



OFFICE OF THE CITY AUDITOR
Long Beach, California

LAURA L. DOUD, CPA
City Auditor

February 27, 2013

Mr. John Gross
Director, Financial Management
City of Long Beach
333 W. Ocean Blvd., 6th Floor
Long Beach, CA 90802

Dear Mr. Gross,

Attached is the Office of the City Auditor's Report of the Business License Revenue Collection Audit. The audit covered the period of May 1, 2010 through April 30, 2012. The audit was completed and the issues were first presented to the Department of Financial Management in November 2012.

The key findings of the Business License Revenue Collection Audit are as follows:

- The City collects approximately \$12 million annually from business license revenue.
- The current balance of receivables due to the City originating from the Business Relations Bureau (Bureau) is estimated to be between \$2.4 million and \$2.6 million (exact amounts cannot be determined due to software problems noted below).
- Collection efforts originate with the Bureau and are transferred to the Billing and Collection Section (B&C) at an unspecified time.
- At the time of the audit, half of the \$2.6 million in receivables had been transferred to B&C or an outside agency and the average aging of those receivables was already over a year old.
- The B&C software system is very old and severely limits management's ability to manage receivables and collections. The Bureau indicated they plan to update their systems this year.
- The Bureau lacks clear processes, procedures and reporting which has led to inconsistent collection efforts and revenue adjustments without adequate supporting documentation.

Management's response to our audit addressed many aspects of these findings. It is pleasing to know that from the time the issues were first presented to the Department of Financial Management in November 2012 to the time of

management's response in February 2013, several improvements were made which will benefit the City, many of which we suggested in the original audit. We are hopeful that these improvements will continue to be made, such as clarifying and formalizing policies and collecting the appropriate revenue due to the City.

It is important to clarify three points which your office noted in its response.

First, the reference to the Bureau being responsible for only \$655,000 in receivables is misleading. The actual total amount of receivables due to the City generated by the Bureau is between \$2.4 million and \$2.6 million. While we appreciate the Bureau acknowledging that its collection process could be improved, merely moving a significant amount of receivables to B&C does not alleviate the Bureau's responsibility for those receivables.

Additionally, it is important to note that approximately 95% of the \$11.7 million that the City routinely receives from business license fees was paid to the City without any collection efforts by Bureau staff. Those payments were made by businesses upon receipt of their annual notice.

Finally, we want to be clear that our intent is to ensure the City collects the revenue it is owed from businesses that are not meeting their obligation. It is unfair to the businesses that pay their fees to allow others to avoid paying. By no means do we advocate making it more difficult for businesses to be competitive in Long Beach.

We are pleased that we were able to work with the Bureau and help identify areas of concern and provide suggestions to remedy those concerns, especially at a time when the Bureau has many priorities and much work to do.

Sincerely,



Laura L. Doud
CITY AUDITOR

cc: Patrick West, City Manager
Mayor Bob Foster
City Councilmembers

Office of the City Auditor

Audit Report

**Business License
Revenue Collection Audit**

February 2013



Audit Staff

City Auditor: Laura L. Doud

Assistant City Auditor: Deborah K. Ellis

Deputy City Auditor: Terra Van Andel

Supervising Senior Auditor: Carolyn Phu

Staff Auditor: Jennifer Rethwisch

Staff Auditor: Damon Melfi

Table of Contents

Executive Summary	1
Background.....	2
Authority and Structure	2
Renewals and Collection	3
Billing and Collections System.....	4
Audit Objective, Scope and Methodology	5
Results.....	6
Unable To Determine Total Account Receivable Balance Outstanding	6
Inconsistent Collection Efforts.....	8
Lack of Sufficient Processes for Adequate Oversight	10
Inadequate Tracking of Unlicensed Businesses	12
Recommendations	13
Appendix	
Appendix A: Billing and Collection (B&C) System Issues.....	A-1
Appendix B: Management's Response.....	B-1
Appendix C: City Auditor Comments on Management's Response.....	C-1

Executive Summary

The Office of the City Auditor (OCA) recently completed an audit of the collection of business license revenue handled by the Business Relations Bureau (Bureau) located within the Department of Financial Management. The audit covered the period of May 1, 2010 through April 30, 2012.

