

Bureau of Licenses

Opportunities to Improve Revenue Collection and Strengthen Internal Controls

April 2004



Office of the City Auditor
Portland, Oregon



CITY OF
PORTLAND, OREGON

OFFICE OF THE CITY AUDITOR
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TO: Vera Katz, Mayor
Jim Francesconi, Commissioner
Randy Leonard, Commissioner
Dan Saltzman, Commissioner
Erik Sten, Commissioner
Thomas Lannom, Interim Director, Bureau of Licenses

SUBJECT: Audit of the Bureau of Licenses, Report #305

Attached is Report #305, an audit of the Bureau of Licenses. The study was included in our annual Audit Schedule published in August of 2003.

As a follow-up to our recommendations, we ask that the Bureau of Licenses Director provide a status report in one year, detailing steps taken to address the report's recommendations. This status report should be submitted to the Audit Services Division and coordinated through the Commissioner's Office.

We appreciate the cooperation and assistance we received from staff in the Bureau of Licenses and the Commissioner's Office in conducting and preparing the report.



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City Auditor

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Bureau of Licenses

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A Report by the Audit Services Division
Report #305



Office of the City Auditor
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Summary

Business license fees and income taxes are important sources of revenue for the City of Portland and Multnomah County. City license fee revenue is budgeted at \$40 million in FY 2003-04, 11 percent of the City's General Fund, and County income tax revenue is budgeted at \$25 million, 6 percent of the County's General Fund. Effective management of the revenue collection effort is critical to ensure stable revenues are available to pay for police, fire, parks, and other public services. To evaluate the performance of this effort, we conducted a performance audit of the City Bureau of Licenses that is responsible for administering the City and County business license laws.

We found that the Bureau has established generally sound administrative practices to carry out the requirements of the City and County codes, successfully addressed a series of new tax collection responsibilities, and implemented a major new management information system. However, a number of improvements can be made to increase fee collection, strengthen internal controls, and improve employee work satisfaction. Specifically,

- changes in methods and increased efforts for collecting accounts receivable, identifying unlicensed businesses, and improving filing

compliance could produce an estimated \$1.9 million in additional City revenue and \$1.2 million for the County

- improved physical security, a stricter adherence to separation of duties, and better written procedures and supporting documentation could reduce the risk of inappropriate handling of revenues
- clearer strategic direction and enhanced performance measurement and evaluation could improve accountability, management/employee communication, and achievement of organizational objectives

In addition, our review of Bureau procedures for waiving penalties and settling fee disputes indicates that controls are in place and working as intended but written policy and more documentation would provide better support for decisions. With assistance from outside legal counsel, our analysis of one large settlement indicates that the Bureau made a reasonable decision on the legal merits of the case and we found no inappropriate actions that might violate responsibilities delegated to the Bureau by the City Code.

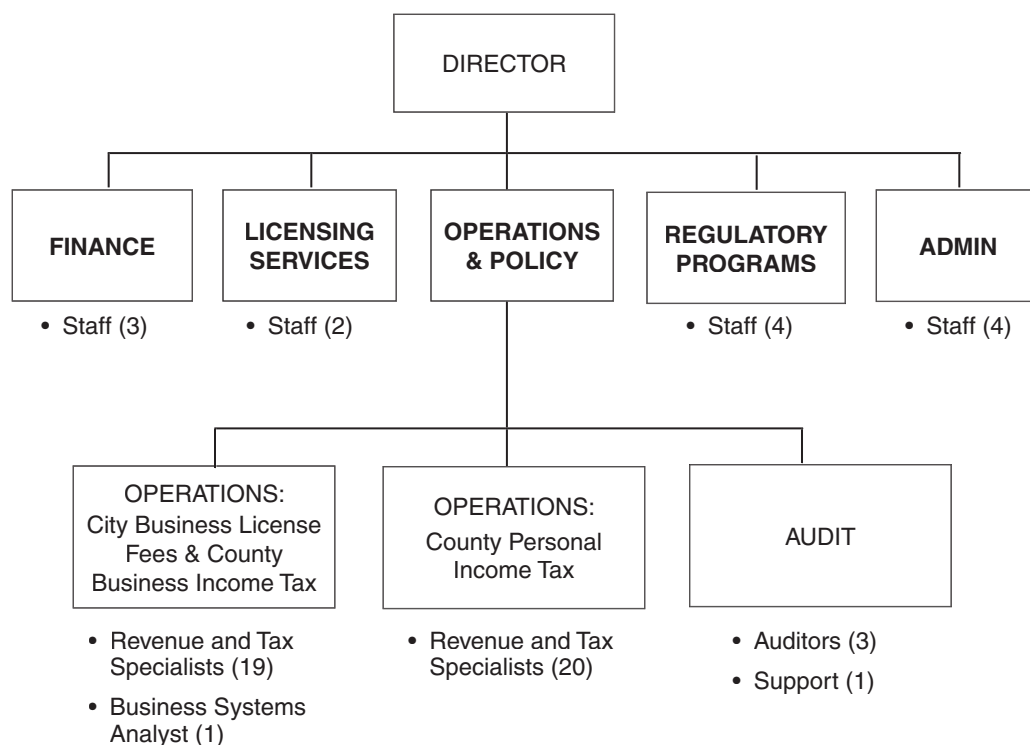
We make a number of recommendations to improve the administration of the business license function conducted by the Bureau in Chapter 5 of this report. The Bureau has already taken action to implement several of these recommendations.

Chapter 1 Introduction

This audit covers our review of the management and operations of the Bureau of Licenses. The audit was approved by the City Auditor and placed on our audit schedule for FY 2003-04. We conducted this audit in accordance with generally accepted government auditing standards and limited our review to those areas specified in the Audit Scope and Methodology section of this report.

Background The primary function of the Bureau of Licenses is to administer fee and tax laws on behalf of the City of Portland, Multnomah County, and various other agencies. County business income taxes, which represent about a third of the revenue collected by the Bureau, are collected through an intergovernmental agreement. Recently the Bureau also began collecting the Multnomah County Personal Income Tax. In addition to collecting business license fees and County income taxes, the Bureau collects a Transient Lodging tax on behalf of Multnomah County, the City, and the Portland Oregon Visitor's Association. The Bureau also licenses and collects fees on various activities such as taxi cabs, pay and park lots, and second-hand dealers. Figure 1 illustrates the Bureau's organization and staffing.

Figure 1 Bureau of Licenses organization chart



SOURCE: Bureau of Licenses internal documents

For purposes of this report, we will refer to the City business license fee and the Multnomah County business income tax collectively as a tax unless otherwise noted.

The Bureau is responsible for collecting taxes in accordance with local ordinances and Bureau administrative rules. The Bureau is also responsible for enforcement of tax and fee laws through the imposition of financial penalties. Implementing this system requires a staff with specialized training, including accountants, collections specialists, and business system analysts.

The activity is critical to the City's financial condition. As shown in Figure 2, the combined revenue from business licenses and lodging taxes in FY 2003-04 represents the third largest revenue source for the City's General Fund, after property taxes and utility franchise fees.

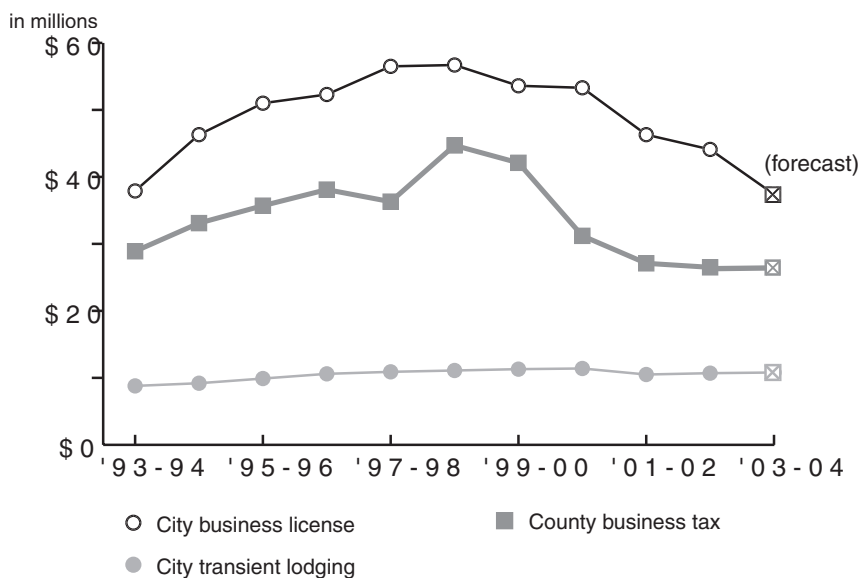
Figure 2 City of Portland General Fund revenue sources

REVENUE SOURCE	FY 2003-04	Percent
Property taxes	\$151,594,887	41%
Utility license fees	\$57,235,993	15%
Fund transfers	\$47,085,068	13%
Business licenses	\$40,664,039	11%
Lodging taxes	\$10,978,701	3%
Intergovernmental	\$27,497,212	7%
Service charges	\$ 21,473,186	6%
Beginning fund balance	\$13,749,115	4%
TOTAL General Fund budget	\$ 370,278,201	100%

SOURCE: City Of Portland FY 2003-04 Adopted Budget

As shown in Figure 3, although City business license and County income tax revenues are higher than 10 years ago, they have declined significantly over the past five years. A further decline in City license fees is forecast for FY 2003-04. Figure 3 also reflects the impact of temporary tax measures. Multnomah County's 1998 temporary tax increase to support local schools is no longer in effect and accounts for a portion of the decline since that time.

Figure 3 City Business License, County Business Income Tax and Transient Lodging revenue (adjusted for inflation)



SOURCE: City of Portland and Multnomah County CAFRs; forecasts from the City of Portland Office of Management & Finance and Multnomah County Budget Office

Business license requirements and collections practices

The City of Portland began requiring business licenses in 1854. Revenues from the fees are discretionary revenues for the General Fund. The General Fund supports activities such as police, fire, parks and general government. All businesses operating in Portland are required to obtain a license or an exemption. Exemptions from the annual fee are granted for businesses that gross less than \$25,000 per year, real estate and insurance agents that are regulated by the State, and individuals whose only business activity is the ownership of less than 10 residential units.

The City of Portland business license fee is 2.2 percent of net business income, with a minimum payment of \$100.

In addition, a temporary surcharge was added beginning in tax year 2002 and was dedicated to funding public schools. Multnomah County's business tax is 1.45 percent of net business income. In both cases, the tax is calculated based on the proportion of total income that is generated in Portland and Multnomah County. Income generated from activity outside the City or County is not subject to the tax. Also, businesses that are located outside the City and County but who generate income inside the City or County are subject to taxes on that income. Determining the percent of income earned within versus outside these areas is called apportionment.

Businesses are required to annually submit tax information on the prior year's business activity on a Combined Report form. It is referred to as a Combined Report because it requires information and calculations for both City and County taxes. The report asks for information concerning net income, potential deductions from income, and the amount of income generated from business inside Portland and Multnomah County.

There are five different types of Combined Report forms, each for a different class of business. Rules and required documentation are slightly different for each major class of business. Businesses are divided into sole proprietorships, corporations, S corporations, partnerships, and estates and trusts. Sole proprietor is the largest single category of business type.

The Business License Information System (BLIS) was implemented in 1998 to help track and monitor payments and collections. Each Combined Report is entered directly

into the BLIS system and a separate column automatically calculates what is owed, while retaining the initial information as reported on the return. At the same time, supporting documentation may be checked for agreement with the Combined Report. The person doing the data entry also performs a cursory review of items to determine reasonableness of apportionment, shareholder compensation, and deductions for prepayments or for net operating losses.

Payments that are received with reports are recorded in BLIS, totaled, reconciled, and forwarded to the Bureau's Finance section. The payments are again reconciled to what was entered into the BLIS system and checks and/or cash are forwarded each day to the City Treasurer's Office.

The Bureau experiences two main busy periods: one is from March 15 to June 1, when April filings are due and one is from September 1 to November 1, when filing extensions are due. We were told by staff that during these periods, Revenue and Tax Specialists spend about 100 percent of their time entering return data into BLIS.

Business types and reported liabilities

According to Bureau records there were over 33,000 returns filed in Tax Year 2002 for City and County businesses as of January 2004. By far the largest type of business that filed was Sole Proprietor, accounting for 43 percent of the total. However, sole proprietorships only make up 11 percent of the total assessed taxes. Corporations make up the largest share of assessed taxes at 38 percent of the total.

