



CITY AUDITOR 345 6th Street, Suite 100, Bremerton, WA 98337-1873 & Phone (360) 473-5369

May 9, 2022

To Audit Committee Members:

Deborah McDaniel, Citizen Member
Jeff Coughlin, Council Member, Audit Committee Chair
Quinn Dennehy, Council Member

Re: Sales Tax Revenue Internal Audit

Dear Audit Committee Members:

At your request and based on the information available to date, I hereby submit my Sales Tax Revenue Audit findings. Primary sources of information relied on for this report are listed in Exhibit 1, attached.

SUMMARY OF FINDINGS

Based on the review outlined in this report, a few recommendations were noted as summarized below:

1. The City of Bremerton (“City”) should consider expanding its breadth of Business and Occupation tax compliance audits.
2. Controls should be implemented to ensure that when a City employee, who was selected by Council as a Designated Individual of the Local Government Investment Pool account, leaves his/her position and then is replaced, the new Designated Individual is reported to the Office of the State Treasurer in a timely manner.
3. For purposes of allocating the affordable housing sales tax, the City should consider developing a Bremerton median income rather than the County/Metropolitan Statistical Area median income it currently uses.
4. The Audit Committee should consider including on its work plan a periodic review of the mathematical accuracy of the budgets and other related tasks deemed appropriate.

Additional details about these findings and other information are reported below.

BACKGROUND

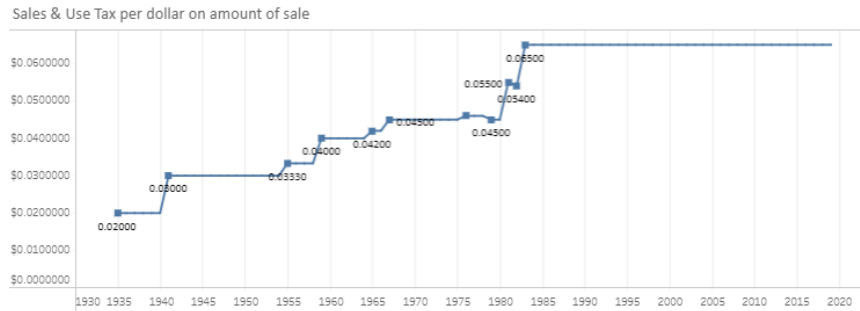
Inception of State Sales and Use Tax¹

Historically, Washington State did not have a sales tax and its predominant revenue source was property tax. However, in November 1932, Washington voters passed Initiative 64, which limited the tax Levy on personal and real property and reduced property taxes by almost 50 percent.

¹ Throughout this report, references to sales tax includes sales and use tax unless otherwise noted.



In March 1935, Governor Clarence D. Martin (D) signed into law the Revenue Act of 1935, which authorized an array of excise taxes, including a retail sales tax that reduced the state’s dependency upon property tax. As shown in the chart below, Washington’s state retail sales tax rate started at two percent in 1935 and increased over the years to its current rate of 6.5 percent.



Source: <https://dor.wa.gov/about/statistics-reports/history-washington-taxes>

In addition to the state sales tax reflected above, in 1970, the State provided legislative authority to cities and counties allowing them to impose a 0.5 percent sales tax for general local government purposes. In 1982, the legislature authorized cities and counties to impose a second 0.5 percent on retail sales for general government purposes, resulting in a combined total of one percent that is still in place today. In addition to the State and City sales tax, the County and Transit District impose sales tax. Plus, beginning July 2003, the state added 0.3 percent sales tax to the selling price of motor vehicles.

Thus, although the State sales tax rate has remained at 6.5 percent since 1983 (notwithstanding the additional sales tax on motor vehicles), local jurisdictions began imposing sales taxes in 1970 that have continued to increase. From 1970 to 2022, local sales taxes have grown from 0.5 to 2.7 percent and account for an additional 41.5 percent over the 6.5 percent state rate. Combining the state and local sales taxes results in a total sales tax rate of 9.2 percent in Bremerton (9.5 percent on motor vehicles). The table below identifies the various local sales taxes in Bremerton, including tax rates, what government entity imposes the tax, and when the tax originated:

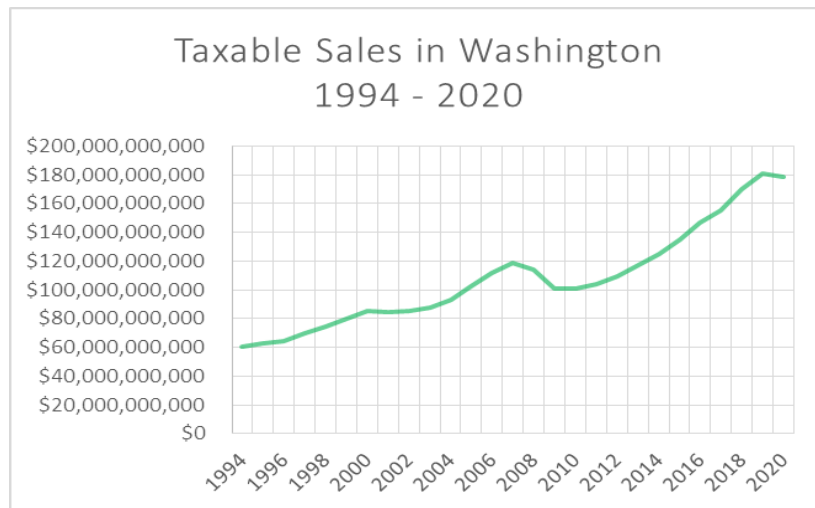
Description	Tax Rate	Cumulative Local Rate	Imposed By	Start Year	RCW
Local taxes:					
Basic sales tax - "First Half Cent"	0.5%	0.5%	City	1970	RCW 82.14.030(1)
Basic sales tax - "Second Half Cent"	0.5%	1.0%	City	1982	RCW 82.14.030(2)
Kitsap Transit - initial	0.3%	1.3%	Transit district	1982	RCW 82.14.045
Criminal justice	0.1%	1.4%	County	1993	RCW 82.14.340
Kitsap Transit - 1st increase	0.2%	1.6%	Transit district	1993	RCW 82.14.045
Juvenile detention	0.1%	1.7%	County	1999	RCW 82.14.350
Kitsap Transit - 2nd increase	0.3%	2.0%	Transit district	2001	RCW 82.14.045
E911 - initial	0.1%	2.1%	County	2004	RCW 82.14.420
Mental health and drugs	0.1%	2.2%	County	2013	RCW 82.14.460
Passenger ferry	0.3%	2.5%	Transit district	2017	RCW 82.14.440
E911 - increase	0.1%	2.6%	County	2022	RCW 82.14.420
Affordable housing	0.1%	2.7%	County	2022	
Current local sales and use tax rate	2.7%				
State sales and use tax rate	6.5%		State		RCW 82.08.020(1)
Total sales and use tax rate in Bremerton	9.2%				



As shown in the table above, two additional sales taxes went into effect in 2022: a 0.1 percent increase of the E911 sales tax and a new 0.1 percent affordable housing sales tax. Washington’s average sales tax rate is 8.66 percent.

Washington State Retail Sales Tax Basis

In addition to the tax rate increasing over time, so has the tax basis. The following chart shows taxable retail sales in Washington increased from \$60 billion in 1994 to \$178.4 billion in 2020:



Destination Based Sales Tax System

Beginning in 2008, Washington uses the destination-based sales tax system, also known as the “streamlined sales tax.” Under this system, the applicable tax rate depends on the location of the sale/delivery, not the location of the business or shipping warehouse. For example, if you buy a piece of furniture that is shipped from a warehouse in Seattle and have it delivered to Bremerton, you will pay the local sales tax rate applicable in the City of Bremerton. But if you take possession of merchandise at a retail business location in Seattle, you will pay the local sales tax rate applicable in the City of Seattle.

Internet/Mail-Order Sales

Prior to 2018, “remote sellers”, those without a physical presence in Washington State, and “marketplace facilitators” who facilitated the sale of products provided by remote sellers, were not required to charge any sales tax for Internet or mail-order sales, although some opted to do so voluntarily. In situations where neither the remote sellers nor the facilitators charged sales tax, use tax was due but seldom collected.

Beginning in January 2018, the Marketplace Fairness Act in Washington State required almost all remote sellers to either collect sales taxes on purchases delivered to Washington, or to inform consumers that use taxes were due and to provide annual reports on this activity to both the consumer and the state Department of Revenue (DOR). Most remote sellers opt to collect and remit sales taxes directly to DOR, rather than track and report use taxes.