The Bureau uses the Billing and Collections software system (Software System) to process all business licenses. This Software System is critical, because it monitors a significant amount of revenue due to the City. The Software System is very old and its ability to easily process and review data is limited. The Bureau is planning to convert to a new software program in 2013; therefore, we performed only a limited review of the Software System's functionality. We have made comments in Appendix A of this report about areas management should consider when converting to a new software program.

The average business license tax is \$383, totaling annual revenue of \$11.7 million received in fiscal year 2012. The current accounts receivable balance is estimated between \$2.4 million and \$2.6 million.¹ Collection efforts originate with the Bureau, and then, at an inspector's discretion, accounts can be transferred to another party for further collection attempts. Our audit only focused on the Bureau's processes surrounding the collection efforts as accounts, on average, are already 13 months old when transferred to the Billing and Collection Section (B&C). After 13 months, the account would be considered stale and collection by B&C is not probable. Of the \$2.6 million, half is with B&C or an outside collection agency.

The limitations of the Software System offer challenges to processing business licenses, but we found little has been done to compensate for the Software System problems. Overall, the insufficient policies, procedures and processes, limited supporting documentation, and insufficient review of data hamper the collection of business license receivables.

Without comprehensive policies and procedures for the collection process, we found no consistency in the collection efforts performed by the Bureau. We reviewed a sample of accounts currently handled by the Bureau and found 87% of the accounts were over 180 days old with few attempts at collection. In addition, certain license renewals tied to out-of-town businesses receive no collection efforts at all. While it was difficult to

¹ The range is due to various receivable reports not reconciling to one another. Please see further clarification in the Background section of this report

determine how much revenue this amounted to, we noted approximately \$549,000 in closed or adjusted out-of-town accounts during the time reviewed.

It does not appear adequate oversight is in place. The Software System limits reporting capabilities, but the Bureau is not compensating for Software System limitations by ensuring proper documentation is maintained and that adjustments are properly authorized. In addition, documents indicating how potential unlicensed businesses are handled are not retained, leaving no audit trail or record of businesses identified or how they were resolved.

We recognize the Bureau's resources have been expended in other areas such as medical marijuana and handling permitting issues and complaints. However, the Bureau should establish adequate policies and processes for the collection of business license revenue and ensure staff has clarity on collection efforts, data is adequately reviewed and authorized, and proper supporting documentation is retained. We respectfully request that in six months management provide a status on the progress taken to implement the recommendations detailed in this report.

Background

Authority and Structure

Long Beach Municipal Code Section 3.80.210 requires businesses, trades, professions, callings and occupations to obtain a business license prior to conducting business within the City of Long Beach (City). Depending on the business type and/or location, business license applications are reviewed by various City departments, such as Development Services, Fire, Health, and/or Police Departments. When the application is approved, an applicable tax amount based on a fixed and/or variable rate is assessed and must be paid by the licensee prior to the start of the business. For those businesses located in the City's Business Improvement Districts (BIDs), BID fees must be paid along with the business license tax. BID fees are collected and remitted to the corresponding district for the promotion of these commercial areas.

Since fiscal year 2010, business licenses have been managed under the Business Relations Bureau (Bureau). This includes the business license processing and collections program, entering applications, mailing bills and notices, reviewing and processing business license appeals, collecting revenues and providing customer service. The scope of our audit was limited to the collection of license renewals.

Renewals and Collection

The average business license tax is \$383, totaling annual received revenue of \$11.7 million in fiscal year 2012. Revenue received for the past three fiscal years is shown in Table 1.