Figure 4 Tax Year 2002 returns by business type
(as of January 2004)

BUSINESS TYPE	Number	TAXES (in millions)			Average return
		City	County	TOTAL	
Sole Proprietor	14,416 (43%)	\$ 5.6	\$ 2.7	\$ 8.3 (11%)	\$574
S Corporation	8,160 (25%)	\$12.1	\$ 6.3	\$18.4 (25%)	\$2,250
Corporation	5,856 (18%)	\$18.4	\$ 9.2	\$27.5 (38%)	\$4,690
Partnership	4,514 (14%)	\$12.0	\$ 6.3	\$18.3 (25%)	\$4,065
Estate & Trust	164 (<1%)	\$ 0.2	\$ 0.1	\$ 0.3 (<1%)	\$1,881
TOTAL	33,110	\$48.2	\$24.5	\$72.9	\$2,197

Note: Fee rows and columns may not add due to rounding

SOURCE: Audit Services Division analysis of data supplied by Bureau of Licenses

In addition, our analysis shows that a relatively small number of businesses account for a large majority of fees. About one percent of the businesses that filed in 2002 paid 50 percent of the revenues.

Bureau faces challenges

The Bureau is facing several challenges which have a significant operational impact on the Bureau and on the overall City budget.

Slowing business license revenue collection

As previously shown in Figure 3, business license revenue is down 22 percent over the last five years. Economists from the Office of Management and Finance prepared an analysis of current revenue collection compared to collections activity during the early 1980s recession and found that the current slowdown in revenue collections is similar to the decline experienced during the 1980s. They con-

cluded that the recent decline in revenues is likely due to economic recession.

Labor-management relations

The Bureau has experienced a number of labor issues in the current fiscal year. During our initial interviews collections personnel expressed dissatisfaction with work assignments, unfair management decisions and favoritism, and poor management communication of strategic direction. Employees have filed eight grievances with the City's Bureau of Human Resources in FY 2003-04 compared to none in the prior two year period.

New tax collection responsibilities

The Bureau is administering and collecting the new Multnomah County Personal Income Tax approved by voters in May 2003. In addition to \$1.1 million in start-up costs, the Bureau will charge the County for the cost of administration through an intergovernmental agreement not to exceed \$3.5 million annually. To administer this new responsibility the Bureau is upgrading its computer systems. In addition, it is hiring approximately 20 permanent and temporary staff, including a supervisor, to oversee operations. The Bureau has also been relocated to a larger space in order to accommodate the additional staff and equipment. Although the tax is a temporary three year tax, the Bureau believes it will benefit from administering its collection.

City Council also passed a temporary business license fee surcharge effective April 2003, to provide bridge funding for local schools for four years. Implementation of this

surcharge, which was retroactive to the Tax Year 2002, required the Bureau to send out thousands of billing notices to businesses that had already submitted 2002 Combined Report forms. In addition, staff fielded the resulting phone calls and entered thousands of adjusted payments.

Organizational initiatives to address these challenges

The Bureau of Licenses has undertaken a number of organizational initiatives to address the many challenges it faces.

BLIS

The Business License Information System (BLIS), implemented over a three-year period from 1995 to 1998, improved the information technology capabilities of the Bureau. BLIS is used to record and track tax information, produce various tax reports, issue collection correspondence, and process payments. Revenue and Tax Specialists (RTS) use BLIS to review businesses in their assigned areas and spot delinquent accounts. Other reports list correspondence that has been sent to businesses. RTSs can use this information to call upon delinquent businesses for fee collection.

Strategic planning

Over the years the Bureau has undertaken a number of organizational initiatives. The Bureau has recently worked on a strategic planning effort that identified main Bureau responsibilities and suggested an alignment of functions to meet those responsibilities. The Bureau has not been able to work on this effort consistently due to routine demands of data entry and the addition of new responsibilities such as

the business license surcharge and the Multnomah County Personal Income Tax.

Job reclassification

In September 2003 the City Council passed an ordinance creating a new job classification – Revenue and Tax Specialist. Staff indicated that over the course of years, and especially since the introduction of the BLIS data system, job task differences among classifications in the Bureau of Licenses became increasingly blurred. Code Specialists increasingly performed data entry work and Office Support Specialists were called upon to review tax return documents and to make more complex decisions. According to managers, these changes in job responsibilities led to dissatisfaction among staff, and confusion about roles and responsibilities. The new classification of Revenue and Taxation Specialist I through V merges the two former classifications into one and provides a job ladder for those taking on increasing responsibilities.

Other initiatives pursued by Bureau

In addition to the major initiatives discussed above, the Bureau has also worked on the following projects:

- Marketing tax collection services to other agencies in order to become self-supporting.
- Improving efficiency through automation including web-based, electronic payment.
- Functional realignment to make the organization more responsive to work demands.
- Improving revenue collection through increased emphasis on collections.

**Audit methodology,
scope, and objectives**

Our audit focused on the management and administration of the City's business license fee and County's business income tax. We evaluated the performance of revenue collection efforts, assessed internal controls over revenue collection and recording processes, and surveyed job satisfaction of employees performing these activities. We did not audit other responsibilities of the Bureau, including administration of transient lodging taxes, regulation of taxis, second-hand dealers, and pay-and-park lots.

We conducted initial work in September and October of 2003, during the planning for implementing collection of the Multnomah County Personal Income Tax. We determined that planning for the new program appeared adequate and additional audit work was not warranted.

The objectives and methodology of our audit work were:

1. To assess the capability of the Bureau to increase business license revenue collection. To accomplish this objective we conducted interviews with collections staff and managers to determine the amount of effort that is devoted to tasks within the Bureau and the impact upon the collection process. We also assessed the completeness of the BLIS data system by estimating the number and value of businesses that may be operating without a business license or paying the required fees. We developed a methodology to estimate the amount of taxes owed, but not paid to the City and County – the “tax gap”.

2. To assess the adequacy of internal controls within the Bureau. To accomplish this objective we identified two major license processes which require well-

developed internal control procedures: revenue payment processing and settlements and waivers. We conducted interviews and observations to gain familiarity with the way the processes are carried out and documented the processes. We conducted tests of various internal control systems to assess the degree to which these systems are working as intended. In order to assess the appropriateness of one very large settlement, we retained the services of outside legal counsel. In addition, we reviewed Bureau-wide control environment issues such as strategic planning efforts and performance measurement and evaluation. We assessed the state of each of the processes using the COSO internal control framework.

3. To assess employee job satisfaction and offer suggestions for improvement. To accomplish this objective we conducted an employee job satisfaction survey. The survey focused on supervision, teamwork, recognition, and job responsibilities. We subsequently held a focus group with employees to gain clarification on certain issues and determine what action steps the Bureau could take to correct problems identified in the job satisfaction survey.

Chapter 2 Increasing Taxpayer Compliance and Tax Collection

The Bureau of Licenses could improve taxpayer compliance and increase tax collection. Although the Bureau has a number of revenue collection processes and tools in place, better collection and audit efforts could result in additional revenue for the City and County. We estimate that improvements in Bureau of Licenses methods and efforts could result in additional revenues to the City of about \$1.9 million and \$1.2 million to the County.

Maximizing tax collection is critical

A fundamental measure of the effectiveness of a tax administration organization is the degree to which taxpayers fully pay what they owe. The “tax gap” is the difference between the revenue that is remitted and that which would be remitted if all the tax laws were adhered to. It is the difference between taxes owed and taxes voluntarily paid, and is a measure of taxpayer compliance.

Closing this gap is important, not just from a revenue producing point of view but as a means of promoting fairness within the taxing system. When some taxpayers do not pay owed taxes an additional burden is placed on taxpayers who fully comply. Taxpayers are more likely

to voluntarily pay what is owed when they believe that everyone is paying their fair share.

According to tax experts, it is unrealistic to expect 100 percent compliance with tax laws, thereby eliminating the tax gap. Full compliance may never be achieved because of unintentional misapplication of tax law, inability to pay the taxes due, intentional fraud, or willful non-compliance by those who do not file. The General Accounting Office, working together with the Internal Revenue Service has identified a set of common principles that can improve the success of taxing agencies. These principles include collecting and using good management information, requiring more complete documentation from payers, increasing audit efforts, and focusing efforts on the most important compliance problems. Figure 5 lists these principles and identifies opportunities for Bureau of Licenses improvements.

Figure 5

COMMON PRINCIPLES FOR TAXING AGENCIES	
PRINCIPLE	POTENTIAL IMPROVEMENTS FOR BoL
1. Good information is critical to identifying compliance problems A taxing organization must systematically estimate the extent of noncompliance and establish a reliable and relevant system of management information.	• Monitor and track collection and compliance performance • Establish performance systems and standards for collection • Update collection policies and procedures
2. Focus on compliance efforts where they will do the most good Efforts should be directed toward identifying the largest compliance problems.	• Upgrade efforts to find unlicensed businesses • Improve audit program to identify patterns of noncompliance, and support enforcement • Use of BLIS to automate exception flags
3. Deal with compliance problems quickly The longer it takes to reach a taxpayer, the less success in correcting the compliance problem.	• Prioritize delinquent accounts for collection • Improve management reports • Increase presence and visibility of staff in the field
4. More visible tax information promotes higher compliance Documentation for items such as income and deductions makes errors less likely and easier to spot. Good records and documentation increases compliance and leads to better results when a return is audited.	• Require more documentation for some filers
5. Collect from as few sources as possible Collecting from single rather than multiple sources is more efficient and effective.	• Continue policy of collecting payments from central offices of businesses with multiple locations, combine whenever possible
6. The simpler the rules, the better The simpler the tax code, the more certain the results in applying it.	• Periodically review City Code and administrative rules for simplification

SOURCES: *Reducing the Tax Gap: Results of a GAO-Sponsored Symposium*. General Accounting Office, June 1995; *Taxpayer Compliance: Analyzing the Nature of the Income Tax Gap*. General Accounting Office, January 1997; Audit Service Division analysis.

Additional fee collection is possible

Our estimation of the “tax gap” and review of current Bureau practices demonstrate that revenue collection and compliance efforts can be improved. We identified the following three components of the tax gap and analyzed the Bureau performance in each area:

- 1) Unlicensed businesses – These businesses have not applied for a license.
- 2) Accounts receivable – These businesses have submitted returns but owe additional fees due to errors or omissions.
- 3) Non-filing businesses – These businesses have applied for licenses and filed returns in the past but did not file subsequently. These businesses may or may not be operating or owe money.

Unlicensed businesses represent significant uncollected revenue

To identify the potential for unlicensed business, we conducted a field review in February 2004 of businesses operating in the Broadway and Weidler area of Northeast Portland. Using a master list of businesses produced by the BLIS system, we canvassed 48 blocks on the two streets to identify errors in the business list. The BLIS master list had the names and addresses of 438 businesses in the area. We identified an additional 45 (10 percent) businesses that were not listed on the master list and appear to need a license.

Based on this analysis we estimate the percent of businesses without a license to be about 10 percent out of a total of 48,000 business accounts listed in the BLIS database. If we assumed that these were sole proprietorships, averaging about \$575 per return, this represents about \$2,800,000 in uncollected revenue for the City and County.

In a prior audit conducted in 1985, we suggested that the Bureau and City take steps to ensure that contractors doing business with the City have licenses. Although we did not perform new tests of contractor compliance, recent interviews with City staff found that the City Auditor's Office, the City Attorney, and the Bureau of Licenses have implemented procedures to provide this assurance. Contractors and other vendors cannot be awarded City contracts without providing a valid, current business license.

The 1985 audit also recognized that many of the efforts to identify unlicensed businesses such as field reviews of street activity and reviews of yellow pages and trade documents were adequate. However, according to Bureau staff, many of these efforts have been reduced. Although no Bureau time records were kept prior to, or during our audit work, our interviews indicate that staff have not regularly conducted field reviews. Staff members complained that they spend too much time entering data into the BLIS system and too little identifying unlicensed businesses and collecting delinquent accounts.

Receivables not collected in a timely manner

As of March 2004, the Bureau reported about \$2.4 million in business license accounts receivable for the City and County combined. These receivables represent 2,927 businesses that were billed in past years by the Bureau but have not submitted payment. While most of the accounts are delinquent for one year, over 580 accounts are delinquent in multiple years. The Bureau initiated an effort to notify 2,508 of these businesses who are most likely to pay. Other businesses will not be currently notified due to various reasons, including if the business is in bankruptcy or the fee is being appealed.

