

CITY HALL • ONE FRANK H. OGAWA PLAZA, 4TH FLOOR • OAKLAND, CALIFORNIA 94612

Office of the City Auditor
Brenda D. Roberts, CPA, CFE, CIA
City Auditor

(510) 238-3378
FAX (510) 238-7640
TDD (510) 238-3254
www.oaklandauditor.com

May 9, 2017

OFFICE OF THE MAYOR
HONORABLE CITY COUNCILMEMBERS
CITY ADMINISTRATOR
CITY ATTORNEY
RESIDENTS OF OAKLAND
OAKLAND, CALIFORNIA

RE: Audit of Tax Penalties and Interest Waivers in the Revenue Management Bureau

Dear Mayor Schaaf, City Council President Reid, Members of City Council, City Administrator, Sabrina Landreth, City Attorney, Barbara Parker, and Oakland residents:

My Office completed an audit of the internal controls pertaining to the waivers of Business Tax penalties and interest. Our objectives were to determine whether business tax penalty and interest waivers were properly authorized and included sufficient evidence and appropriate managerial oversight over this process.

The City of Oakland Revenue Management Bureau (Revenue) assesses and collects municipal business taxes and fees, totaling more than \$75 million for fiscal year 2015-16. Revenue assesses penalties and interest on delinquent business taxes. Taxpayers may request the waiver of these penalties per the Oakland Municipal Code.

The audit found that many standard controls and practices for the waiver of tax penalties and interest were not followed and the department had not developed a formal documented policies and procedures manual. This resulted in non-evidenced waivers, prohibited waivers, and an inconsistent tracking of waivers granted. Our recommendations were developed to help management remediate these deficiencies. Specifically, our recommendations call for a formal fee waiver policy and procedures manual, proper reporting and system access controls, and training of staff that supports management's directions.

The City recently contracted with a new service provider for a taxpayer record system that was implemented at the end of December 2016. Changes were made to processes and workflows in the Revenue Management Bureau. Many of these new processes address the control weaknesses identified in our report.

Audit of Tax Penalties and Interest Waivers in the Revenue Management Bureau
May 9, 2017

I want to express our appreciation to the Revenue and Tax Administrator and to the Director of Finance and their staff for their cooperation during this audit and to their commitment to improving the practices and processes in the Revenue Management Bureau and Treasury that will strengthen controls around the practices of business tax penalties waivers.

Respectfully submitted,



BRENDA D. ROBERTS
City Auditor

Enclosure

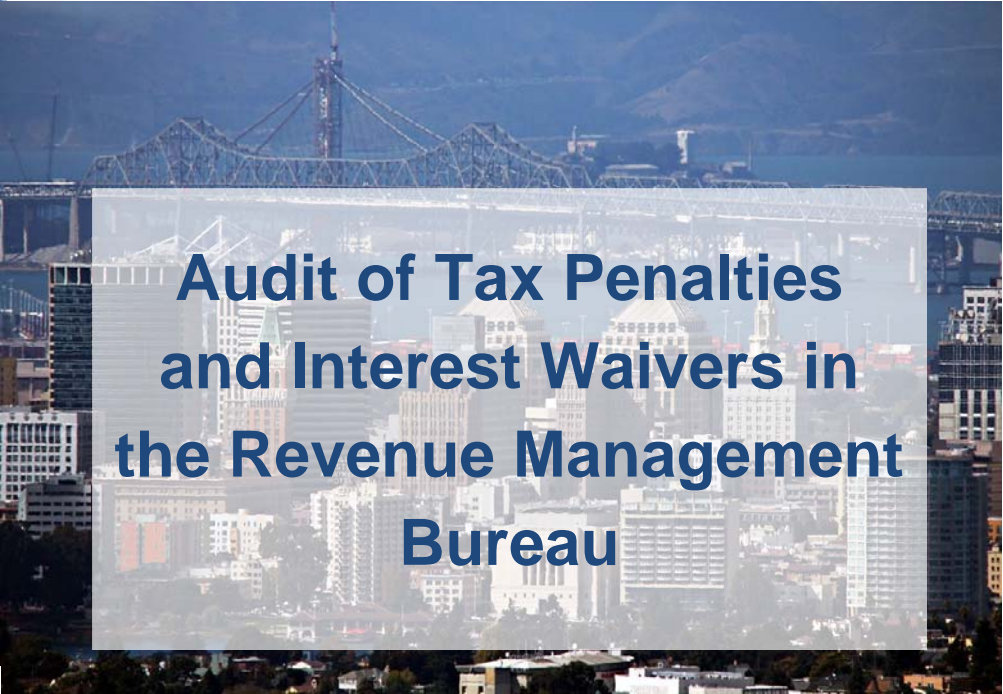
cc: Margaret O'Brien, Revenue and Tax Administrator
Katano Kasaine, Director of Finance
Kirsten LaCasse, Controller
Paige Alderete, Assistant Controller
Sarah Schlenk, Bureau Budget Administrative Manager