Below is a summary of Washington state retail sales and use tax collections the latest ten fiscal years:



Fiscal Year	Retail Tax (\$000s)			Use Tax % of Total
	Sales	Use	Total	
2012	\$ 6,755,388	\$ 486,305	7,241,693	6.7%
2013	7,180,526	524,101	7,704,627	6.8%
2014	7,720,827	564,996	8,285,823	6.8%
2015	8,255,132	592,857	8,847,989	6.7%
2016	8,979,623	643,880	9,623,503	6.7%
2017	9,514,975	682,737	10,197,712	6.7%
2018	10,291,675	702,756	10,994,431	6.4%
2019	11,170,430	765,206	11,935,636	6.4%
2020	11,357,457	728,483	12,085,940	6.0%
2021	12,525,688	847,853	13,373,541	6.3%

Sources: https://dor.wa.gov/sites/default/files/legacy/Docs/Reports/2021/Tax_Statistics_2021/Tax_Statistics_2021.pdf, https://dor.wa.gov/sites/default/files/legacy/docs/reports/2017/Tax_Statistics_2017/Table2.pdf

SALES TAX REVENUE PROCESS

Businesses collect sales tax from customers and remit the tax to the DOR. The DOR calculates how much tax is owed to the City by type of tax. DOR then sends an electronic file with this information to the Office of the State Treasurer (OST), which deposits the funds directly to the City’s interest bearing Local Government Investment Pool (LGIP) account. At the end of each month, the OST sends to the City a remittance advice detailing the funds received by type of tax/BARS Code.

The OST requires an LGIP Authorization Form from the City that identifies persons authorized (“Authorized Individuals”) to make deposits and withdrawals to/from the City’s LGIP account and designates the bank account where LGIP funds can be transmitted.² By way of a resolution, City Council designates an individual (“Designated Individual”) authorized to make changes to the LGIP Authorization Form. A Designated Individual selects the Authorized Individuals. Currently, per Resolution No. 3338, the Finance Director and Assistant Finance Director/Treasurer, Mike Riley and Sheri Jackson, respectively, are the Designated Individuals and the current Authorized Individuals³ for making fund transfers to/from the LGIP account are Mr. Riley, Ms. Jackson, and Judie Carlson, Accounting Assistant Senior.

To add or remove Authorized Individuals, a new LGIP Authorization Form must be signed by a Designated Individual and submitted to OST. After a Designated Individual leaves his City position, the City is supposed to notify the OST immediately upon the replacement of that person. It was noted during our review that the City did not notify the OST in a timely manner when recent Designated Individuals were replaced. Importantly, this posed minimal financial risk to the City because, as previously noted, in transferring funds out of the LGIP account, the funds can only be directed to the City’s designated bank account.

Controls should be implemented to ensure changes in the Designated Individual are reported to OST in a timely manner.

² For the City’s protection, funds can only be transferred to the one bank account designated on the LGIP Authorization Form. Changes to the participant’s bank information must be submitted in writing to the OST.

³ Authorized Individuals are approved by one of the Designated Individuals to make fund transfers to/from the LGIP account.



RISK

Based on interviews with Mr. Riley and representatives from the DOR, the greatest sales tax revenue risk is whether the business collects the appropriate sales tax from the customer and remits all the sales tax to the State. In most jurisdictions, auditing business compliance with collecting and remitting sales taxes is the DOR’s responsibility, including in Bremerton. However, because the City has a local Business and Occupation (B&O) tax, the City can audit business compliance with collecting and remitting local B&O tax, which can reveal issues with sales tax reporting as well.

Based on my review of the sales tax process and interview with Mr. Riley and Ms. Jackson, besides the business compliance risk noted above, other risk associated with the sales tax revenue process appears low.

AUDITING LOCAL B&O TAX

The City currently performs desk audits of B&O tax, and has considered field audits of business compliance with collecting and remitting local Business & Occupation (B&O) tax but has not moved forward with field audits. Through the process of auditing local B&O tax, the City could simultaneously audit sales tax. I understand some in City leadership perceive auditing B&O tax conflicts with the “welcoming” message they wish to convey to small business. However, in 2021, City Council increased the B&O tax exemption to \$1 million; thus, small businesses (those with less than \$1 million in revenue) are no longer required to pay B&O tax.