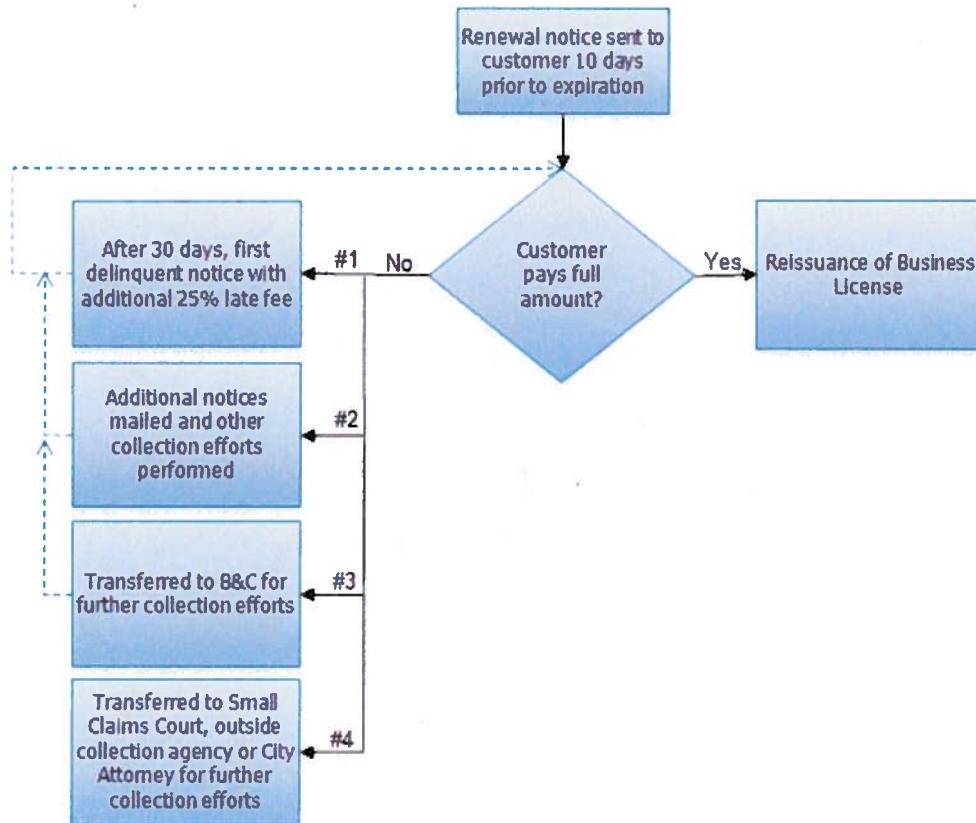
Table 1
Annual Business License Revenue
Fiscal Year 2010 through 2012

Fiscal Year	Annual Revenue
2010	\$ 11,800,000
2011	\$ 12,100,000
2012	\$ 11,700,000

Licenses are valid for one year after the issuance date, unless otherwise noted. Ten days prior to the license expiration date, the Bureau mails renewal notices. Accounts not paid within 30 days after the due date are considered delinquent, and a delinquent notice with a 25% penalty of the total amount due is mailed. An additional 10% penalty on the first of each following month, up to a maximum of 100%, is applied if the account remains unpaid.

In addition to notices issued automatically by the Billing and Collection software system (Software System), inspectors are responsible for making phone calls, performing site visits, and issuing Notices of Violations and citations in an effort to collect amounts due. Issued citations are forwarded to the City Prosecutor's Office for potential processing as a misdemeanor. Once efforts have been exhausted by the Bureau, delinquent accounts are transferred to the City's Billing and Collection (B&C) Section to perform further collection efforts. If B&C is unsuccessful, accounts may then be referred to Small Claims Court, an outside collection agency, or the City Attorney's Office. No other penalties, such as shutting down a business for non-payment, are allowed under the existing Municipal Code. Exhibit 1 illustrates the business license collection process as explained by Bureau staff.

Exhibit 1 Business License Collection Flowchart



While the Software System is reporting just over 34,000 active accounts, we know a considerable number of accounts are duplicates. If a business has a prior year outstanding balance, and the account has been transferred to B&C for collection, the Software System allows the Bureau to establish a new, duplicate, account for the current year amount. Of the 102 accounts we tested, approximately 25% of the businesses had multiple accounts assigned to them.

Billing and Collections System

The Bureau uses the Software System to process the renewal and collection of business license revenue. This Software System is extremely old and has limited functionality. The Bureau is currently planning to migrate to another City software program, Hansen, which is used to process related transactions such as permits for Fire, Health, and Code Enforcement. Because the Bureau has recognized the Software System's limitations and is in the process of moving to a new software program, we did not audit the Software System's controls in depth. Instead, Appendix A highlights key areas management should correct when configuring the Hansen software.

The Bureau is using the Inspector Report generated from the Software System to manage their collection efforts. This report lists accounts overseen by the Bureau that are over 30 days old. Bureau staff was unable to provide additional reports detailing total business license receivables held by all groups and their age. Therefore, we worked with Technology Services (TS) to obtain reports that would provide a more comprehensive picture of account receivable numbers. After we received the reports from TS, we performed several procedures to gain assurance that the reports were reliable and that we understood the data in each report. These procedures included verifying totals, reconciling data to column headings, and cross checking totals between reports to identify and reconcile variances. After completing the procedures and reconciling the differences, we were able to rely on the report data with assurance to determine the estimated outstanding balance of receivables. Appendix A includes comments about report reliability that should be addressed when migrating to the new software program.