City Auditor
Brenda Roberts
CPA

May 9, 2017

Audit Team:
Lisa Ringer,
Performance
Auditor

Mark Howard
Carnes,
Performance
Auditor



Audit of Tax Penalties and Interest Waivers in the Revenue Management Bureau



OFFICE OF THE CITY AUDITOR

Table of Contents

Introduction	1
Background	1
Audit Findings	3
Conclusions	5
Recommendations	5
Statement of Compliance with Government Auditing Standards	7
Objective	7
Scope	7
Methodology	7
Management Response.....	APPENDIX A

Introduction & Background

Introduction

The Office of the City Auditor initiated an audit of internal controls pertaining to the request for waivers of penalties and interest on business taxes, based on an internal complaint and at the request of the then Interim Revenue and Tax Administrator (Revenue Administrator).

Our objective was to determine whether business tax penalty and interest waivers were properly authorized and included sufficient evidence and appropriate managerial oversight over this process.

By focusing on the identification of waived tax penalties and by developing a more stream-lined way to collect these monies, our city can significantly improve its revenue streams.

Background

The City of Oakland Revenue Management Bureau (Revenue) assesses and collects municipal business taxes and fees annually from approximately 60,000 individuals and companies conducting business within the City. Business Tax Revenue for fiscal year 2015-16 was \$75.57 million.

Revenue classifies taxes by type and determines applicable tax rates allowed under the Oakland Municipal Code (Code).¹

Business taxes are not waived. However, some business entities are exempt from business tax. They include, but are not limited to, the following:

- Small Businesses (annual gross revenues do not exceed \$2,500)
- Entities that qualify for non-profit tax exempt status
- Affordable housing projects that receive federal and/or state low income housing tax credits
- Family daycare providers licensed for up to 14 children

Business taxes are due annually on March 1 and are considered delinquent if not paid by then. Revenue imposes penalties of 10% on the unpaid tax which increases to 25% after two months.

It also imposes interest of 1% monthly on unpaid amounts. Interest is not considered a penalty and is used to compensate the City for the loss of the use of business tax revenue. Interest cannot be waived.

¹ Oakland Municipal Code Business Tax Section 5.04: [Business Tax Section 5.04](#)

Introduction & Background

Taxpayers may request a waiver of penalties assessed on late or unpaid business taxes. Requests must be submitted by the taxpayer in writing and include the reasons for the request and supporting documentation.

The Director of Finance, or designee, has the exclusive authority to waive penalties as stated in the Code, which provides guidance to Revenue for the waiver of penalties as follows:

- The business operation is no longer located in Oakland and the taxpayer continues to receive a tax invoice
- Information in the City's taxpayer record system is missing
- The taxpayer can show that the invoice was received late
- The statute of limitations prevents Revenue from collecting the penalty

Revenue issues a refund to the taxpayer when a penalty was paid in error. Examples include duplicate penalties or a penalty assessed and paid that should have been waived due to an exclusion.

In December 2016, the City contracted with a new service provider, HdL,² for a taxpayer record system, replacing the prior system. This audit report's findings and recommendations should be taken into consideration to ensure that safeguards and controls are integrated into this new system and the related work practices.