Figure 6 Accounts receivable as of March 2004
(City and County combined)

Tax Years delinquent	# of accounts	Value of receivables
1 year	2,705	\$1,250,056
2 year	385	\$473,799
3 year	114	\$354,598
4 year	45	\$299,515
5+ years	41	\$123,633
SUBTOTAL	3,290	\$2,501,601
Bureau adjustment*	- 363	- \$87,704
TOTAL	2,927	\$2,413,897

* The Bureau identified accounts that had been misclassified.

SOURCE: Bureau of Licenses

Our review of the Bureau's procedures for managing accounts receivable indicates that timely and consistent collection efforts have not been taken. For example, while Bureau procedures clearly call for collection notices to be mailed to businesses according to a schedule, our review found little evidence that mailings are timely. In some cases more than a year passed between notifications.

We believe that more active and timely management of accounts receivable amounts would result in additional recovered revenue.

Significant number of non-filing businesses

The Bureau reports that there are over 11,000 businesses that filed a business license return in one year, but did not file in a later year (about 24 percent of the total active accounts). In addition, over 5,000 of these businesses have not filed in multiple years (see Figure 7).

Figure 7 Number of businesses considered “non-filers”

# years not filing	# of businesses
1	5,511
2	2,491
3	1,323
4	895
5	952
SUBTOTAL	11,172
Estimated out of business	- 4,800
TOTAL	6,372

SOURCE: Bureau of Licenses BLIS database and Audit Services Division analysis.

Although the Bureau considers these accounts “delinquent”, they are more clearly distinguished as “non-filing” businesses. According to the Bureau, businesses may not file for a number of reasons including that they may no longer be operating. We estimate that about 10 percent of the businesses listed in the BLIS system (about 4,800) may be out of business or no longer located in the City or County.

Assuming again that non-filers are sole proprietors, we estimate these 6,372 non-filers may owe the City and County about \$3.7 million.

Estimate of the total tax gap

In summary, we estimate the total business license tax gap for both the City and County to be about \$8.8 million. Conversations with experienced Bureau staff and IRS literature suggests that about \$3.1 million may be realistically considered to be collectible. The collectibility rate can vary depending on a number of factors including economic conditions, the level of taxpayer compliance, staffing efforts, and the effectiveness of collection tools and methods. An estimated split of 55 percent to the City and 45 percent to the County yields a collectible amount of \$1.9 million for the City and \$1.2 million for the County through increased collection efforts. Figure 8 illustrates the tax gap.

Figure 8 Estimate of the “tax gap”

FACTOR	#	Tax gap	Amount collectible*	County share	City share
Unlicensed businesses	4,822	\$2,772,650	\$831,795	\$374,308	\$457,487
Accounts receivable	2,927	\$2,413,900	\$1,206,950	\$362,085	\$844,865
Non-filing businesses	6,372	\$3,663,900	\$1,099,170	\$494,626	\$604,544
TOTAL		\$8,850,450	\$3,137,915	\$1,231,019	\$1,906,896

* Collectibility factor applied to tax gap (50% for accounts receivable, 30% for unlicensed and non-filing businesses)

SOURCE: Audit Services Division analysis; accounts receivable from Bureau of Licenses

Recent Bureau efforts to improve compliance and collections

Over the past few years, the Bureau has explored a number of strategies to improve taxpayer compliance.

Web site and on-line payment. The Bureau has an extensive amount of information on their web site. The site contains report forms and links to the City Code and administrative rules. The Bureau is currently working on a method of paying fees and taxes on-line.

Address correction tools and data matching. Although not conducted recently, the Bureau in the past has used several automated methods to identify businesses that are not in the database and may need a license. For example, matching the BLIS database to databases from the Portland Fire Bureau, the Water Bureau, the City of Gresham, and

Metro identified about 363 names of non-exempt businesses not known to the Bureau. Although the Bureau reports that automated data matching remains time consuming and problematic because of differences in data base structures, it can provide valuable leads on potential taxpayers. The Bureau also uses a commercial product called AccuMail that receives updated address information periodically from the U.S. Postal Service so that the database addresses can be cleaned.

Presumptive fee policy and revised collections process. The Bureau is currently redesigning its collection process and developing a presumptive fee process. City Code gives the Bureau the authority to assume fees are due from delinquent filers. In the past, the Bureau has not aggressively assigned values to these delinquent filers but under the new policy the BLIS system will automatically estimate fees and generate billing notices. In addition, Revenue and Tax Specialists will receive periodic reports on delinquent filers in their assigned areas with a ranking by estimated tax liability. This will help them focus on the highest value accounts. Staff will follow-up on all accounts within one year. The adoption of this new process should help identify businesses that are no longer in business, exempt due to income level, or truly delinquent in paying taxes.

Additional opportunities to improve collection and compliance

Our interviews with Bureau staff, review of current practices, and reading of GAO principles indicate that there are additional opportunities to improve administration of business license fee and tax collections. Revenue collection and compliance can be improved by:

- expanding field collection efforts
- strengthening the audit program
- improving documentation requirements on returns
- using automated monitoring tools
- measuring collection performance

Expand and improve collection efforts

During the course of our audit the Bureau initiated several new efforts to increase collection. The “Director’s Challenge” held in March 2004 helped identify over 560 potentially unlicensed businesses. We support these efforts and make additional suggestions below to expand revenue collections.

- *Update methods for identifying unlicensed businesses.* We identified a number of techniques in our 1985 audit for finding unlicensed businesses that are no longer consistently used by the Bureau staff. We think the Bureau should re-emphasize some of these techniques such as annual field reviews. Other methods such as review of business periodicals may need update and review

in light of new tools available such as the world-wide web. An updated plan for finding unlicensed businesses should identify common tools and approaches to be consistently used by collections staff.

- *Increase the visibility of staff in the field.*
Interviews we conducted support that the Bureau has placed less emphasis on field work in recent years. Staff in the field can help collect delinquent accounts, assist businesses in filling out forms and to educate new businesses on license requirements. Field contacts can help improve voluntary compliance.
- *Prioritize delinquent accounts for collection.*
The Bureau recognizes the importance of prioritizing accounts for collection and has included it as an element in the new presumptive fee policy. Currently, however, delinquent accounts are not prioritized for collection nor automatically flagged by the BLIS system. Staff look for potential compliance problems as they are entering data into the system. Prioritizing collection efforts based on some criteria such as large and frequent delinquencies would help staff focus on accounts with the greatest recovery potential among the thousands of delinquent accounts.
- *Improving collection reports.* Collection reports are not easy for field staff to use. Not only are

delinquent accounts not prioritized, but staff must compile information from multiple reports in order to get necessary collection information. For example, reports on delinquent amounts are on a separate report from lists of correspondence sent to delinquent businesses. This makes field collections unnecessarily difficult.

Strengthen the auditing program

The Bureau does not employ a systematic approach for auditing business license returns. Although the Bureau's four person Audit staff provides valuable administrative and technical assistance to taxpayers and other Bureau personnel, more time should be spent systematically auditing returns. In accordance with GAO and IRS principles, systematic audits can help improve compliance rates and revenue generation.

As reported to us in interviews, Audit staff do not follow a systematic audit plan but spend much of their time attempting to find recoverable revenue by entering the larger business license returns into the BLIS system. These accounts are generally more complicated and involve tax liabilities over \$1,000. The Bureau's Audit staff have also analyzed the results of specifically designed database queries to spot potential compliance issues. While these efforts allow auditors to apply their expertise to the most complicated returns, and constitutes a valid risk-based auditing approach, it allows little time for more systematic audit efforts which could identify ways to improve taxpayer compliance. A systematic approach would include

a mix of audited returns selected by both random and risk-based methods. Under a systematic approach auditors would develop a method for selecting, reviewing and analyzing relevant information from returns in order to identify taxpayer behavior. When consistent patterns of taxpayer mistakes are identified, they can be addressed by a number of methods including simplifying instructions, redesigning returns, or clarifying rules.

Improve tax return documentation requirements

Opportunities exist to improve the documentary support provided by taxpayers on business income and apportionment within the City and County. Figure 9 shows the types of business tax filers and the nature of documentation requirements. While corporations and partnerships are required to submit copies of federal or state tax returns, sole proprietors and estates and trusts are not asked to submit any supporting documentation. According to the IRS, sole proprietors are the class of business most likely to fail to include reportable income. More documentation on reported business income would give the Bureau more assurance that correct fees are paid.

In addition, documentation is not required for any class of business to support the apportionment of business income outside Multnomah County or the City. Net income and apportionment decisions have a significant impact on the amount of tax liability and affords significant opportunity for manipulation by payers. Without supporting documentation from the taxpayers indicating where income is earned, the Bureau has little basis for audit or assurance filings are reasonable.

Figure 9 Type of businesses and documentation requirements

TYPE OF BUSINESS	% of reports	REQUIRED DOCUMENTATION
Sole Proprietorship	43%	None
S Corporation	25%	IRS Form 1120S: Income Tax Return for S Corporation, Schedule K: Shareholder's share of income, credits, deductions
Corporation	18%	Oregon Tax Form 20: Excise Tax Return
Partnership	14%	IRS Form 1065: Partnership Income tax form Schedule K
Estate and Trust	<1%	None

Note: Businesses may be required to provide additional information for net operating losses and deductions in certain cases.

SOURCE: Bureau of License data for Tax Year 2002

Use automated tools to flag errors and fee deviations

Based on our conversations with Bureau staff, there may be opportunities to employ automated capabilities of BLIS to flag potential compliance problems. While the system currently checks for math errors in returns, other automated features are not fully employed. Collections and audit staff now spend time manually checking returns for potential problems. This extends data entry time and takes time away from field collection efforts and more systematic audit efforts. While manual review and judgement cannot be entirely eliminated, we believe entering Combined Reports “as filed” while utilizing more automated features

could give staff more time to focus on collection and audit efforts. Adding automated features would require programming time and effort but may offer payback in staff hours and improved compliance.

Measure and monitor collection performance

A consistent approach for measuring and monitoring the performance of the Bureau in achieving compliance with business license requirements would help the Bureau report to Council and manage its operations. The Bureau may want to consider the following performance measures.

The summary performance measure for the Bureau is the “tax gap”. It is important that the Bureau develop a procedure for annually estimating the amount of this gap. We suggest that a relatively simple measure using presumptive fee estimates, unlicensed businesses, and outstanding receivables be used for this purpose.

In addition, there are three basic components of compliance for which measures should be developed. They are:

- **Payment compliance.** This is the proportion of fee liability that is remitted on a timely basis. This could be generated by internal information in the BLIS system. This would be total amount received (timely) divided by the total liability for a given tax year (after adjustments). This is only for those who filed returns.

- **Filing compliance.** This is the proportion of required returns that are filed in a timely manner. This is the number of returns actually filed divided by the returns that are required to be filed. This would require the Bureau to estimate the number of unlicensed businesses. This could be accomplished by the field inspections suggested above.
- **Reporting compliance.** This is the proportion of fee liability that is accurately reported on timely filed returns. In other words, this measures how accurately filers filled out their returns. This can be determined through increased auditing (as suggested above). Audits can identify where filers are having trouble and result in corrective actions - either by redesigning forms, or improving instructions and/or rules.

The Bureau also needs to develop other performance measures for individual programs within the Bureau. The Audit Services Division, in conjunction with the Office of Management and Finance, the Bureau of Planning, and by City Council directive, has done extensive work on a system of Managing for Results, which includes information on measuring performance. The Bureau may wish to consult these documents and request assistance from these organizations to develop their own Managing for Results system.

Chapter 3 Strengthening Internal Controls

Organizations need good internal controls to safeguard resources from loss, waste, and abuse and to help ensure that organizational goals and objectives are achieved. Our review of the Bureau of Licenses' internal controls over business license revenue indicates that controls are generally in place and are functioning properly.

Nothing came to our attention during the course of our review that would indicate inappropriate use of City resources. However, we found that controls could be strengthened in several areas by further separating duties in the revenue processing functions, improving the documentation of policies and transactions, and upgrading the physical security of resources. Additionally, the overall control environment in the Bureau could be strengthened by establishing a clear strategic direction and performance expectations, and by improving communication between top management and staff.