Audit Objective, Scope and Methodology

The objective of our audit was to assess whether the collection of business license taxes were managed appropriately and efficiently by the Bureau. The scope of the audit covered May 1, 2010 through April 30, 2012. Although the Bureau forwards delinquent accounts to B&C for further collection efforts, our audit did not include procedures to assess the effectiveness of B&C's efforts due to the advanced age of the receivables when received by B&C.

During our audit, we performed the following procedures:

- Reviewed Long Beach Municipal Code Section 3.80 *Business License Tax* and Business Relations Bureau policies and procedures;
- Interviewed Business Relations Bureau personnel and obtained an understanding of the internal controls related to our audit objectives;
- Reviewed system access to the business license database, Billing and Collections System, for appropriateness;
- Reviewed available system reports to determine the status, aging and amount of business license accounts receivable as of April 30, 2012;

- Reviewed delinquent accounts within the system to determine the efficiency, consistency and adequacy of the Bureau's collection efforts, on a sample basis; and
- Reviewed hardcopy documentation to determine the efficiency and adequacy of identifying unlicensed businesses, on a sample basis.

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.

Results

The Business Relations Bureau (Bureau) uses the Billing and Collections software system (Software System) to process the renewal and collection of business license revenue. Due to its age, this Software System has many limitations, making it difficult to process and review data. Bureau management is aware of the Software System's issues and is currently planning to migrate to another City software program currently being used to process permits related to Fire, Health, and Code Enforcement. Appendix A of this report addresses specific limitations or deficiencies occurring in the Software System that should be addressed when configuring the new software program to meet business licensing needs and ensure establishment of proper controls.

Moving business license operations to a new software program will provide better tools to manage the outstanding accounts; however, we found other deficiencies which need to be addressed in order to ensure the City maximizes the collection of revenues. Issues concerning insufficient policies, procedures and processes, limited supporting documentation, and insufficient review of data are hampering the collection of business license receivables.

1. *Unable To Determine Total Account Receivable Balance Outstanding*

Unfortunately, the Software System was unable to produce reports that reconciled to one another to determine a true accounts receivable balance of outstanding business license revenue. When the audit was initiated, Staff was not reviewing or generating reports to analyze total receivable balances due. For this reason, we worked with

Technology Services to obtain reports to clarify the total accounts receivable balance.² We reviewed the reports available, and it is our best estimate that the outstanding balance ranges from \$2.4 million to \$2.6 million as of April 30, 2012. Some accounts also include Business Improvement District (BID) fees that the Bureau is responsible for collecting on behalf of the districts. The amount of BID fees represents approximately \$201,000 of the \$2.4 million to \$2.6 million range. The range does not include closed accounts that have outstanding balances totaling \$253,000.

Collection efforts originate with the Bureau, and then, at an inspector's discretion, accounts can be transferred to the Billings & Collection Section (B&C) for further collection attempts. B&C has the following options to deal with an account: handle it themselves, take to Small Claims Court, or transfer to the City Attorney or to an outside collection agency. Table 2 details the amounts handled by the various parties as of April 30, 2012.

Table 2
Accounts Receivable Totals by Group
As of April 30, 2012

Current Collection Efforts	Balance
Business Relations Bureau	
Current	\$ 639,000
Over 30 Days Old	655,000
Subtotal Business Relations Bureau	\$ 1,294,000
Collection Agency *	899,000
Billing & Collections	414,500
City Attorney	5,800
Total Receivables Outstanding	\$ 2,613,300
* Includes accounts in Small Claims Court	

A complete and accurate report of all account receivable balances is critical information the Bureau needs in order to oversee the collection process and determine where collection efforts are most needed. When migrating to a new software program, the Bureau must ensure adequate reporting exists. In the meantime, the Bureau should develop a method to ensure this information is compiled and evaluated.

² Please refer to the Background section of this report for further information on the procedures performed during the audit to determine the total account receivables balance.