We inquired of 12 Washington city finance/audit directors as to whether they audit local B&O tax. Ten responded with five of the ten directors stating they audit businesses for compliance with local tax reporting, either full or limited scope audits. Bellevue stated they get a four to one return on the investment in field audits, and Kent stated they believe they have increased compliance as a result of auditing. The cities that offered they do limited scope/desk audits when issues surface, stated comprehensive audits would be performed but for limited resources. The five cities that answered they do not perform B&O compliance audits, they may do limited scope/desk audits (I did not ask about desk audits – some cities offered that information.) Below is a summary of the responses:

City	Does City Audit Local B&O	Reason	Return On Investment	Contact
Kent	Yes, believes auditing increases compliance.		Increased compliance	Robert Goehring, Internal Audit and Tax
Bellevue	Yes, perform field audits with a staff of 6 in-house auditors		4 to 1	Troy Lucas, Tax Manager
Burien	Perform limited scope audits when issues arise.			Eric Christensen, Finance Director
Everett	Limited scope audits. Plan to expand.	Resources		Susy Haugen, Finance Director
Lacey	Perform limited scope audits when issues arise.	Resources		Troy Woo, Finance Director
Des Moines	No, a small city with limited resources.	Resources		Jeff Friend, Deputy Finance Director
Issaquah	Previously performed audits. File Local is helpful.	Resources		T. Robert Hamud, Chief Finance Officer
Kenmore	No. Will look into implementing in the future.			Leticia Salcido, Finance & Administration Director
Bainbridge Island	Not yet. Plan to start with business license compliance audits.	Resources		DeWayne Pitts, Finance Director
Port Townsend	No.	Resources		Nora Mitchell, Finance Director

In light of the potential benefits of improved self-reporting and additional revenue, the City should reconsider expanding from local tax desk audits to field audits. The previous concern about appearing unwelcoming toward small business has likely been eliminated through the increased exemption.



ANNUAL ACTIVITY

Sales tax revenue accounts for approximately 25 percent of the City’s General Fund revenue, averaging approximately \$11.2 million annually the past six years (2016 through 2021).⁴

Year	Retail		Criminal Justice	Local Revitalization	Affordable Housing	Hotel/Motel	Total Sales Tax
	General Fund	Wastewater					
Amount:							
2016	\$ 8,007,178	\$ 75,552	\$ 591,311	\$ 352,173	\$ -	\$ 555,836	\$ 9,582,050
2017	8,568,933	87,043	628,843	356,074	-	637,422	10,278,315
2018	9,113,213	77,053	714,626	339,982	-	697,643	10,942,517
2019	9,593,552	94,703	750,319	314,259	-	708,787	11,461,620
2020	9,937,137	79,430	770,137	330,000	21,702	502,967	11,641,373
2021	11,155,872	105,530	875,172	330,000	97,121	643,393	13,207,088
Total	\$ 56,375,885	\$ 519,311	\$ 4,330,408	\$ 2,022,488	\$ 118,823	\$ 3,746,048	\$ 67,112,963

As shown below, total sales tax revenue has increased each of the past five years although not in each category. Remarkably, retail sales tax revenue increased in 2020 and 2021, during the COVID-19 pandemic, which Mr. Riley explained was, in part, due to increased Internet sales in Bremerton during the pandemic. However, a number of industry categories maintained strong sales during the pandemic. The most significant decrease was the Hotel/Motel tax in 2020, when the hospitality industry experienced a significant economic downturn due to the COVID-19 pandemic.

Year	Retail		Criminal Justice	Local Revitalization	Affordable Housing	Hotel/Motel	Total Sales Tax
	General Fund	Wastewater					
Year to year change:							
2016							
2017	\$ 561,755	\$ 11,491	\$ 37,532	\$ 3,901	\$ -	\$ 81,586	\$ 696,265
2018	544,280	(9,990)	85,783	(16,092)	-	60,221	664,202
2019	480,339	17,650	35,693	(25,723)	-	11,144	519,103
2020	343,585	(15,273)	19,818	15,741	21,702	(205,820)	179,753
2021	1,218,735	26,100	105,035	-	75,419	140,426	1,565,715
Total	\$ 3,148,694	\$ 29,978	\$ 283,861	\$ (22,173)	\$ 97,121	\$ 87,557	\$ 3,625,038

The table below shows the year to year change expressed as a percentage:

Year	Retail		Criminal Justice	Local Revitalization	Affordable Housing	Hotel/Motel	Total Sales Tax
	General Fund	Wastewater					
Year to year growth:							
2016							
2017	7.0%	15.2%	6.3%	1.1%	NA	14.7%	7.3%
2018	6.4%	-11.5%	13.6%	-4.5%	NA	9.4%	6.5%
2019	5.3%	22.9%	5.0%	-7.6%	NA	1.6%	4.7%
2020	3.6%	-16.1%	2.6%	5.0%	NA	-29.0%	1.6%
2021	12.3%	32.9%	13.6%	0.0%	NA	27.9%	13.4%
Average	5.6%	2.6%	6.9%	-1.5%	NA	-0.8%	5.0%

⁴ 2021 amounts do not reflect changes in receivables.