² The City Council approved the selection of a taxpayer records vendor, HdL (<https://www.hdlcompanies.com>), after the completion of a Request for Proposal process. This contract was approved by Council in April 2016, and the new system was implemented in December 2016, replacing the prior taxpayer system.

Audit Results

Audit Findings

1. Authorization for waivers was not evident

We sampled 25 waivers amounting to more than \$540,000 (penalties or interest) granted spanning a five-year period 2010–2014. The highest dollar waivers were selected.

Only four of the waivers sampled evidenced authorization. The reasons for granting the waivers were evident in only 15 of the samples we tested. None of the records cited the Waiver Policy, Administrative Instruction or Code as a basis for granting the waiver.

2. Interest was waived contrary to requirements of Municipal Code

Five of the 25 waivers we tested were interest waivers, totaling more than \$154,000. The Code permits the waiver of tax penalties and provides guidance for the circumstances under which these are appropriate. It does not permit the waiver of interest assessed on unpaid taxes. These waivers had no evidence of authorization or justifications noted.

3. Staff access and permission rights not monitored

Management does not have an established, regular process to review and validate user access. Revenue staff was able to alter invoices without written evidence of the Revenue Administrator's authorization. In one instance, Revenue staff prepared a tax invoice with excessive penalty and interest charges in the amount of \$330,000. This invoice was prepared for interest and penalties on past due business taxes of less than \$200 – a practice to prompt the taxpayer to contact Revenue and make arrangements to pay the outstanding taxes. The charges were subsequently waived and the tax invoice for \$330,000 was voided.

The activity logs indicate this invoice was prepared anonymously. That is, the staff created transactions or input data into the system without using the assigned employee login account. Using an anonymous login makes it impossible for management to identify the employee responsible for the transaction.

4. Transactions were not monitored

Management did not review staff's activity to ensure that waiver transactions were accurately recorded. As a result, there was no means to collect waiver transactions so that regular reports could be generated and reviewed by management.

Audit Results

5. No formal written Waiver Policies and Procedures are in place

Policies represent guiding principles used to set the direction for a function or activity. Procedures are the series of steps to be followed in a sequence order to accomplish the end result.

Revenue has not formalized its Business Tax waivers policy and has not set forth documented procedures for the acceptance of waiver requests and the decision-making process to authorize waivers. Of the 25 waivers tested, 21 were not evidenced and 5 interest waivers were granted. Also, management has not maintained a log of penalty and interest waivers.

Auditor's Conclusions & Recommendations

Conclusions

Management must address the risk that transactions could be prepared without management's knowledge, approval or authorization, and without appropriate documentation to support management's decisions.

The City Auditor's recommendations have been developed to assist management in strengthening these controls as they establish and put into place better work practices and procedures. Doing so enables management to streamline the collection process and increase its revenue streams.

Recommendations

The City Auditor acknowledges that the Revenue Management Bureau recently implemented a new taxpayer record system replacing the prior system. The following recommendations should be considered to ensure the new system's automated and process controls conform to City ordinances and policies for the waivers associated with business taxes.

1. Fee Waiver Authorization

Management should update or develop formal fee waiver policies and procedures with approval by the City Administrator so that:

- Waivers are authorized and approved by the Director of Finance, with documentation prior to granting them
- Training should be provided to all Revenue staff, emphasizing the compliance requirements for waivers

2. Proper Reporting and System Access

The current system workflow should be re-designed so that waivers cannot be processed without proper authorization.

Formal training should be provided to authorized users to ensure that waivers are coded appropriately and that sufficient evidence of authorization is retained and scanned into the system. This will allow waivers to be tracked and monitored so that the system can provide regular reporting to management. This also allows the Revenue Administrator to certify all transactions are in compliance with policies and procedures.

Auditor's Conclusions & Recommendations

Management must ensure that all employees are provided the appropriate access to systems according to assigned tasks and that the ability to waive fees is properly restricted to authorized staff and adequately monitored to reduce the likelihood of fraudulent waivers.