2. Inconsistent Collection Efforts

Age of Receivables

Typically, account receivable balances are managed on a current basis up to 90-120 days. The longer an account remains outstanding, the less likely it is to be collected. We were able to determine the Bureau retains accounts, on average, for 13 months before transferring to B&C for further collection efforts. For this reason, our audit only focused on the Bureau's attempt at collection. After 13 months, the account would be considered stale and collection by B&C is not probable. B&C is currently handling half of the \$2.6 million accounts receivable total. More timely collection efforts within the Bureau during the first 120 days could significantly decrease the amount of accounts forwarded to B&C. Since the audit was initiated, Bureau staff has increased review of the accounts, and it appears accounts are being transferred to B&C sooner.

Collection Results

The Software System automatically applies penalties and sends a late notice to the business if payment is not received after 30 days. This occurs each month for nine months. Inspectors begin additional collection procedures when an account becomes delinquent at 30 days and appears on the Inspector Report. Inspector Reports are intended to reflect all accounts delinquent for greater than 30 days. However, we noted a difference of approximately \$200,000 between the Inspector Reports and other reports listing open accounts over 30 days old.

The Inspector Report is the main receivable report currently used by the Bureau to identify accounts needing collection efforts. Inspector Reports during the period reviewed totaled 1,015 accounts. We reviewed 102 of these accounts and found 87% of them were over 180 days old, with 39% over a year old.

Table 3
Test Sample of Aged Accounts Receivable
Managed by Bureau

Days Outstanding	Number of Accounts	% of Total
31-180	13	13%
181-360	49	48%
361 +	40	39%
Total	102	100%

The Inspectors state their collection procedures usually include a call, a site visit, and then a Notice of Violation. However, the type and frequency of the collection effort is at the discretion of the Inspector and varies between accounts and inspectors. The Bureau does not maintain manual supporting documentation detailing collection efforts. The only audit trail is in the Software System. There is a small note screen where inspectors can input what has been done. Details are brief due to Software System space limitations and reports monitoring this information are not available. We reviewed the online data available of the 102 accounts noted above. Of the 89 accounts over 180 days delinquent, we found that in 93% of those accounts reviewed, all three steps, a call, a site visit, and a Notice of Violation, had not been performed. As noted in the Background section of this report, Inspectors may also issue a citation. We did not see evidence in the Software System of citations issued on any of the accounts reviewed. There was no consistency among the Inspectors in their collection attempts, and we found no clarity when an account should be escalated to the next step or transferred to B&C.

When an account is transferred to another group for collection, the "status" is changed in the Software System. However, the Bureau has the ability to establish a duplicate account for a business to record the new annual tax. Of the 102 accounts reviewed, we found 26 accounts (25%) had a duplicate account. This indicates that 1 in 4 businesses that we sampled is over a year late in paying their business license tax. However, we did note that in one case, a business had 5 different accounts. The Bureau is responsible for handling the current balance, while another group could be handling the prior year(s) balance. Bureau management stated that they do not oversee or monitor accounts handled by other groups, so it is unclear how efforts are coordinated to capture all monies due.

Payment plans were established for four of the businesses we reviewed. Payment plans can be an effective tool to assist businesses in paying their taxes, but in the cases

we found, it appeared all the businesses had defaulted. One business had five different payment plans established between August 2009 and April 2012 and defaulted on all five plans. Over the three years, the Bureau sent the account to another group for collection five times, but subsequently requested each time for the account to be returned to them for handling until it was eventually sent to Small Claims Court.

Staff noted that they strive to be “business friendly” so they work with the accounts that are having difficulty paying, which may lengthen the collection time. It is important that the City do all it can to assist and promote businesses; however, “business friendly” should not be non-collection of fees. Allowing businesses to operate without paying for a license penalizes all the businesses that are compliant. There are many different policies and practices a city can implement to help businesses, and management should establish a clear, written policy for how it can meet their “business friendly” goal.

Out-of-Town Businesses

The City provides a license to businesses that may operate in Long Beach, but their main location or address is in another city. For example, a contractor may be based in Lakewood but is performing construction work within Long Beach. In order to have an account in the Software System, a business must have paid for a license in a prior year. As these licenses come up for renewal, it is the Bureau’s policy not to attempt collection. If the account is unpaid after approximately 45 days, the Software System automatically closes the account and leaves the balance outstanding. We found \$254,000 of closed accounts with outstanding balances, which under the Bureau’s current policy, likely had no collection efforts beyond the original 30-day late notice. Some of the out-of-town accounts do not close automatically, requiring a manual adjustment to write-off the balance. In the month the audit was initiated, adjustments to this type of account totaled an additional \$295,000.