Description of internal controls

Internal controls are policies, procedures, and activities designed to help an organization achieve its management objectives, safeguard resources, report reliable information,

and comply with applicable laws. To accomplish our report objectives we reviewed three major internal control elements:

Control Environment – The control environment sets the tone for the organization, influencing the control consciousness of employees. Factors include ethical values, competency, communication between management and staff, management’s operating style and philosophy, and organizational culture. The control environment serves as the foundation for all other control components by providing organizational direction and structure, and encouraging effective communication.

Control Activities – Control activities are the policies and procedures that help ensure that management directives are carried out. They include activities such as record keeping, supervision, authorizations, verifications, reconciliations, and segregation of duties. Control activities may also include methods for ensuring physical security of assets and resources and preparation of management information and reports.

Monitoring – This includes monitoring the internal control system through on-going reviews, separate evaluations, or both. On-going monitoring functions include regular supervisory and management reviews as well as activities that staff perform in their work. Separate evaluations are activities undertaken to check controls outside of the normal monitoring process.

Regardless of how well planned and implemented, internal control systems cannot provide absolute assurance that an agency is meeting all of its objectives. Controls can be circumvented by the collusion of two or more people, and employees and managers may choose not to follow established

Figure 10

INTERNAL CONTROLS REVIEW		
PROCESS REVIEWED	CURRENT CONDITION	POTENTIAL IMPROVEMENTS
1. Business License revenue processing Strong internal controls give reasonable assurance that funds are received and deposited appropriately, accurately, and that financial information is reliable.	- Procedures in place for Finance & Operations sections' work, but written cash handling procedures do not exist. - Managers provide adequate review. - Most receipts documented and authorized but field/counter receipts need improvements. - Firmer separation of duties needed. - Physical security lacking in some areas.	- Create written cash handling policies and procedures. - Improve documentation, authorization and control of field/counter receipt books. - Establish firmer separation of duties. - Improve physical security efforts.
2. Penalty waiver & settlement Good controls apply fairness from case to case, give assurance that adjustments have been appropriately reviewed and authorized, and that such adjustments are consistent with policy and sufficiently documented.	- Authorizations and documentation of request letters largely adequate. - Criteria for settlements reasonable but not documented. - Bureau consults with City Attorney's Office when licensee pursued through court. - Informal delegation of responsibility for settlements to policy manager.	- Keep copies of all supervisory signoffs. - Document criteria used to analyze settlements. - Consult with City Attorney's Office about large settlement amounts. - Formalize delegation of responsibility to policy manager for settlements. - Write internal memo to document reasons for pursuing settlement and result.
3. Selected bureau-wide controls Bureau-wide controls serve as the foundation for all other controls by providing organizational direction and structure.	- Signed confidentiality oaths not in all Bureau personnel files. - Effort made to document good employee work. - Bureau lacks strategic plan, performance measures, and goals. - Performance evaluations rarely completed.	- Retain all signed confidentiality oaths in Bureau personnel files. - Renew strategic planning efforts. - Develop meaningful performance measures and goals. - Conduct annual performance evaluations.

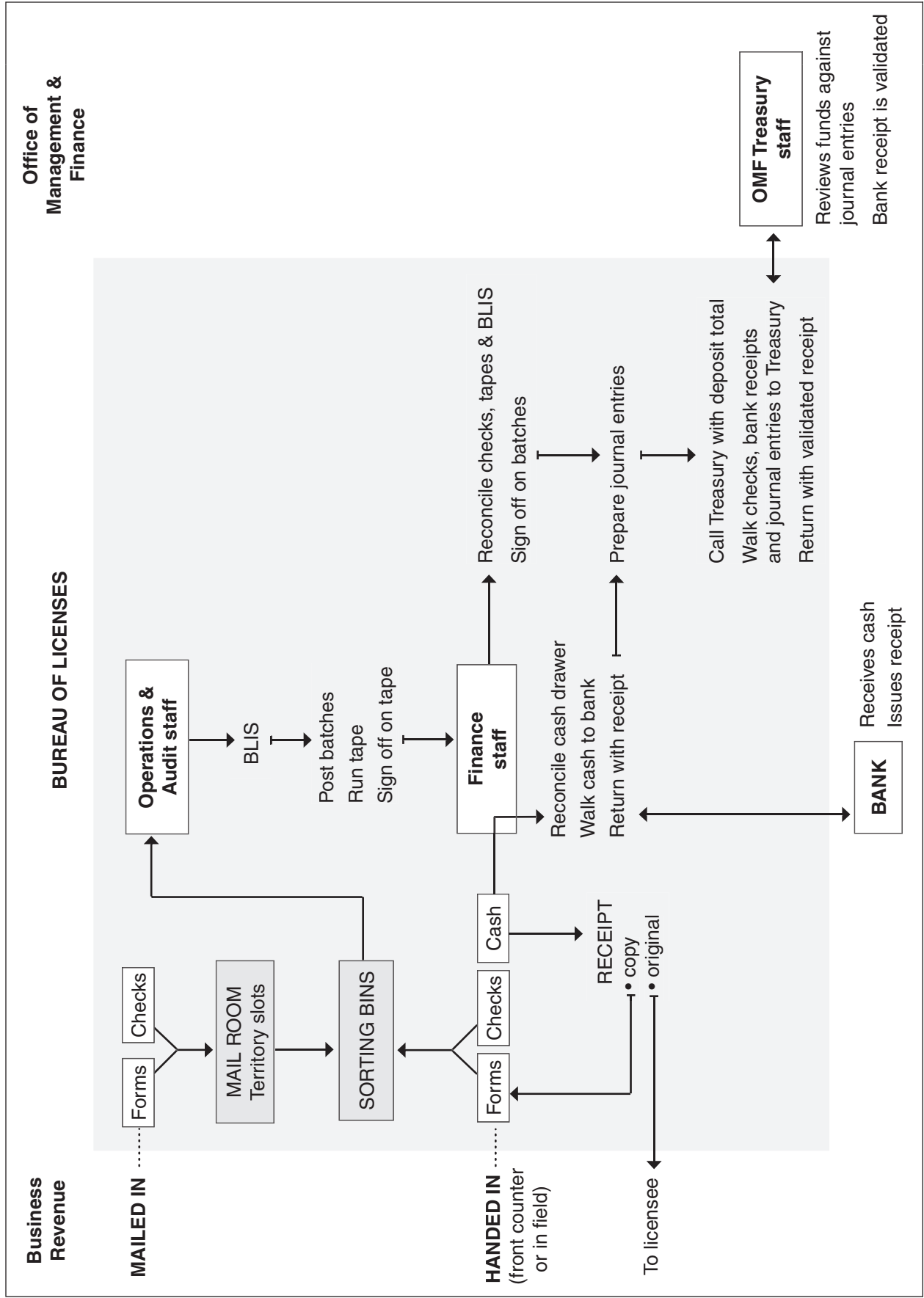
procedures. In addition, the design of the control system may reflect resource constraints and the benefit of the controls must be weighed against their implementation costs. While internal controls cannot completely eliminate the risk of error or of inappropriate actions, well-conceived procedures and a good control environment can minimize the potential for abuse.

Our review focused on the adequacy of the Bureau-wide control environment as well as specific control activities associated with the receipt, processing, review, and recording of business license fees. We also reviewed policies and practices for applying and waiving penalties and settling accounts for less than amounts initially owed. These areas were reviewed because a lack of good controls could mean a loss of revenue for the City of Portland and for Multnomah County.

Controls over revenue processing are in place and working but improvements are possible in several areas

Our review of the Bureau's activities related to processing business license revenue showed that controls are in place and working as intended but improvements are possible. Our review shows that existing internal controls give reasonable assurance that funds are received, recorded, and deposited appropriately and accurately, and that financial information is reliable. Better separation of duties, improved physical security and more controls over receipt books could further strengthen controls. A flow chart of the Business License revenue process is provided in Figure 11.

Figure 11 Flow chart of business license revenue process



Basic written procedures are generally complete

We found written procedures for the Finance and Operations sections for the business license revenue process. These procedures describe the specific steps involved in processing batches of fee revenue in BLIS, checking the batch totals against total receipts, and preparing the accounting entries for City Treasury. Batches generally are bundles of 50 checks and are prepared by Operations and, at times, the Audit section staff. The procedures also describe the steps for balancing the deposits at the end of the day against internal spreadsheets.

Some policies and procedures could be more complete. We found improvements that could be made, particularly regarding cash handling. Up-to-date, written procedures would clarify steps and provide more assurance that revenue is handled well.

Comprehensive policies and procedures need to be in place that explain the Bureau's policies on accuracy and timeliness, describe the procedures that will be followed, and explain who is responsible for performing certain tasks and giving authorizations. Failure to have such controls in place can lead to confusion or misunderstandings and increase the risk of misuse or loss of revenues. In addition, policies and procedures allow management to set the tone in terms of the importance of the tasks and clearly communicate the value of ethical behavior.

Managers provide appropriate levels of review of the incoming business license revenues

The Bureau's Accounting Supervisor reviews financial reports produced by the City's central Accounting Division

every accounting period and every quarter, and balances the information against the Bureau's internal balancing spreadsheets. Financial reports on business license revenues are also reviewed by the Bureau's Operations and Policy Manager as well as by the Director. In addition, the Bureau provides financial information to the City Economist in OMF who examines it for trends when working on the City's financial forecast.

Controls over receipt books need improvement

Treasury receipts are usually issued to licensees when they pay fees at the Bureau's front counter. While receipts are needed most to document cash transactions, licensees paying with checks are also often given receipts. We reviewed 1,109 Treasury receipts (T-receipts) that were issued during six selected months of calendar year 2003. We found that 97 percent of the receipts were properly completed, indicating amount, date, payee, and Bureau staff handling the transactions. Only nine receipts (less than 1 percent) were not initialed/authorized by Bureau staff, and 16 receipts (about 1 percent) were missing. The Finance section keeps track of the T-receipt sequences and reports any voided or missing receipts to City Treasury, which also tracks the receipt numbers. Staff indicated that missing receipts are researched by the Finance section and generally occur because they are accidentally misplaced.

In addition to reviewing T-receipts, we examined the "temporary receipts" issued to businesses who pay license fees to a Bureau representative in the field. (Temporary receipts are also infrequently used at the Bureau counter). Our review of seven receipt books containing a total of 434

receipts showed that six books were generally completed accurately. However, one book had 115 missing duplicates of the original receipts. While the book contained receipt stubs for the missing receipts, stubs do not contain sufficient information on the payment to document amount received and payee. Moreover, most stubs were not completed as required and there were numerous blanks. Nearly all lacked employee initials.

Receipt duplicates are important to document amounts of cash and checks received. Without duplicates of the actual receipts it cannot be determined if these receipts were issued appropriately or not.

Finance section lacks consistent separation of duties

When working with business license revenues, employees in the Operations and Audit sections perform data input of received revenues and the Finance section employees prepare revenues for deposit into the City Treasury. With the exception of the supervisors, staff in the Operations and Audit sections cannot access the computer screens used by the Finance section to prepare a batch of revenues for deposit. The Finance staff, however, have access to both types of screens – data input as well as deposit preparation.

If the Finance Section staff finish with their duties early, they may help the Operations section by entering revenue data into BLIS. The Finance staff generally alternate who is responsible for preparing revenues for deposit for the day. However, there are times when the same person in the Finance section enters records in BLIS, tallies the revenues, checks the batch, and prepares it for deposit.

We sampled 539 journal entries from January 2003 through mid-January 2004. Out of the 539 journal entries, 84 (approximately 16 percent) had the same person performing the initial data entry in BLIS as well as preparing the journal entry for deposit. Failure to separate the duties of revenue recording from revenue deposit increases the risk of error and the potential for abuse.

Physical security of information and revenues is lacking in some areas

Licenses moved from the 1900 Building to 111 Columbia Street in January 2004. In both locations during office hours, access to the Bureau work areas is controlled with key cards, except the entrance to the general reception area. We did an impromptu check of the Operations section at both locations on two occasions to assess whether revenue and licensee information was left out on desks by staff who were out of the office for the day. Our first check in December 2003 showed that checks and licensee information was fairly accessible once past the reception area. Some materials were out openly on desks, while some were in file organizers. We performed another check at the new location in February 2004 and found some improvement. More drawers were locked but there was still material left out. Based on the spot checks performed and the staff interviews conducted, some staff still do not have the capability to lock up materials (such as having locking drawers). In addition, sorting bins for returns and payments are left out at night in the Operations section and are not secured.

Managers and staff appear to be aware of the need for better controls on the physical security of checks and cash. This concern was expressed by some managers and by several staff in interviews. The Bureau has made some provisions, such as locking the mail room at night and adding locked drawers for some staff. Even with these measures, however, security can be improved by putting away materials at the end of the day.

