



**CITY AUDITOR**

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September 30, 2013

Honorable Patty Lent, Mayor  
Members of the City Council

The City Auditor has completed the attached report entitled *Review of Tax and License Division*. This was scheduled on the 2013 work plan.

One reason this report was included in the work plan is because only two employees collected and processed over \$8 million in taxes and licenses in 2012. They do a great job with their limited resources. There are no findings to report.

The Finance Department recognizes the potential internal control weaknesses with the limited staff and does as best they can within the budget limitations. Their response letter is attached.

The assistance of Jeanette Wischhoefer is greatly appreciated.

Please contact me if you would like any further information.

Sincerely,

Gary W. Nystul

cc: City Attorney  
Director of Financial Services

# **REVIEW OF TAX AND LICENSE DIVISION**

## **Purpose**

The City Auditor routinely reviews various funds, departments and divisions. This review of the activities of the Tax and License Division of the Department of Financial Services was scheduled on the 2013 work plan.

## **Scope**

The procedures used, and tax and license revenue collected for 2012 were reviewed.

## **Statement of Auditing Standards**

This performance audit was conducted in accordance with Generally Accepted Government Auditing Standards, except section 3.82 which requires an external peer review. Those standards require the auditor to plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on audit objectives. The auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

## **Objectives**

- Review the process used to collect B&O taxes and other similar taxes
- Review oversight by management
- Report any observations for economy, efficiency, effectiveness or improvements to the system of internal control

## **Summary of Results**

- There could be a weakness in the system when one of the two employees is absent due to schedules or leave
- There is some concern about software upgrades and new licensing project

## BACKGROUND

The Tax and License Division of the Department of Financial Services collects the City Business & Occupation tax. It also collects utility taxes, issues business licenses and landlord licenses, as well as other business related licenses and taxes. The two employees collected \$8,273,440 in 2012.

The following table reports revenue collected in 2012 by the Division.

### 2012 REVENUE

#### GENERAL FUND

B&O Taxes	\$2,724,721
General Business License	428,312
Punchboard/Pulltab	74,095
Business Tax Interest & Penalty	50,006
Amusement Games	4,580
Misc. Regulatory License	4,500
Card Rooms	2,765
Peddler/Mobile Vending	875
Bingo	466
Business License Refunds	150
Dancing & Entertainment	70
Charitable Solicitations	25
Subtotal	<u>3,290,566</u>

#### UTILITIES

Electric	1,761,320
Telephone	1,287,545
Cable TV	615,796
Garbage	459,384
Gas	389,955
Subtotal	<u>4,514,000</u>

#### PARKING FUND

Parking Tax	<u>468,874</u>
Subtotal	468,874

<b>TOTAL</b>	<u><b>\$8,273,440</b></u>
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With only two employees, the daily processing tasks are divided so one employee opens the mail and batches the checks. The other employee runs the receipt, prepares the deposit, and posts the payments to the individual accounts. All tax returns and business license applications are also scanned into Laserfiche for archival.

The TaxTools software is used for four functions. These are business licenses, landlord licenses, B&O taxes and state sales tax remittances. The software maintains a record of tax and license payments as well as contact information for each entity.

The present version of TaxTools software is not compatible with Microsoft Windows 7. City employees who must use this software are unable to upgrade their computer operating system. TaxTools has reportedly been working on an upgrade that will be available soon that will correct the compatibility issue.

Sales taxes are collected by the State Department of Revenue who remits the city's portion monthly. The collection detail the state provides includes such as the business name, standard industry code, and the monthly revenue paid to the city for each business. The software allows the preparation of various reports of the revenue received by the city.

The following table shows the net change in business licenses by year. The city issued 4,557 business licenses in 2012. In 2010 the staff initiated an inquiry campaign, sending letters to potential businesses searching for additional businesses that should have city licenses. This project netted an increase of 643 business licenses.

<b>Year</b>	<b>New</b>	<b>Closed</b>	<b>Net Change</b>
2007	460	465	-5
2008	494	540	-46
2009	542	626	-84
2010	1,123	480	643
2011	553	638	-85
2012	561	527	34

The staff uses various means to search for firms who should have city business licenses and/or pay B&O taxes. These methods include using city building permit data and a subscription to a federal contract award database. However, there is limited staff time to do extensive comparisons and send out inquiry letters.

There is a collection process for those who do not pay. In some cases it is necessary to use sales tax data to estimate what the business should have reported for B&O tax. The collection process includes a series of letters and notices encouraging voluntary compliance and ending with referral to a collection agency.

The city licenses landlords with an annual fee. In 2012 there were 1,121 licenses issued. The change in number of licenses for the last six years is as follows.

<b>Year</b>	<b>New</b>	<b>Closed</b>	<b>Net Change</b>
2007	106	3	103
2008	131	3	128
2009	147	30	117
2010	118	34	84
2011	156	67	89
2012	122	66	56

## **OBSERVATIONS AND RECOMMENDATIONS**

### **1. Mail Processing**

The preferred internal control procedure for processing mail receipts is for one employee to open the mail and batch the checks with a second employee preparing the deposit and posting the receipts to the accounting system. The processing of payments is divided between the two staff members resulting in a good segregation of duties. However, when one member is absent due to vacation, sick leave or scheduled day off, the segregation is difficult. Vacation leave could be in excess of 30 days per year total for the two employees. There is often no one to fill in for the absent employee. This creates a weakness in the system. The Finance Department is aware of the issue and works with the available staff.