Sales tax from motor vehicles and parts dealers is by far the single highest sales tax generator in Bremerton, accounting for over 30 percent of Bremerton sales tax revenue in 2021. Of the 57 industry categories that reported retail sales tax in Bremerton in 2021, four categories account for over half of Bremerton’s retail sales tax revenue: Motor vehicles and parts dealers (31.6 percent), Food services and drinking places (7.5 percent), Specialty trade contractors (6.6 percent), and Construction of buildings (6.2 percent).

COMPLIANCE – USE

Basic Sales Tax/First and Second Half-Cent

Every city, town, and county in Washington has imposed the first half-cent sales tax; and almost every city, town, and county has imposed the full second half-cent sales tax⁵. For each half-cent, the combined city/county rate may not exceed 0.5 percent for each half-cent tax, so cities and counties must share the revenue. With the revenue sharing, 15 percent of each 0.5 percent collected within the City is distributed to the county, and the remaining 0.85 percent is the City’s portion. The DOR retains one percent of the tax revenue as an administrative fee.

Use of the first and second half cent is unrestricted. Because the retail sales tax may be used for any lawful purpose, compliance testing concerning the City’s use of this tax is deemed unnecessary.

Criminal Justice Sales Tax

This non-voted sales tax is imposed by the County and shared with all the cities and towns in the County. Ten percent of the criminal justice sales tax revenues are distributed to the county, while the remaining 90 percent is split between the county and its cities on a per capita (population) basis. The county’s per capita share is based on the unincorporated population. The DOR retains one percent as an administrative fee.

The criminal justice sales tax revenue is restricted and must be used for criminal justice. The City’s primary institutions of criminal justice include law enforcement, courts, and prosecution⁶. The 2020 budget for these departments exceeded \$14 million and the criminal justice sales tax revenue was \$770,000. Because the expenditures far exceed the tax revenue, testing whether the funds were used for their intended purpose is deemed unnecessary.

Affordable Housing Sales Tax

In the 2019 Legislative Session, the Washington State Legislature approved Substitute House Bill 1406, which authorized the governing body of a city or county to impose a local sales tax for the following restricted uses:

- Acquisition, construction or rehabilitation of affordable housing or facilities providing supportive housing;
- Operations and maintenance costs of affordable or supportive housing; and
- Providing rental assistance to tenants whose income is at or below sixty percent of the City median income.

The affordable housing sales tax is 0.0073 percent of retail sales in the City and is credited against the State’s 6.5 percent sales tax. Thus, the tax does not result in higher sales taxes

⁵ As of 2019, cities Asotin and Clarkston and counties Asotin and Klickitat each imposes the second tax at 0.3 percent. Their calculations for revenue sharing are slightly different than described in this section.

⁶ Part of the City’s Legal Services department.



for the consumer. The tax provides an additional source of funding to address housing needs in the City. The City imposed this tax through Ordinance No. 5377 that was passed by the City Council October 2, 2019. Consistent with SHB 1406, the Ordinance states the tax must be used to assist persons whose income is at or below sixty percent of the City of Bremerton median income.

Affordable housing sales tax revenue is reported in the General Fund Non-Departmental account. The revenue started in late 2020 and, according to Section 8 of Ordinance No. 5377, this tax is scheduled to expire 20 years from the date it was first imposed. The annual total affordable housing sales tax revenue for 2021 was approximately \$100,000. The City uses this revenue source to assist the working poor and seniors who are struggling to pay their rent. This is carried out through a partnership with Bremerton Housing Authority (BHA). The City budgeted to fund \$100,000 to this program in 2021, and according to Mr. Riley, it was fully expended.

During the audit, it was noted that the median income used by BHA to evaluate eligibility for this rental assistance program is based on the Bremerton/Silverdale Metropolitan Statistical Area (MSA) median family income by size of household, rather than the Bremerton median income. The MSA data used by BHA is based on HUD estimates for all of Kitsap County using data from the American Community Survey, a survey conducted by the US Census Bureau.

The State statute (RCW 82.14.540) does not specify a data source for determining median family income. A finance consultant from MRSC stated the two typical sources he has seen used for median family income are from the Office of Financial Management (OFM) and the HUD source used by the City. According to Andrea Spencer, Director of Community Development, HUD's Bremerton/Silverdale MSA median income by size of household is the industry standard used for housing programs. The HUD estimated MSA median family income for 2019 was \$85,500.