Penalty waiver and settlement controls are followed, but written guidelines and supporting documentation are needed

City Code (sections 7.02.200 and 7.02.700) gives the Bureau broad authority to apply and waive penalties and to settle controversies on disputed amounts owed. Our review of penalty waivers showed that the Bureau has established and is following reasonable controls. The Bureau's written penalty waiver policy is largely complied with, written requests are required and received, and supervisory authorizations are provided. However, procedures for settlement of disputed amounts are not in writing and better documentation would help support settlement decisions. Also, if authority to make settlement decisions is delegated by the Director, the delegation is required to be in writing.

The application and waiver of penalties for delinquent fees are authorized by City Code and defined in the Bureau's Voluntary Compliance Policy and Penalty Assessment Policy. In accordance with these policies, the Bureau may waive penalty amounts to assist businesses with compliance and to encourage future voluntary compliance. Requests for a penalty waiver must be requested in writing and approved by team leaders or Bureau managers.

The City Code also permits the Director to settle disputed amounts through correspondence and discussions with businesses. Settlements are rare and Bureau staff identified only four during the last three years. While the Bureau does not have a written policy on how settlements will be administered, according to management staff settlements generally are made when the Code or other applicable laws are vague or not definitive, when the cost of pursuing the liability outweighs the potential benefit, or in hardship cases.

Documentation requirements for penalty waivers are largely followed and most authorizations were obtained

We identified all waivers recorded in the BLIS database for Tax Years 2000 and 2001 representing 365 waivers worth approximately \$200,000. The majority of the waivers in those two years were for under \$100. We selected a sample for testing that included all the waivers that were over \$1,000 (26 waivers), plus 33 smaller waivers.

Our review showed that 55 of the 59 waivers in the sample had documentation of a written request from the licensee, as required by Bureau policy. In addition, 54 of the waivers showed evidence of appropriate authorization for the waivers by a team leader or supervisor. However, three of the five waivers without evidence of appropriate authorization were over \$1,000. One was a multi-year waiver for \$6,799.

Settlements met criteria and were authorized by management

Our analysis of the four identified settlements in the past three years showed that the Bureau followed their established informal criteria for making settlement judgments. Specifically, settlements were entered into when law or code was unclear, the cost of pursuing the disputed liability was prohibitive, or for taxpayer hardship cases. Each settlement received supervisory review and authorization from the Bureau's Audit Supervisor and/or the Operations and Policy Manager. While the authorization to make settlement decisions was verbally delegated by the Director to the Operations and Policy Manager, the City Code (section 7.02.200(A)) clearly requires the Director to delegate this authority in writing.

We spent considerable time analyzing one large settlement made in 2003 for Tax Year 2001. With assistance from outside counsel with extensive tax experience, we evaluated all the records pertaining to the tax filing including federal, state and local income records; correspondence between the Bureau audit staff and the business tax representative; relevant state and local tax laws; and documents related to the final settlement amount. Based on this review, we believe, the Bureau made a reasonable settlement decision consistent with the legal merits of the dispute and we found no inappropriate actions that might violate the responsibilities delegated to the Bureau by the City Code. In the opinion of our outside legal counsel, the settlement reached was reasonable and consistent with the doubt as to the correct legal standard that would apply to certain income of the business. In addition, counsel stated that

there was no indication that factors other than the legal merits of the arguments of the two parties were a consideration in the resolution.

Written criteria and improved documentation would better support settlement decisions

Although policies used by the Bureau to support settlement decisions appear reasonable, more comprehensive written policy could help staff resolve disputed amounts and provide more support for settlement decisions. In addition, we believe written policy should require clear documentation illustrating the factors considered in making the settlement and justifying the settlement decision. The Bureau may wish to also consider obtaining legal advice from the City Attorney on the legal merits of settlement proposals before final determinations.

Bureau-wide control environment can be strengthened

The Bureau should take steps to improve the overall control environment of the organization. While management and staff expressed a strong commitment to the organization, the Bureau lacks a clear strategic direction to guide its operations and performance measures to track progress and communicate performance expectations. The Bureau also rarely conducts staff performance evaluations and does not consistently keep documentation of confidentiality oaths signed by staff.

The Bureau lacks a clear strategic direction

Although the Bureau's current mission is to maximize fee and taxpayer compliance with the business license law, staff are confused about the purpose of the Bureau and

the direction of its programs. When asked in the employee survey to rate the item “As an organization we know where we’re going and how to get there,” the employees ranked the statement eighth lowest of the 41 items.

Confusion about the mission of the Bureau may result from management placing more emphasis on marketing its tax data and business services to other government jurisdictions and reducing emphasis on its core functions of administering the Business License law. While offering new services may help the Bureau become self-sufficient in the future, staff understanding of the direction of the Bureau and the relevance to its core functions may have been affected.

Based on interviews with Bureau managers and supervisors, strategic planning efforts were started but were halted due to other priorities. Management expressed an interest in resuming their work on strategic planning but indicated that they have not had time in recent years to complete those tasks.

Lack of meaningful performance measures and goals

The Bureau’s current performance measures do not include comprehensive measures of efficiency or effectiveness and do not demonstrate a clear relevance to the core functions of the Bureau. It is important for the Bureau to have a good set of performance measures and relevant goals that connect to a mission statement for a number of reasons. Goals provide a framework for more detailed levels of planning and at the Bureau level provide a unifying theme for programs and activities.

In Chapter 2, we recommended creating measures for three basic components of compliance, as well as suggesting how this could be done. These measures would help the Bureau focus on its core function and would improve the organization's control environment.

The overall control environment in an organization is also improved if program goals and objectives are clear and performance expectations are understood and measured. Performance measures allow an organization to determine its progress toward meeting the goals and objectives set forth in an organization's strategic plan. Good measures would allow the Bureau to monitor and measure compliance, to identify problems and allocate resources accordingly, to improve customer service, and to report accountability to top management and the City Council.

During interviews managers expressed the importance of performance measures and the need to develop a more comprehensive set.

Performance evaluations are rarely conducted

Employee performance evaluations are an important internal control technique because they provide assurance that expectations are communicated and that progress meeting expectations is periodically assessed. In addition, performance evaluations also give employees an opportunity to discuss work satisfaction with their supervisors.

The Bureau of Human Resources Administrative rules require annual performance evaluations for all non-represented staff. In addition, the current union contract specifies certain periods of employment, such as probationary periods, where evaluations are required.

The majority of Bureau staff are in represented positions, so evaluations are not required annually. However, since annual performance evaluations are a good organizational practice, we decided to review the Bureau's employee files to see how frequently evaluations were being done.

Of the 50 employee files reviewed, only four files included performance evaluations. One file had evaluations performed by another bureau before the employee transferred to Licenses. The other three files were for non-represented staff in the Audit Section. Each of these included a one-page write-up to document performance for the years 1997 and 1998. One file also included an evaluation for 1994-95. Other non-represented staff files had no annual evaluations. Discussion with managers after the test revealed that evaluations had been done for the audit staff in 1996, 2001, and 2004, but had not been included in the Bureau's personnel files.

The personnel files did include documentation of disciplinary situations, and praise for employees' work.

Our survey of employee satisfaction identified performance evaluations as an area of dissatisfaction. Employees rated the item "My performance evaluations are used to improve my performance" the lowest of all 41 on our survey.

Confidentiality oaths not always in personnel files

City Code sections 7.020.230 and 7.02.730 require business license information be kept confidential and state that failure to do so is punishable by a fine and/or imprisonment.

This is an important control technique to help ensure confidential taxpayer information is not shared publicly and communicates to employees the importance of taxpayer information. Signed confidentiality oaths are required for Bureau employees and agents. They serve as a control by ensuring staff and agents understand non-disclosure requirements and the penalties associated with failure to comply.

We reviewed all personnel files in the Bureau to determine whether these signed forms were present as required. Of the 50 reviewed, 39 files (78 percent) had signed confidentiality oaths. Of the 11 that were missing, four were for staff that had been hired in the last three months. It should be noted that some of the missing oaths were found by Bureau staff after the testing was completed, and Bureau managers indicated new staff sign the oath on their first day.

Chapter 4 Improving Employee Satisfaction

Employee satisfaction has a significant impact on productivity. Research has shown that successful achievement of organizational objectives is partly dependent upon maintaining highly motivated employees.

Our review indicates that employees in the Bureau are only moderately satisfied with their jobs. Although committed to their jobs, most employees expressed dissatisfaction with Bureau supervision, communication with management and teamwork. Efforts can be taken to increase employee job satisfaction in several areas.

Research methodology

In order to more fully understand employee work satisfaction at the Bureau, we conducted an employee survey and held a focus group discussion. The purpose of these efforts was to identify specific areas of satisfaction and dissatisfaction so that positive actions can be undertaken to address problem areas and improve productivity.

The survey instrument was designed to obtain information about six major aspects of work at the Bureau:

Job characteristics – how happy are employees with certain aspects of the job such as pay, benefits, autonomy, variety?

Employee support – how satisfied are employees with things done on their behalf to enable them to do a better job, such as training and equipment, and with the recognition they receive for their work?

Supervisory/management style – how satisfied are employees with management's employee interaction, perceived competency, and fairness?

Team environment – how well do employees work together as a team?

The organization as a learning environment – how well employees think the organization does in learning from its mistakes and listening to what they have to say?

Individual commitment – how committed are the respondents and others in the organization to doing a quality job, and how long do they plan to stay in the Bureau?

Employees were asked to rate their feelings toward a variety of statements on a scale of 1 to 5, where a score of 1 represented "Disagree Strongly" and 5 represented "Agree Strongly". In addition to these 41 closed-ended survey questions, we asked respondents to list the three most important things the Bureau could do to increase their job satisfaction.

We distributed surveys to all of the non-supervisory employees on the morning of December 8, 2003 and asked for their return by interoffice mail within five days. Of the 37 surveys we distributed, 26 (70 percent) were returned.

We also conducted a focus group meeting with four employees who volunteered to help refine our understanding of the survey data. At that meeting, we asked employees if the results were consistent with their general feelings about the state of employee satisfaction, and what actions could be taken by the Bureau to improve job satisfaction in light of the survey results.

Survey limitations

The results of our survey reflect the perceptions of the employees and may, or may not, reflect objective reality. However, perceptions may be as important as reality in affecting employee satisfaction and productivity. Differences in perceptions point to a need for better communication between management and staff.

In addition, subsequent to the release of the survey results to the Director and the Commissioner's Office in December 2003, the Bureau Director was placed on administrative leave and an Interim Director was named. The survey results contained in this report reflect attitudes in December 2003, prior to the appointment of the Interim Director in January 2004.

Survey and focus group results

Overall, employees are only moderately satisfied with employment at the Bureau. Employees rated overall satisfaction as 3.2, with 3.0 representing "neither satisfied nor dissatisfied" on the scale of 1 to 5. The following narrative and figures 12 and 13 summarize the results of the survey.

Employees appear to have a high level of commitment to their work. Survey respondents believe their work is important; they are proud of their work, and they intend to stay for the foreseeable future. In addition, employees are generally satisfied with most attributes of the job itself such as the level of autonomy, variety, and decision-making afforded them, as well as the salary and benefits.

Employees are not as satisfied with teamwork at the Bureau. Members of our focus group indicated that their primary concern was the lack of effective teamwork among members of their Revenue and Tax Specialist work group. However, participants indicated they are generally satisfied with teamwork interactions with other functional work-groups such as Finance and Audit staff. Also, there is a perception that employees are not treated equally and that problem employees are not held accountable. This appears to be the primary source of complaints about teamwork.

Employees seem to be satisfied with the training, equipment and recognition they receive. However, when asked whether performance evaluations were used to improve job performance, the question received the highest negative response in the entire survey. As discussed in the previous chapter, very few staff have received performance evaluations.

Employees are clearly not satisfied with certain aspects of their supervisory relationships. While employees believe that mid-level managers are qualified to do their jobs, they are dissatisfied with the top management leadership. Employees expressed a concern that mid-level managers are not given adequate support from upper management

to do their jobs effectively. Comments indicated that while employees personally liked the Director, they believed he should be more visible, exert more control over his high-level staff, and explain what is done with employee suggestions that arise from process improvement teams.