**Recommendation:** Additional staff should be trained to provide relief when one member is absent in order to maintain proper segregation of duties for the preferred internal control.

**2. New Business Licenses**

In 2010 the staff initiated a campaign to inform businesses of what activities they might engage in that would require them to obtain a city business license. As indicated in the table above, that year had a net increase of 643 business licenses.

**Recommendation:** This effort by the staff should be commended.

**3. Small Utility Tax Returns**

A review of Utility Tax receipts disclosed some remittances for small amounts such as \$0.07, \$0.81 and \$0.87. Some firms file monthly reports with zero tax due. Filing of monthly returns with little or no taxable income is a cost to the business and the city for processing. BMC Section 2.86.040 gives discretion to the Director of Financial Services to assign monthly, quarterly or annual reporting for B&O taxes.

**Recommendation:** Consideration should be given to allow the Director of Financial Services the same discretion with utility taxes to report quarterly or annually.

**4. Landlord Licensing**

There is a new licensing program being initiated for landlords. This may present significant challenges to the Tax & License division if they will be responsible for initially recording the licenses. At present it appears the staff has little time for researching businesses that should be reporting for B&O taxes and business licenses. The additional work load may decrease this beneficial auditing even more.

**Recommendation:** The City could consider providing additional staff or re-assignment of responsibilities to ensure the Tax & License staff has adequate time to do their present work.

**5. Software**

The TaxTools software used for these tax and license functions is not compatible with Microsoft Windows 7 operating system. Those employees who use TaxTools are unable to upgrade their computer operating system. The software company is planning for the new version to be issued in August. The City is well aware of the situation, but there is presently no alternative to this vendor.



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## MEMORANDUM

**Date:** September 25, 2013  
**To:** Gary Nystul, City Auditor  
**From:** Becky Hasart, Director Financial Services  
**RE:** Response to Tax and License Division Review

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Per BMC 2.18.060, please find below the official response to the above referenced audit report.

*Summary of Results – There could be a weakness in the system when one or two employees is absent due to schedules or leave*

The Financial Services Department recognizes the potential for a weakness in its internal controls due to staffing levels. As with all departments of the City, our staffing levels are commiserate with the available resources. We cannot implement the ideal level of internal controls but we do make adjustments (backup training, review procedures) to maximize our controls given the resources currently available. In addition, Tax and Licensing is the only area within the accounting functions of financial services to have more than one employee dedicated to its assigned function, thus allowing us a higher level of internal controls in comparison to other functions within Financial Services.

*Summary of Results – There is some concern about software upgrades, and new licensing project*

The City utilizes Microflex as a third party vendor in its daily procedures in the tax and licensing division. As referenced in the attached audit report, there are currently no other viable vendors for this work. We are aware of the challenges associated with the current version of Microflex and we have been working with this vendor to start the process of implementing the necessary conversions in anticipation of the next software upgrade. Microflex has been in the process of implementing a web based platform to replace the current version. Testing and delays on their part has pushed back the implementation of the new version from August 2013 to October 2013.

Information and response regarding the new licensing project/initiative will be found in responses to the observations and recommendations #4.

*Observations and Recommendations: #1. Mail Processing*

As mentioned above in the response to Summary of Results, the Financial Services Department recognizes the potential for a weakness in its internal controls due to staffing levels. As with all departments of the City, our staffing levels are commiserate with the available resources. We cannot implement the ideal level of internal controls but we do make adjustments (backup training, review procedures) to maximize our controls given the resources currently available. In addition, internal controls are consistently reviewed by the Washington State Auditors as part of their annual audit.

*Observations and Recommendations: #2. New Business Licenses*

The campaign in 2010 was initiated after conversion from the prior tax and license system and the database records were reviewed and updated. This campaign is an ongoing effort each year. We concur that our available staff does an excellent job with this effort given the limited resources we have.

*Observations and Recommendations: #3. Small Utility Tax Returns*

The discretion provided to the Financial Services Director regarding B&O taxes found in BMC 2.86.040 does not extend to utility tax returns. This issue has been reviewed as recently as 2012, at which time the policy decision was to not make changes.

*Observations and Recommendations: #4. Landlord Licensing*

During 2013, Council has implemented new regulations regarding landlord licensing/registration. Because this is a new initiative, it is too early to determine if additional staff is needed to accomplish this program. As part of the budget request for fiscal year 2014, Financial Services is requesting \$13,000 for temporary help to assist with the initial recording efforts for the anticipated increase in landlord licensing and registration. We will monitor the impacts of this program and should it start to impact existing efforts regarding B&O tax auditing and receipting, the B&O tax auditing and receipting will remain the priority for existing staff.

*Observations and Recommendations: #5. Software*

As mentioned above in the response to Summary of Results, the City utilizes Microflex as a third party vendor in its daily procedures in the tax and licensing division. As referenced in the attached audit report, there are currently no other viable vendors for this work. We are aware of the challenges associated with the current version of Microflex and we have been working with this vendor to start the process of implementing the necessary conversions in anticipation of the next software upgrade. Microflex has been in the process of implementing a web based platform to replace the current version. Testing and delays on their part has pushed back the implementation of the new version from August 2013 to October 2013.