- Revenue staff should not have the ability to adjust taxpayer amounts owed without management approval
- Revenue staff should not have the ability to prepare and bill tax invoices without management authorization

3. Department Policies and Procedures for Waivers

Revenue's waiver policy, currently in draft form should be expanded to include:

- Designated waiver approval authority (for example, Director of Finance may approve waivers up to \$5,000, City Administrator over \$5,000); and any instance where dual approval is required
- Reporting requirements to City Administrator and City Council (for example, monthly cumulative waivers reports to the City Administrator, quarterly and annual cumulative waivers reports to City Council)
- Assurance that waiver language in the policy conforms to the Oakland Municipal Code

Procedure manuals should be developed to include:

- Requirements for proper waiver approval documentation
- Examples where waivers are appropriate and inappropriate
- Description of Revenue's quality review process to ensure that waivers are granted to taxpayers in compliance with the Code and policies and procedures

Statement of Compliance, Audit Objective, Scope & Methodology

Statement of Compliance with Government Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Objective

The audit objective was to confirm that penalties and interest waivers requests were authorized in compliance with city ordinances, policies and procedures.

Scope

We tested selected waived business tax penalties and interest granted for the years 2010 through 2014. Management did not retain records of waivers of tax penalties or interest. We performed our testing from a listing compiled by Revenue staff, which may not represent the entire reporting of waivers granted to taxpayers during this time period.

We did not test or review refunds paid to taxpayers.

Methodology

In conducting the audit, we:

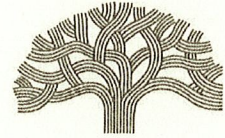
- Reviewed the relevant Municipal code and Revenue's policies, procedures and instruction manuals pertaining to waiving penalties and interest.
- Examined and tested waivers of penalties and interest documentation for compliance with policies and procedures, accuracy and completeness, and proper authorization.
- Interviewed Revenue staff and supervisors and observed waiver procedures and practices.
- Reviewed to ensure waiver documentation was retained on file and appropriately safeguarded.
- Reviewed the 2015 – 2016 Alameda County Grand Jury Report related to management issues within the City of Oakland's Revenue Management Bureau.

APPENDIX A

(This page intentionally left blank)



CITY OF OAKLAND



CITY HALL • 1 FRANK H. OGAWA PLAZA • OAKLAND, CALIFORNIA 94612

Office of the City Administrator
Sabrina B. Landreth
City Administrator

(510) 238-3302
FAX (510) 238-2223
TDD (510) 238-2007

April 20, 2017

The Honorable Brenda Roberts
Oakland City Auditor
1 Frank Ogawa Plaza, 4th Floor
Oakland, CA 94612

RE: City Administrator's Response to the Audit of Tax Penalties and Interest Waivers in the Revenue Management Bureau

Dear City Auditor Roberts:

The City Administration and the Revenue Management Bureau of the Finance Department appreciate the Audit of Waivers report, which highlights areas and processes in need of attention and improvement.

My office is working with the Revenue Management Bureau to develop a management action plan that will address the issues noted in the report. Many of these have already been resolved with the recently implemented electronic revenue and taxpayer record system, provided through HdL. Other procedural changes have been put into place to confirm that the system's controls conform to City Ordinance and policy.

The attached matrix that follows lists the audit recommendations and includes our comments to each recommendation. We have identified the responsible manager for implementation and our estimated time frames to complete. Many of these recommendations have now been implemented and are so noted.

I want thank the City Auditor and her staff for their open communication. Management was kept up to date on all progress and presented with findings of process and control improvements as they were identified. This valuable service keeps the City running smoothly and efficiently.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Sabrina B. Landreth', with a long, sweeping horizontal line extending to the right.