The lowest rated domain related to the Bureau as a learning organization. Employees feel that Bureau managers do not do a good job of listening and acting upon their concerns. They do not feel that top managers are attuned to their everyday problems, nor do they collect information from employees about working conditions. Employees in the focus group and in the surveys expressed a frustration that managers arrive at conclusions without taking their concerns into account and are rarely available for consultation.

Addressing problem areas

Our review of survey results, focus group discussion and staff interviews lead us to several conclusions about employee satisfaction and potential solutions to identified problem areas. In particular, we believe several steps could help improve employee satisfaction:

Establish opportunities for frequent and consistent communication with employees. Involving all employees in developing a clear strategic direction will help management communicate the direction of the Bureau to staff. Initiating annual performance evaluation sessions with every employee could also help assess progress toward goals, remove barriers to better performance, and identify training and support needs. Annual performance evaluations might help improve communication and the perception

Figure 12
Employee survey results (ordered highest to lowest)

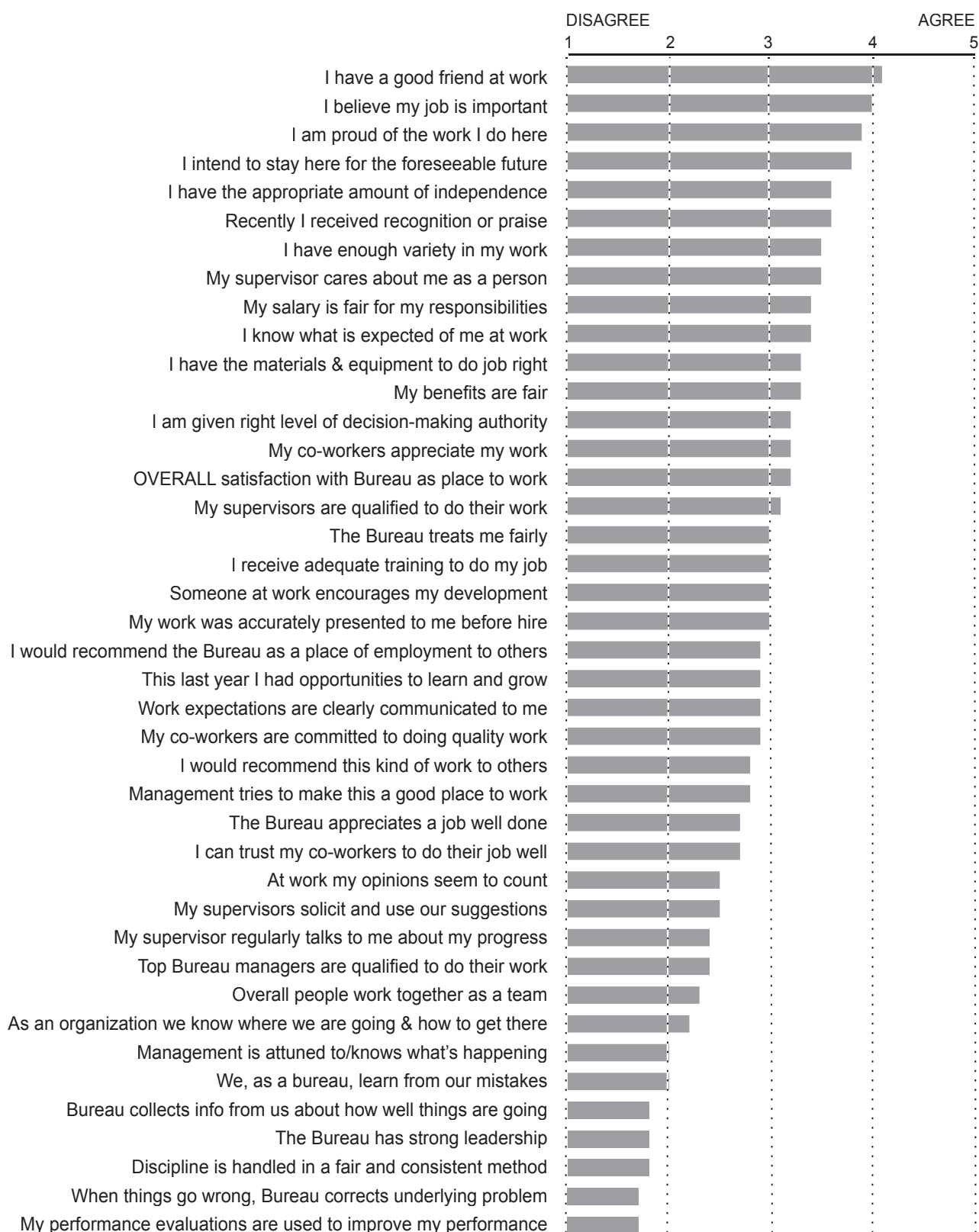
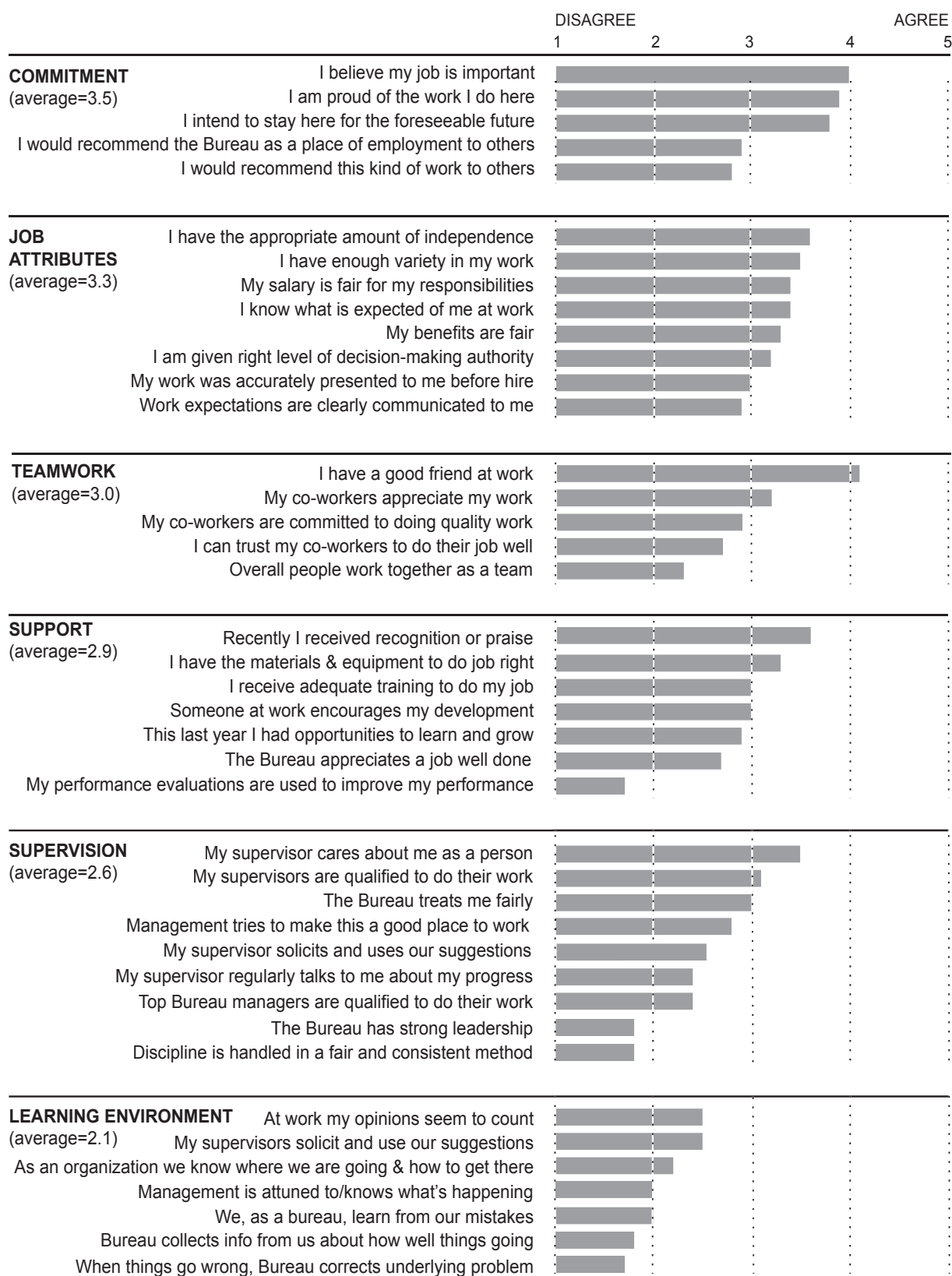


Figure 13
Employee survey results (grouped by domain)



of fairness. Performance objectives for individuals, teams, and the Bureau are important ingredients to improving productivity and teamwork. Equally important is recognizing employees when goals and objectives are met.

The Director should be more visible and involved with Bureau employees. The Director and his top managers should engage employees more frequently, and strive to actively listen to employee concerns. Top managers need to openly respond to employee-generated proposals and ideas that result from process improvement teams. Feedback from employees needs to be acknowledged as a very important part of the internal improvement process.

An assessment of employee satisfaction should be conducted periodically to monitor improvement in job satisfaction. The Bureau may wish to use the survey instrument employed in this report as a model.

Chapter 5 Recommendations

During the course of our audit work, the Bureau of Licenses initiated a number of significant changes to increase the collection of business license and tax revenue and to improve compliance with local tax laws. These efforts should produce new revenues for the City and County. We support these initiatives and propose additional recommendations to reduce the “tax gap”, strengthen internal controls, and improve communication between Bureau management and employees.

In order to **improve taxpayer compliance and revenue collection**, we recommend that the Bureau take the following actions:

1. **Expand and improve revenue collection practices**

The Bureau should update methods for identifying unlicensed businesses and develop common approaches to be used by collections staff. Collections staff should be more visible in the field to collect delinquent accounts, assist taxpayers, and educate new businesses on license requirements. The Bureau should also continue to implement procedures to prioritize delinquent accounts for

collection based on risk criteria and focus on accounts with the greatest recovery potential. To assist field collection staff, the Bureau should improve the usefulness of collection reports by consolidating information that is currently available in separate documents.

2. Strengthen the auditing program

The Bureau should develop a more systematic approach to auditing business license returns. Instead of spending significant time entering data, staff should develop a standard revenue audit program. The audit program should define more standard methods for reviewing, analyzing, and selecting returns for audit based on risk criteria related to size, compliance patterns, and complexity. Auditors should identify consistent patterns in compliance problems in order to improve business license instructions, simplify instructions, or amending rules.

3. Increase tax return documentation requirements

The Bureau should require additional documentation from taxpayers to support reported income and apportionment decisions. Additional documentation would provide more assurance that reported income and apportionment was reasonable. Bureau staff should strive to develop a documentation method that is the least onerous on the taxpayer while providing the necessary information.

4. Increase use of automated monitoring tools

The Bureau should explore opportunities to use more automated capabilities of the BLIS system. The Bureau should consider entering Combined Reports “as filed,” while using BLIS to flag potential compliance problems. While programming effort will be needed, we believe that employing more automated monitoring will reduce time spent on manual reviews and free collection and audit staff for more productive work.

5. Measure and monitor collection performance

The Bureau should develop a consistent approach for measuring their performance in achieving business compliance with business license requirements. A consistent measurement of the “tax gap” would help the Bureau track and report its overall performance. We believe that relevant and reliable measures of payment, filing, and reporting compliance would also improve decision making and accountability.

In order to **strengthen internal controls** over the administration of business license revenues, we recommend the Bureau take the following actions:

6. Initiate additional controls over revenue processing

The Bureau should establish a firm separation between the initial entry of account information in the BLIS

system and processing of documents for Treasury deposit. While flexibility is needed to use staff for different duties during high workload periods, the same person should not perform recording and deposit functions. Also, receipt books should be controlled more tightly to ensure that all receipts are accounted for, payment amounts are recorded, receipts are initialed by staff, and the licensee name is legible. Finally, providing locking drawers would provide additional physical security over licensee returns in Bureau offices and reduce the risk of the release of confidential tax information.

7. Develop written policies and better documentation for settlements

The Bureau should develop written policies to guide the settlement of disputed amounts. While City Code gives the Bureau Director clear authority to settle controversies between the Bureau and businesses, the Bureau should formalize the criteria in writing. The policy should also require development of a settlement record and written documentation of settlement rationale used to support decisions. The Director should also provide written delegation of authority to make settlement decisions if authority is given to another staff person and consider obtaining City Attorney counsel for large settlement amounts.