Although not the industry standard statistic used for housing programs, a different table from the American Community Survey (Table ID DP03, 2019: ACS 5-Year Estimates) provides estimated median family income for cities, as summarized below. As shown, Bremerton's median family income is substantially less than its Kitsap neighbors and the \$85,500 HUD MSA median family income used by BHA. A shortcoming of the DP03 table is that it does not provide the median income by size of household. The household information may be reported in a different ACS table.

The last line in the table below shows the 2019 estimated MSA median family income from the DP03 table is about four percent higher than the HUD MSA estimate, which seems reasonably close, which suggests the DP03 data could be reliable. A comparison of more years of data could provide a better indication of the comparability of these data sources.



Place	2019 Median Family Income (DP03)		Compared to \$85,500 HUD MSA	
	Amount	Margin of Error	Difference	% Difference
		+/-		
Bremerton	\$65,622	\$3,743	-\$19,878	-23.2%
Port Orchard	85,219	12,167	-281	-0.3%
Poulsbo	99,120	12,185	13,620	15.9%
Silverdale	95,555	7,435	10,055	11.8%
Bainbridge Island	143,367	7,517	57,867	67.7%
MSA per DP03	89,107	1,698	3,607	4.2%

The City Legal department has opined it is acceptable for the City to continue to use the Bremerton/Silverdale MSA median income for determining program eligibility, although Legal also agreed it would be acceptable to derive a median income that reflects the fact that Bremerton’s median income is substantially less than the other cities in its MSA.

Importantly, it should be noted that although income is used to evaluate eligibility for the rental assistance program, the applicants are also reportedly ranked to ensure funding goes to those with the greatest need. This ranking is a good means for mitigating the usage of County income instead of Bremerton income.

Based on the sources noted above, the 2019 median family income in Bremerton is substantially less than the 2019 MSA/County median family income. The City should consider more definitively assessing the reliability of the DP03 data, and if found to be reasonably reliable, incorporate the data in its eligibility assessment. By way of example, the City could account for Bremerton’s lower income by adjusting the HUD median family income using a formula based on Bremerton’s income compared to the rest of the MSA

Alternatively, the City could try to work with the State to develop a reliable Bremerton median income.

Local Revitalization Financing (LRF) Sales Tax

The LRF Program was created by Second Substitute Senate Bill 5045 (the “Act”), passed by the state legislature in 2009. The Act does not increase taxes to citizens – it merely reallocates incremental increases in existing taxes that result from improvements planned in the Revitalization Area.

In 2009 and through Ordinance 5088, the City formed the Bremerton Harborside Revitalization Area, and successfully applied for funding through the LRF Program. The City uses the LRF funding to help pay the Park Plaza Parking Garage bond payments. In 2021, the City will receive an estimated \$365,000 of LRF sales tax revenue, which will be applied toward the 2021 bond payment of \$530,000.⁷ According to Mr. Riley, the LRF sales tax revenue expires in 2023 and the current outstanding bond balance is \$5.85 million.

Hotel/Motel Tax

The hotel/motel tax is a consumer tax on lodging charges for periods of less than 30 consecutive days for hotels, motels, rooming houses, private campgrounds, RV parks, and similar facilities. This two percent tax on lodging revenue is in addition to the state and local sales taxes, yielding a total sales tax of 11.2 percent on lodging revenue.

⁷ Mr. Riley stated the annual bond payment decreases to \$369,000 beginning in 2031.



The hotel/motel tax revenue is awarded to select applicants, which can include the City and/or other parties, for the following uses:

- Tourism marketing;
- Marketing and operations of special events and festivals designed to attract tourists;
- Operations *and* capital expenditures of tourism-related facilities owned or operated by a municipality or a public facilities district, including repayment of general obligation bonds (RCW 67.28.150) or revenue bonds (RCW 67.28.160) for eligible capital projects; or
- Operations of tourism-related facilities owned or operated by nonprofit organizations (but *not* capital expenditures).

Lodging Tax Advisory Committee (LTAC) staff reviews the lodging tax funding applications for completeness and to ensure the stated use complies with state law. When questionable uses are noted, LTAC staff submits those applications to Legal for review.

After an applicant is awarded hotel/motel tax funds, the Finance Contract Administrator drafts a contract that specifies the award use. When the applicant submits invoices for expense reimbursement, the Contract Administrator confirms the expenditures agree with the intended use, then approves the invoice. The Accounts Payable Specialist then verifies data entry accuracy and appropriate signature authority.

