

These efforts may be yielding results. A recent employee satisfaction survey conducted by the Revenue Bureau found that scores on all questions concerning the organization as a “learning environment” have improved since our 2004 audit. Scores improved significantly on statements such as, “My supervisors actively solicit and use our suggestions for improving things at work”, and “Management is attuned to, and knows what is happening with day-to-day operations”.

Management informed us they intend to regularly administer the employee survey and to involve employees in using the results to improve the organization.

Recommendations

The License and Tax Program has clearly made great progress in implementing the recommendations from our previous audit. Based on our current work, and to enhance the progress already made, we suggest management consider the following recommendations:

1. The Bureau continue to look for improved methods for securing individual work cubicles to ensure that sensitive information such as personal banking information and business account information is as closely guarded as possible.
2. Adoption of the Strategic Plan as soon as practical given the Division's inclusion in a larger Revenue Bureau.
3. Continued regular employee satisfaction surveys with results reported to employees. Data analysis should include a break-out by work group when possible. Management may wish to establish a cross-functional team to review the results and develop action steps.

RESPONSE TO THE AUDIT



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November 16, 2006

TO: Gary Blackmer, City Auditor
FROM: Sue Klobertanz, Director *Sue Klobertanz*
SUBJECT: Response to Revenue Bureau License & Tax Division Audit (Report #337)

Thank you for the opportunity to comment on your follow-up audit of the Revenue Bureau's License & Tax Division.

The Bureau appreciates the auditor's recognition that significant improvements have occurred since 2004. As you are aware, an important result of our new collections process has been a significant increase in general fund revenues for both the City of Portland and Multnomah County. *Additional City-only collections resulting from system improvements total over \$9.8 million since July 2004.* Additionally, the tax gap and the number of unlicensed businesses have markedly decreased since your audit as a result of our improvement efforts.

Responses to your recommendations follow.

Recommendation 1 – Security

Security is extremely important both to the Bureau and to our customers to ensure that their financial information and payments are protected. Access to the Division is restricted by security guards, after hour elevator lock-down, card key access and video surveillance. We will continue to look for improved methods for securing sensitive information within the office. However, we believe that there needs to be an appropriate balance between security and the individual work needs of our employees at their workstations. While we will continue to encourage that documents be locked away at individual workstations, due to our other security measures, management believes the security risk is low if documents are left out where other employees can easily access them when necessary.

Recommendation 2 – Strategic Plan

The Bureau agrees that the adoption of a Strategic Plan is an important and needed step, not only for the License & Tax Division, but also for the Revenue Bureau as a whole. The Division had a final draft Strategic Plan ready but put the effort on hold after the formation of the Revenue Bureau. Management intends to work on this plan over the next 12-18 months as the Revenue Bureau moves from its implementation phase to ongoing operations.

Recommendation 3 – Employee Satisfaction Surveys

Bureau management also agrees with your recommendation to continue regular employee satisfaction surveys and report the results to employees. As the Revenue Bureau works to establish itself as an innovator in quality customer service and e-commerce capabilities, we believe it is critical that we continue to provide our employees with a work environment where they are valued. Conducting the employee satisfaction survey on an annual basis will help us measure our success and identify areas for continued improvement.

The Revenue Bureau's goals are to provide quality customer service, effective revenue collections and e-commerce convenience. We appreciate your independent assessment of our progress in these areas.

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Revenue Bureau License and Tax Division: Program makes significant progress since last audit

Report #337, November 2006

Audit Team Members: Ken Gavette
Sherry Wu

This report is intended to promote the best possible management of public resources. This and other audit reports produced by the Audit Services Division are available for viewing on the web at: www.portlandonline.com/auditor/auditservices. Printed copies can be obtained by contacting the Audit Services Division.

Gary Blackmer, City Auditor
Drummond Kahn, Director of Audit Services

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Street Paving: Current contract management practices put asphalt price and supply at risk (324C, September 2006)