8. Improve Bureau-wide control environment

The Bureau should improve the overall control environment by clarifying the strategic direction of the Bureau,

developing meaningful performance measures, and ensuring that signed confidentiality oaths are retained in personnel files. Management should develop clear goals and performance measures, communicate these performance expectations to all staff, and initiate annual performance reviews of the organization and staff.

In order to **improve employee job satisfaction**, we recommend that management take the following actions:

9. Establish more frequent opportunities to communicate formally and informally with staff

Bureau management should involve all employees in the development of its strategic direction and performance measures. Management should communicate these elements orally and in written form to ensure performance expectations are understood, barriers to better performance are removed, and training and support needs are identified and acted upon. Annual performance evaluations would help improve communication, productivity, and teamwork. The Director should also strive to be more visible to staff to understand employee concerns, address problem areas, and acknowledge good performance. Periodic employee satisfaction surveys would help track improvements in job satisfaction.

Responses to the Audit



CITY OF
PORTLAND, OREGON
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April 12, 2004

To: Gary Blackmer, City Auditor
From: Randy Leonard, Commissioner of Public Safety
Subject: Response to Bureau of Licenses Audit

I appreciate the work you have done in completing the audit of the Bureau of Licenses, which I requested at the beginning of fiscal year 2003-04. The audit validates our finding that the Bureau has been remiss in the past in emphasizing core business license tax collection and compliance responsibilities, and must work quickly to implement collection industry best practices.

The audit identified a City/County "tax gap" of \$8.9 million, with the collectible portion of \$1.9 million for the City and \$1.2 million for the County. The Bureau believes the tax gap is as much as \$14.6 million and the collectible portions are \$2.9 million for the City and \$2 million for the County. The Bureau has taken a number of aggressive steps to implement policies and procedures that will ensure comprehensive compliance with the tax law. In addition to those that you have suggested, some of the Bureau's policy and procedural innovations include:

1. This summer the Bureau will implement "data matching" with the State of Oregon Department of Revenue, which will enable it to identify unlicensed businesses operating in the City/County. The Bureau will also be working closely with a number of other agencies and City bureaus (including the Fire Bureau, Bureau of Development Services, and Water Bureau) that have regular contact with businesses to ensure maximum internal data matching.
2. Full enforcement of penalties against non-compliant businesses. Past Bureau practice was to routinely waive penalties for delinquent taxpayers.
3. Increased advertising and outreach to businesses to ensure they are aware of the law and the Bureau's incentives for self-identifying.
4. An aggressive delinquent collections effort with coordinated automated/manual collection procedures. Along with targeted calls made by the Director, this effort will include a dedicated attorney to press for legal remedies against the worst offenders.
5. Targeted quarterly field visits to identify unlicensed businesses and hold delinquent businesses accountable. Employees will begin using City vehicles with "business license enforcement" markings to establish high visibility in the business community.

As you know, since March the Bureau has initiated two major efforts in the areas of collections and compliance. The collections effort centers on the mailing of final demand notices to 2,508 seriously delinquent businesses with a total balance owed of \$1.6 million. These efforts began March 15, 2004, and already the Bureau has collected over \$283,000 from these accounts and brought 746 businesses into compliance. The field survey compliance effort focused on identification of unlicensed businesses. To date, the Bureau has identified 561 potential business locations, and has positively identified 25 new businesses, eight of which are corporations. Twenty of these delinquent accounts had been operating without a business license for multiple tax years.

The Bureau is closely tracking the outcome of all the efforts outlined above to identify exactly how much new revenue is attributable to each. I am requesting a follow-up audit be conducted one year from now with an emphasis on the impact of our collection efforts relative to the collectible revenue projections made by your office and the Bureau.



CITY OF
PORTLAND, OREGON
BUREAU OF LICENSES
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April 12, 2004

TO: Gary Blackmer, City Auditor

FROM: Thomas Lannom, Interim Director
SUBJECT: Response to Audit of Bureau of Licenses

Thank you for the opportunity to comment on your audit titled *Opportunities to Improve Tax Collection and Strengthen Internal Controls*. The last audit of the Bureau of Licenses (BOL) was conducted 19 years ago. BOL encourages more frequent scrutiny of its collection and compliance improvement efforts and requests a follow-up audit to benchmark progress as soon as your audit schedule allows. In any event, the Bureau will present the City Auditor and City Council at least three written progress reports not later than three months, six months and one year from the audit release date.

As noted in the audit, BOL's tax and fee collection activities are "critical to the City's financial condition." The FY2003-2004 City Adopted General Fund Budget anticipates business license revenue of \$40.7 million. Your audit identifies an overall "tax gap" of \$8.85 million (City and County) including \$1.9 million collectible for the City and \$1.2 million for the County. Consequently, the Bureau of Licenses should be able to collect at least 4.7% more than the Adopted Budget for business license revenues. This is a very significant finding in light of the current condition of the City and County budgets.

However, an analysis by the Bureau indicates the audit may have substantially understated the actual tax gap by using a conservative methodology in computing the estimated value of unlicensed business taxes. Adjusting for this conservative approach by using actual historical data, the overall City and County tax gap may be as high as \$14.6 million. The City's collectible portion of this amount is estimated at \$2.9 million, over seven percent of current budgeted business license revenue.¹ The County's collectible portion is estimated at over \$2 million.

The Bureau strongly agrees with the portions of the audit identifying needed improvements, particularly in the areas of collections and compliance. As noted in the audit, the Bureau has taken a number of measures to improve current collection and compliance practices, but there is much work yet to be done. Since the auditors and the Bureau agree that significant improvements in collections and compliance are needed, and this area of inquiry has direct and significant consequences for the City

General Fund, the Bureau's response will focus on issues related to collections and compliance.

Prompt Collections and Compliance Actions are Critical to Success

The primary objective of a tax collection program should be to collect the greatest amount of revenue possible in the shortest period of time with the least amount of effort. Failure to take prompt and effective collection action encourages some taxpayers to procrastinate when future payments become due since failure to act gives the impression that little or no action will be taken against non-compliers.ⁱⁱ Successful tax delay/avoidance experiences also foster a lax collections environment in the City as a whole, encouraging some businesses to marginalize the need to pay their tax.ⁱⁱⁱ

Tax avoidance impacts the City General Fund in terms of foregone revenue, but also creates a structural equity problem in the marketplace itself since businesses that fail to pay their fair share are at a clear advantage over compliant competitors. The tendency of some businesses to avoid paying taxes increases pressure on the City to make up the difference in revenue by increasing the marginal tax rate or decreasing allowable deductions, thereby shifting an even greater proportion of the tax burden onto businesses, which are in compliance with the law.

Collections and Compliance Practices at BOL

The audit correctly identified most or all of the collections and compliance problems at the Bureau of Licenses. However, in some cases, the audit understated the severity of the problems facing the Bureau.

Collection Efforts

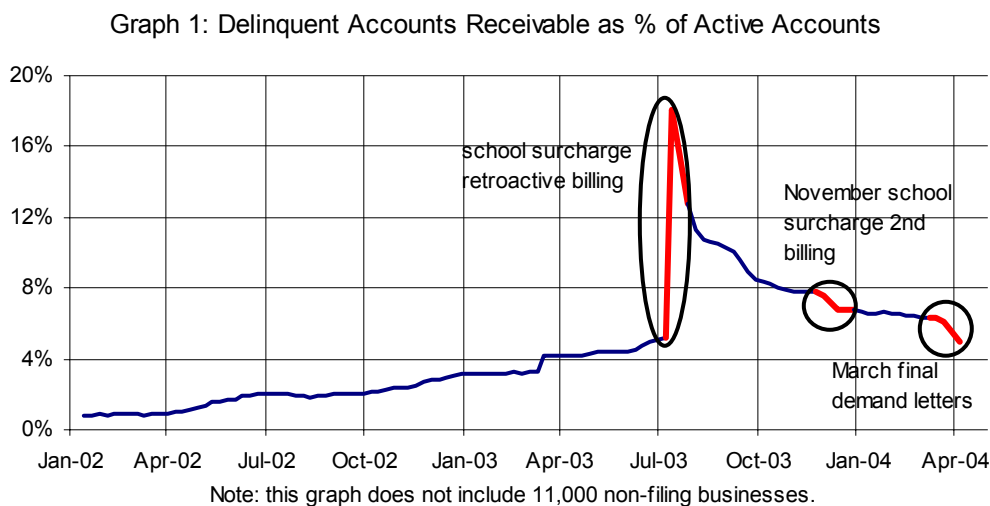
The first step an agency must take to effectively collect receivables is to have clear, written, management supported internal procedures that will be used to bill and collect accounts receivable. These procedures must be timely and should spell out what action should be taken and when the action should be taken.^{iv}

While BOL has some limited written procedures for the collection of taxes and license fees, there is no comprehensive approach to delinquent/non-compliant business account management evident in the Bureau. In particular, the Bureau has not communicated internally or externally that collections and compliance is a top priority, and has not implemented a clear collections strategy integrating automated and manual (phone calls, field visits) processes.

Coordinated manual and automated processes are widely known to produce far more payments from delinquent account holders than either effort in isolation. While the Bureau has been working on implementing a more automated correspondence process, it has not focused enough attention on effective account management and manual processes. As noted in the audit, "the Bureau's procedures for managing accounts receivable indicates that timely and consistent collection efforts have not been taken." The audit further notes that, "in some cases more than a year passed between

notifications.”^v

As illustrated by the graph below, correspondence can dramatically reduce the delinquency rate of known accounts receivable. However, failing to aggressively pursue accounts receivable results in sustained high delinquency rates. Note that the pattern from January 2002 to July 2003 indicates a steady increase in the delinquency rate, which represents a slow denigration of collections and compliance efforts. In July 2003, a new school surcharge was retroactively applied to thousands of accounts, causing a severe jump in the delinquency rate.^{vi} Second demand billings for delinquent school surcharge accounts were not mailed until November 2003. Note that after the second demand billing, there was a marked decline in the delinquency rate, but the overall delinquency rate has still not recovered to pre-July 2003 levels, which were already at an 18-month high. Two years after the delinquency rate first started showing signs of distress, the Bureau has still not recovered.^{vii}



On March 15, 2004 the Bureau mailed 2,508 final demand letters to accounts receivable 90 or more days past due with total balances of \$1.6 million (City and County). Over half of these accounts had not received an invoice in the previous six months. As of this writing, 746 of these accounts are resolved with total payments (City and County) of \$283,988, representing 17% of the \$1.6 million billed.

Organizational and Structural Barriers to Collections Success

Historically collections staff at BOL have exercised a moderate degree of autonomy in the prioritization of their daily work, within general guidelines. While this approach to decision-making is appropriate to the degree of skill and experience epitomized by most BOL collections staff, it has had the unintended consequence of encouraging some staff to focus on the portions of their jobs they enjoy the most, to the detriment of the areas they find less enjoyable. Since collections and compliance work often involves difficult conversations with angry taxpayers, and the Bureau has not placed a high value on collections and compliance work in terms of goals or performance

measures, the natural inclination is for staff at all levels to place a low priority on this kind of work.

A lack of adequate tools is compounding the motivation problem. The database used for collections and compliance is called BLIS (Business License Information System). This database is an excellent tool for tracking thousands of business accounts, but as the audit noted, it does not provide an adequate interface for efficient collections work.^{viii}

In short, BOL has inadvertently created organizational and structural barriers to effective collections and compliance efforts. Top Bureau management is now clearly focused on the goal of improving collections and compliance, and that message is being conveyed to staff at all levels of the organization. A more directed and structured approach to collections with clear collection goals, policies and procedures is being developed to address under-collection. A “collections module” will be implemented within BLIS. This module will address several of the shortcomings mentioned in the audit.

Compliance Efforts

Since the implementation of BLIS, the Bureau has moved dramatically away from a past practice of sending collectors into the field to encourage payment on existing accounts and discovering new accounts. The Bureau’s recent philosophy has been that in-office collections efforts are far more cost effective and efficient than field collection efforts.

While it is true that many more businesses can be contacted using automated correspondence or phone calls, the effectiveness of any given contact is markedly less than a face-to-face visit. Further, a lack of field contact with delinquent or non-compliant business owners coupled with a stream of under-enforced correspondence does more harm than good because it reinforces the belief that ultimately the City will take no substantive action against non-compliers. As noted in the audit, “staff members complained that they spend too much time entering data into the BLIS system and too little identifying unlicensed businesses and collecting on delinquent accounts.”