From the point of application through payment to the applicant, the City has controls in place to ensure lodging tax funds are used in compliance with state law.

COMPLIANCE - TIMING:

Most retailers remit their sales taxes to the Department of Revenue (DOR) on a monthly basis, with remittance due by the 25th of the following month. The DOR distributes those collections, plus interest, to the City on the last business day of the following month after subtracting a small administrative fee. This means that for most purchases, there is a 60 to 90-day lag between the underlying transaction (the retail sale) and the City's receipt of the related sales tax revenue. For instance, if a sale is made in November – whether on the 1st or 30th – the sales tax is typically remitted to DOR by December 25, and DOR would then distribute the money (minus a small administrative fee) to the City around January 31.

In the General Fund, the City reports the current year's January receipts (from November sales transactions) in the *prior* year as Taxes Receivable and Sales Tax Revenue. The current year's February receipts (from December sales transactions) are also reported in the prior year but February's receipts are reported as Taxes Receivable and Unearned Revenue. The State Auditor's Office has reviewed and concurs with the City's sales tax revenue reporting.

Local sales tax revenues are in DOR's possession for approximately one month prior to distribution and accrue interest during that time. Interest earned on the funds collected is paid to the City under the provisions of RCW 82.14.050.

SALES TAX BUDGETS

Budgeted sales tax revenue is estimated by the Finance Department. The budgeted amounts are based primarily on historical data, current trends, and economic reports provided by the State. The LRF sales tax revenue is determined by the State.



The COVID-19 pandemic first affected the local region the first quarter of 2020 and presented economic uncertainty. Conservatively, the City submitted a mid-year budget revision in 2020 for sales tax, reducing budgeted retail sales tax revenue \$1.1 million to \$8.6 million. Actual retail sales tax revenue for 2020 ended up approximately \$300,000 higher than the original budgeted amount.

From 2017 through 2020, on average the City’s actual sales tax revenue was within about two percent of the budgeted sales tax revenue.⁸ The City derived a conservative sales tax revenue budget for 2021 and ended the year approximately 17 percent over budget.

During my review of the 2022 sales tax budget (not yet published), it was noted that a summary of general fund revenue incorrectly showed some data in the wrong year. For example, 2017 revenue was shown under the 2018 heading. Finance staff was appreciative of the finding and updated the schedules to reflect the correct data in the corresponding year.

The table below compares budget and actual sales tax revenue the past five years:

Description	2017	2018	2019	2020	2021
Retail Sales Tax (GF and WW):					
Actual	\$ 8,655,976	\$ 9,190,266	\$ 9,688,255	\$ 10,016,567	\$ 11,261,402
Less beginning of year budget (A)	8,450,000	8,748,000	9,690,000	9,725,000	9,390,000
Difference	205,976	442,266	(1,745)	291,567	1,871,402
Criminal Justice:					
Actual	\$ 628,843	\$ 714,626	\$ 750,319	\$ 770,137	\$ 875,172
Less budget	630,000	600,000	690,000	770,000	725,000
Difference	(1,157)	114,626	60,319	137	150,172
Local Revitalization:					
Actual	\$ 356,074	\$ 339,982	\$ 314,259	\$ 330,000	\$ 330,000
Less budget	355,680	362,800	330,000	330,000	330,000
Difference	394	(22,818)	(15,741)	-	-
Affordable Housing:					
Actual	\$ -	\$ -	\$ -	\$ 21,702	\$ 97,121
Less budget	-	-	-	74,616	77,236
Difference	-	-	-	(52,914)	19,885
Hotel/Motel:					
Actual	\$ 637,422	\$ 697,643	\$ 708,787	\$ 502,967	\$ 643,393
Less budget	605,000	605,000	650,000	750,000	470,000
Difference	32,422	92,643	58,787	(247,033)	173,393
Total:					
Actual	\$ 10,278,315	\$ 10,942,517	\$ 11,461,620	\$ 11,641,373	\$ 13,207,088
Less budget	10,040,680	10,315,800	11,360,000	11,649,616	10,992,236
Difference	\$ 237,635	\$ 626,717	\$ 101,620	\$ (8,243)	\$ 2,214,852
Percent difference	2.4%	6.1%	0.9%	-0.1%	20.1%

⁸ The two percent is based on the original budget in 2020.