Sabrina B. Landreth
City Administrator

cc: Katano Kasaine, Finance Director
Margaret O'Brien, Revenue & Tax Administrator

Attachment: Audit Tracking Matrix

Audit of Tax Penalties and Interest Waivers in Revenue Management Bureau

Management's Response to City Auditor's Report



	City Auditor's Recommendations	Management Response	Responsible Party	Target Date to Complete
1	<p><u>Penalty Waiver Authorization:</u></p> <p>Management should update or develop formal penalty waiver policies and procedures to be approved by the City Administrator that include:</p> <ul style="list-style-type: none"> Verifying that each waiver is authorized and approved by the Director of Finance or designee, with documentation before granting the waiver Requiring supervisory review and approval of all waivers 	Oakland Municipal Code, section 5.04.520 allows for the waiver of penalties at the discretion of the Finance Director. On November 2, 2016, the Revenue Management Bureau created a new penalty waiver policy that requires requests for waivers be formally submitted to the Revenue & Tax Administrator in writing. Upon review, if the request meets the criteria for waiver, the Revenue & Tax Administrator will submit the request to the Finance Director for review and authorization to waive.	Revenue and Tax Administrator	11/02/2016
	Management should provide training to Revenue staff to only process waivers in compliance with new processes and procedures.	The new local tax software restricts the ability for waiving of penalties in the system to management level staff only. Staff has been trained to forward any waiver requests to the Revenue & Tax Administrator.	Revenue and Tax Administrator	2/15/2017
2	<p><u>Proper Reporting and System Access:</u></p> <p>The current system workflow should be re-designed so that waivers cannot be processed without proper authorization.</p>	The new local tax software restricts the ability for waiving of penalties to management level staff. If a waiver is approved by the Finance Director, all supporting documentation must be scanned into the system and attached to the account in question.	Revenue and Tax Administrator	2/15/2017
	Formal training should be provided to taxpayer system users to ensure that waivers are coded appropriately and that sufficient evidence of authorization is retained and scanned into the system.	The new local tax software restricts the ability for waiving of penalties to management level staff. Per policy, all approved requests shall flow from the Finance Director to the Revenue & Tax Administrator and then to the System Administrator who will process the change and attach all supporting documents.	Revenue and Tax Administrator	11/02/2016

Audit of Tax Penalties and Interest Waivers in Revenue Management Bureau Management's Response to City Auditor's Report



	City Auditor's Recommendations	Management Response	Responsible Party	Target Date to Complete
	<p>Management must ensure that all employees are provided the appropriate access to systems according to assigned tasks and that the ability to waive fees is properly restricted to authorized staff and adequately monitored to reduce the likelihood of fraudulent waivers.</p> <ul style="list-style-type: none"> Revenue staff should not have the ability to adjust taxpayer amounts owed without systematic management approval Revenue staff should not have the ability to prepare and bill tax invoices without systematic management approval 	<p>The new local tax system allows for the restriction of user abilities based upon the user profile.</p> <p>With the new local tax system:</p> <ul style="list-style-type: none"> General revenue staff <u>does not</u> have the ability to adjust taxpayer amounts The new local tax system creates a separation of duties based upon user profiles. This control has been implemented 	Revenue and Tax Administrator	2/15/2017
3	<p><u>Department Policies and Procedures for Waivers:</u></p> <p>The current Revenue Management Bureau's policy of the documented tax and penalty waivers should be approved by the City Administrator and expanded to include the following:</p> <ul style="list-style-type: none"> Clear identification to whom the waiver request must be submitted Identify who has waiver approval authority (for example, Director of Finance up to \$5,000, City 	<p>Management agrees with the proposed changes and will add the changes to the policy document. The updated policy document will be disseminated to all staff upon completion.</p>	Revenue and Tax Administrator	4/15/2017

Audit of Tax Penalties and Interest Waivers in Revenue Management Bureau Management's Response to City Auditor's Report



	City Auditor's Recommendations	Management Response	Responsible Party	Target Date to Complete
	<p>Administrator over \$5,000)</p> <ul style="list-style-type: none"> • Requirements for proper waiver approval documentation as well as what constitutes sufficient documentation • Document instances where dual signature is required (for example, above \$5,000 threshold and any repetitive waivers to a single taxpayer within a 12-month period) • Provide examples where waivers are appropriate and inappropriate • Document the quality review process • Document reporting requirements (for example, monthly cumulative waivers reports to the City Administrator, quarterly and annual cumulative waivers reports to City Council) • Ensure waiver language conforms to Oakland Municipal Code regarding waivers resulting in refunds 			