On March 9, 2004 the Bureau sent eleven collectors into the field for four hours specifically to identify unlicensed businesses. To date, this effort has resulted in the identification of 33 new BLIS accounts, 28 of which were previously non-compliant businesses. Of the 28 non-compliant businesses, 20 of them had been operating without a license for multiple tax years. The disposition of hundreds of potential businesses locations is still pending.

The Bureau has recently re-established the practice of field collections and compliance work. The Bureau is closely tracking the ongoing results of the March 9 effort to determine the opportunity cost/benefit of field collections as compared to office

collections. However, a purely quantitative cost/benefit analysis of field work will not reveal how many businesses come into voluntary compliance as a result of the possibility of a field visit, so the best ongoing collections and compliance strategy will almost certainly include a blending of the two approaches, with field work occurring at least quarterly. The next field effort will take place on May 13, 2004 when the Bureau follows up on businesses with significant past due balances, which did not respond to the March 15, 2004 demand letter referenced above.

BOL will Implement the Recommendations of the Audit

The Bureau has recently undertaken a number of significant steps to improve collections and compliance, internal controls and employee job satisfaction. The Bureau strongly agrees with the audit recommendations and will implement them. Some specific recommendation implementation strategies are addressed below.

Expand and Improve Revenue Collection Practices

1. The Bureau will implement a more aggressive and timely delinquent collections effort with coordinated automated/manual collection procedures. The Bureau is working on a draft collections process using recognized industry best practices while targeting currently delinquent accounts in focused collection efforts to minimize additional "back slip."
2. This summer the Bureau will implement "data matching" (database comparisons) with the State of Oregon Department of Revenue, which will enable it to identify unlicensed businesses operating in the City/County. The Bureau is also working closely with a number of other agencies and City bureaus to ensure compliance with the Business License Law.
3. Full and fair enforcement of penalties against non-compliant businesses. Past Bureau practice was to routinely waive penalties for delinquent taxpayers.
4. Increased advertising and outreach to businesses to ensure they are aware of the law and the Bureau's voluntary compliance incentive for self-identifying. Advertising efforts will be timed just before field visits to encourage businesses to voluntarily comply rather than "get caught."
5. A dedicated attorney to press for legal remedies against the worst offenders. The attorney will explore the possibility of placing liens and garnishments against the property or income of chronic offenders.
6. The Bureau will implement individual and organizational performance measures, which will directly tie to collections and compliance.
7. The Bureau will hire a dedicated employee to focus specifically on unlicensed business identification.
8. The Bureau will implement presumptive billing for non-filing accounts.
9. The Director will participate directly in collection activity, including making collection calls to the largest and most challenging delinquent accounts.

Strengthen the Audit Program

The Bureau will begin research on best practices related to risk-based criteria used to identify non-compliance patterns.

Increase Tax Return Documentation Requirements

The Bureau will begin requiring additional documentation for some classes of filers.

Increase use of Automated Monitoring Tools

The Bureau is currently designing several reports and will explore options regarding the automation of a number of tasks related to monitoring.

Measure and Monitor Collection Performance

The Bureau has been researching best collections practices and is weighing a number of performance measures in addition to those mentioned in the audit. With regard to individual performance as it relates to organizational performance, the Bureau has recently implemented a policy of performance evaluations for all staff. The past practice of giving all staff maximum possible merit increases without documented performance evaluations has been halted. The Bureau will fully implement pay for performance.

Develop Written Policies and Better Documentation for Settlements

The Bureau has convened an internal committee of managers and auditors, which will review all settlements and requests for penalty waivers. The committee has been meeting since February 2004 and will continue to refine the settlement and waiver process while documenting the interpretation and application of Code and administrative rules.

Establish More Frequent Opportunities to Communicate with Staff

The Bureau Director has established an ongoing, rotating schedule of meetings with all employees. The management team has determined that management needs to more fully engage staff in decision-making at the earliest possible stages. Top managers are also going to begin participating in direct discussions with union leadership about areas for labor and management to partner.

BOL's Computation of the "Tax Gap"

The Bureau of Licenses agrees with the overall methodology adopted by the auditors in the estimation of the tax gap. However, the audit methodology appears to be conservative in its treatment of all potentially unlicensed businesses as sole proprietor tax entities (which averaged only \$574 per return in tax year 2002).^{ix} As pointed out by the auditors, while no particular estimate methodology is the "one right" answer, the Bureau's analysis demonstrates the tax gap may range up to \$14.6 million, and offers a more aggressive counterpoint to the auditor's analysis.^x *All of the variance between the Bureau-estimated tax gap and the auditor-estimated tax gap is attributable to the treatment of sole proprietor accounts underlying an estimated 4,822 unlicensed businesses.* Otherwise, the methodologies and assumptions are identical.

On April 7, 2004, as the audit was being finalized, the Bureau undertook an independent analysis of 1,220 accounts which were previously unlicensed but brought

into compliance after being identified by the Bureau using a range of tools over at least four tax years.^{xi} This analysis resulted in the conclusion that a reasonable approach to estimating the value of tax revenue associated with unlicensed businesses is to assume approximately 65% of the unlicensed accounts are sole proprietors, and the balance are a mix of entity types (corporations, s-corporations and partnerships).

The Bureau began by assuming the distribution of all current unlicensed account entity types would mirror the distribution of entity types in the 1,220 previously discovered unlicensed accounts. The 1,220 previously discovered unlicensed accounts were then compared to three other sets of data to validate the distribution of entity types within the first data set. In any instance where another data set indicated corporations, partnerships, s-corporations or estates/trusts might be overstated in the first data set, the comparison data set distribution was retained for that entity type for purposes of the calculation. Using this methodology accomplishes two important goals. It ensures the distribution of entity types in the first data set is reasonable, and it errs on the conservative side by favoring sole proprietors in the analysis. The blue circles on Table 1 indicate the distributions retained for each entity type at the conclusion of the analysis. Sole proprietors were assumed to constitute 46.8% of all unlicensed businesses (the maximum sole proprietor distribution in any given data set) plus the remainder of all businesses not otherwise accounted for. The red circle in the lower right corner indicates the tax gap number to be carried forward to the next stage of the analysis (See Table 2). A discussion of the results of each comparison follows.

Table 1: Analysis of Unlicensed Businesses by Entity Type

Unlicensed Business	Percent of 1,220 Unlicensed Accounts	Percent of 33,100 TY 2002 Returns	Percent of 1,024 Prospect Accounts	Percent of 25 Accounts in Field Survey	No. Accts	Avg. 2002 Return	Unlicensed Entity Type Tax Gap
Sole Proprietor*	46.8%	43.0%	42.1%	32.0%	3,134	\$ 574	\$1,798,916
S Corporations	10.8%	25.0%	6.2%	32.0%	299	\$2,250	\$672,750
Corporations	18.7%	18.0%	14.8%	20.0%	714	\$4,690	\$3,348,660
Partnerships	22.8%	14.0%	34.3%	16.0%	675	\$4,065	\$2,743,875
Estates and Trusts	0.9%	<1%	2.5%	0.0%	0	\$1,881	\$0
Total	100.0%	100.0%	99.9%	100.0%	4,822	\$2,197	\$8,564,201

*46.8% of 4,822 unlicensed accounts plus 877 accounts not captured in other categories equals 3,134 accounts.

Note: circled percentages chosen to use most conservative method (favoring sole proprietor overall).

First, the 1,220 previously discovered unlicensed accounts were compared to 33,110 actual tax year 2002 filings (the first column compared to the second). This comparison indicates the distribution of entity types in the first data set is reasonable for purposes of this analysis when compared to the larger population of entity types in BLIS. It also indicates that partnerships might be overstated in the first data set, so the percentage of partnerships in the second data set (blue circle) is retained for purposes of the analysis.

Second, the data was compared to 1,024 accounts formerly entered into BOL's "Prospects" database (the first column compared to the third), which is a database used

to research potential new businesses prior to setting them up as confirmed business accounts in BLIS. These accounts were subsequently found to be actual businesses with entity type distributions as indicated in Table 1. Note that since this test indicated that s-corporations and corporations might constitute a lower proportion of entity types than in the first data set (or any other on Table 1), their percentages were retained for purposes of the analysis.^{xii}

The third validation test involved checking against the initial results of the recent "Director's Challenge." On March 9, 2004 eleven BOL employees canvassed areas within the City limits in search of unlicensed businesses. As of April 9, 2004 the canvassing effort resulted in 33 new accounts composed of 28 businesses operating without a license and five exempt organizations. Of the 28 businesses operating without a license, 25 have identified entity types as follows: eight corporations, eight sole proprietors, five partnerships and four s-corporations.^{xiii} While this data set is quite small, it is very current and represents a "real world" validation. As indicated by the blue circle, estates and trusts were entirely removed from the BOL analysis as a result of this test.

These validation tests confirm that assuming unlicensed businesses are a mix of entity types is a reasonable approach, and that 35% of unlicensed business may be entity types other than sole proprietors. Table 2 summarizes the impact this new approach has on Figure 8 of the audit report. The red circle highlights the new unlicensed business tax gap brought forward from Table 1. The new unlicensed business tax gap then drives changes in the table using the same calculations and assumptions adopted by the auditors.

Table 2: Audit Report #305, Figure 8 "Tax Gap" as revised by Bureau of Licenses

Entity Type	# Accts	Tax Gap	Amount Collectible*	County Share	City Share
Unlicensed Business	4,822	\$8,564,201	\$2,569,260	\$ 1,156,167	\$ 1,413,093
Accounts Receivable	2,927	\$2,413,900	\$1,206,950	\$ 362,085	\$ 844,865
Non-filing business	6,372	\$3,663,900	\$1,099,170	\$ 494,626	\$ 604,544
Total	14,121	\$ 14,642,001	\$ 4,875,380	\$2,012,878	\$ 2,862,502

*Collectibility factor applied to tax gap (50% for accounts receivable, 30% for unlicensed and non-filing businesses).

Ongoing General Fund Revenue

BOL believes tax revenue resulting from unlicensed businesses should be treated as ongoing revenue, since it represents a stream of income the City would not otherwise realize, and which has not been included in other projections.^{xiv} See Table 3 for a summary of estimated City collectible business taxes.

Table 3: Summary of Three City Collectible Tax Estimates

Organization	One-time	Ongoing*
BOL's Estimate*	\$ 2,862,502	\$ 1,413,093
Auditor's Estimate**	\$ 1,906,896	NA
FPD's Estimate***	\$ 1,350,000	\$ 500,000

*BOL's ongoing estimate is based on the collectible portion of unlicensed businesses.

**For presentation, BOL treated the auditor's gap estimate as one-time.

***Mayor's proposed budget.

Endnotes

ⁱ See Tables 1 and 2 for detail.

ⁱⁱ See the California State Board of Equalization's *Compliance Policy and Procedures Manual*, Chapter 7 for a more complete discussion.

ⁱⁱⁱ It should be noted that an estimated four out of five Portland Businesses are in compliance with the Business License Law and regularly pay their taxes in full.

^{iv} See State of Oregon Department of Administrative Services, *Oregon Accounting Manual*, No. 35.20.40.PR for a more complete discussion.

^v This statement is exceedingly generous. As of March 11, 2004 the Bureau had not mailed an invoice to an even 1,000 accounts receivable for at least one year, 394 of which had not received an invoice from the Bureau in over two years.

^{vi} The retroactive nature of the application was outside the Bureau's control.

^{vii} The Bureau did not begin systematically recording delinquency rate information until February 2004, so it was not in a position to identify this trend. The graph itself is a reconstruction of the probable delinquency rate over time using a query constructed specifically for this document. The auditors did not have access to this information during the course of their audit.

^{viii} As noted in the audit, "not only are delinquent accounts not prioritized, but staff must compile information from multiple reports in order to get necessary collection information."

^{ix} Tax year 2002 is not yet complete, so this average may change slightly.

^x Further, the Bureau of Licenses would be remiss in endorsing a conservative methodology or low collection targets when it should be focused on setting the goal of maximum tax collection and compliance.

^{xi} Discussions with the audit staff indicate this data was not previously at their disposal.

^{xii} There may be some overlap between the unlicensed account analysis of 1,220 accounts and the Prospects database analysis of 1,024 accounts. However, the degree of overlap is thought to be low and will therefore not significantly change the analysis under the first two validation tests.

^{xiii} Final status is still pending for over 500 potential businesses.

^{xiv} The City Economist will need to be consulted to check this assumption.

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