The annual budget is nearly 300 pages and includes many schedules. With the finding of misaligned data, the Finance department has asked whether Internal Audit can review the budgets prior to them being published. The City Auditor agrees that another level of review would be helpful. While Internal Audit cannot be responsible for the accuracy of the budgets, pending Audit Committee's discretion, Internal Audit could include on its work plan a periodic review of the mathematical accuracy of the budgets and other tasks deemed appropriate.

OTHER

Accounting for Interdepartmental Revenue Sharing

In July 2001, the COB General Fund ("General Fund") and the COB Wastewater Utility ("Utility") entered into an agreement that provided the General Fund would share certain incremental tax revenues with the Utility. The purpose of the agreement was to compensate the Utility for project costs associated with preparing numerous land parcels to be sold for commercial purposes that would generate additional Business and Occupation (B&O) and sales tax revenue for the General Fund as a result of businesses re-locating to the improved property.

The Revenue Sharing Agreement (Agreement) stipulated a formula for calculating the incremental tax revenue to be shared by the General Fund with the Utility. The Agreement also provided that the term of the agreement would continue until a total of \$1,100,000 of incremental tax revenue had been received by the Utility.

Staff from the City Community Development department calculated the incremental tax owed to the Utility and maintained a spreadsheet of amounts paid by month and year. Community Development submitted the amount owed to Finance, who then remitted payment to the Utility. Neither Community Development staff nor Finance staff was aware that the Agreement would end when \$1.1 million had been received by the Utility. Coincidentally, the Utility reached its \$1.1 million during the time this issue was raised in the audit.

Although this Agreement was interdepartmental with no risk of funds being improperly remitted to an external party, controls should be in place to notify appropriate staff when the term of the agreement ends and no additional funds are due to the Utility. Controls should be implemented to ensure other agreements (if any), whether interdepartmental or not, are set up to alert the appropriate personnel when such agreements have terminated.

CITY ASSISTANCE

I wish to acknowledge my appreciation of City staff assistance and cooperation during this audit. Any feedback, questions, or comments are always welcome. Please contact me if you need additional information.

Sincerely,

Jennifer L. Sims CPA/CFF, CFE
City Auditor

cc: Mayor Wheeler
Mike Riley, Finance Director
City Council



Exhibit 1

Information Sources

Records:

1. [Municipal Research Services Center \(MRSC\) Sales & Use Taxes in WA State Article dated May 17, 2021](#)
2. [MRSC Sales Tax Rates & Components Table dated July 1, 2021](#)
3. [WA Department of Revenue \(DOR\) Local Business & Occupation Tax Rates Table](#)
4. [US Census Median Family Household Income \(Selected Economic Characteristics\) Table for Bainbridge Island and Poulsbo](#)
5. [US Census Median Family Household Income \(Selected Economic Characteristics\) Table for Bremerton-Silverdale-Port Orchard](#)
6. [Housing & Urban Development \(HUD\) Median Family Household Income Table for Bremerton](#)
7. [Kitsap Sun Article dated July 19, 2019](#)
8. [Kitsap Sun Article dated June 23, 2021](#)
9. [Kitsap Daily News Article dated July 19, 2021](#)
10. [Kitsap Sun Article dated December 12, 2021](#)
11. [Kitsap Sun Article dated December 14, 2021](#)
12. [Kitsap Sun Article dated January 11, 2022](#)
13. [Kitsap Sun Article dated January 27, 2022](#)
14. [Substitute House Bill 1406](#)
15. [Resolution No. 3318](#)
16. [Ordinance No. 5353](#)
17. [Ordinance No. 5377](#)
18. [Resolution No. 3214](#)
19. [Resolution No. 3241](#)
20. [Resolution No. 3338](#)
21. [Ordinance No. 5088](#)
22. [Sales Tax Budget Narrative \(excerpt from City of Bremerton 2022 Budget\)](#)
23. Finance Audit Trail Reports 2016-2021
 - a) [Sales Tax](#)
 - b) [Local Revitalization Financing](#)
 - c) [Affordable Housing \(2020-2021\)](#)
 - d) [Lodging Tax](#)
 - e) [Criminal Justice](#)
24. [Interdepartmental Revenue Sharing Agreement dated July 5, 2001](#)
25. Revenue Entries and Corrections relating to Interdepartmental Revenue Sharing Agreement from 2001 to 2021
26. [Professional Services Agreement with Kitsap Community Resources dated January 20, 2021](#)
27. [Professional Services Agreement with Bremerton Housing Authority dated January 20, 2021](#)