Inspectors stated that they have no jurisdiction over these businesses to collect, because they cannot visit a site located out of the city. Since the business at one time paid for a license, it is unclear why the City would not make more of an attempt to collect. The closed accounts mentioned above totaled \$549,000.

3. Lack of Sufficient Processes for Adequate Oversight

Policies, Procedures and Processes

At the time of the audit, the only written policies and procedures in place addressed processing business license transactions in the Software System. It did not include instructions on steps for collection, timing of account escalation, retention of supporting documentation, transactional authority, handling of adjustments, proper review or

training. The lack of sufficient policies has resulted in inconsistent collection efforts and contributed to the \$1.5 million in outstanding receivables over 300 days old.

New policies and procedures are currently being drafted. We reviewed the draft document, and while it is an improvement over the current manual, it still lacks key components regarding the collection process, such as defining delinquent accounts, appropriate collection steps, when they should occur. In addition, adequate review procedures such as assessment of collection rates, retention of appropriate documentation to support collection efforts, adjustments and training should be included.

Process Management

We were unable to ensure adequate oversight is occurring due to a lack of written policy, inconsistencies in staff's understanding of all processes, and no evidence of reviews. We could not identify personnel responsible for reporting operational data such as collection rates and receivable aging or whether transactions were properly reviewed and authorized. There are two lead supervisors, but their duties are more task-oriented and do not include oversight responsibilities. Until October 2011, there was a customer service supervisor; however, it does not appear this position was performing any of these duties either. We did note that an additional Inspector position is included in the fiscal year 2013 budget for which the cost is expected to be funded through increased collections. In order to reap the most benefit from this new position, the Bureau must first establish more comprehensive policies, procedures and effective oversight processes to address the inconsistencies with collection efforts.

While the limitations of the Software System are well-known, we could find no indication the Bureau was actively reviewing and cleansing the database to ensure it was reliable. Reports in the Software System are limited and difficult to understand, but we could find no evidence the data was being reviewed and staff could not provide reasons for why data varied between reports. Basic information needed to manage operations, such as account receivable balances and aging, collection rates, account adjustments or closures, and accounts transferred to other groups for collection, is not being generated.

As noted earlier, adjustments are made in the Software System each month and can be substantial. We were only able to obtain the net adjustment amount for the four months we reviewed. The adjustments included both increases and decreases to receivable balances. Staff was unable to provide reports that captured the details of the adjustments or any supporting documentation that the account changes were properly authorized. Since anyone with access to the Software System has the ability to make account adjustments, the Bureau must establish processes to ensure they are handled

appropriately. The following table represents the net adjustments for the four months reviewed:

Table 4
Net Receivable Adjustments
Feb 2012 – May 2012

Month	Amount
Feb 2012	\$ (81,000)
March 2012	40,000
April 2012	(290,000)
May 2012	\$ 43,000

As mentioned on page 10, in April 2012, Bureau staff eliminated the receivable balances of open out-of-town accounts by \$295,000. That is the reason for the larger balance for that month as shown in the table. However, because the table represents "net adjustments" and system reports detailing all adjustments were not available to us, we were not able to determine what other adjustments occurred that resulted in a net amount of \$290,000.

4. Inadequate Tracking of Unlicensed Businesses

The Software System does not track potential unlicensed businesses that may be identified through an Inspector's daily routine or through organized sweeps of particular locations. Other than the Inspector's notes, the information is not entered into any other spreadsheet or database. The notes are eventually thrown out, leaving no history of how the item was resolved. This method does not leave an audit trail; therefore, we were unable to determine or verify how much effort was incurred by staff to identify unlicensed businesses in the city.

Recommendations

In order to maximize the collection of business license revenue, we recommend the Bureau do the following:

1. Ensure policies and procedures provide clear guidance to staff on the appropriate method and expectations of receivable collection. The policies and procedures should, at a minimum, include collection steps, timing of escalation of efforts, coordination with other areas such as the B&C Section, adequate supporting documentation, and proper authorization and review.
2. Improve oversight of the collection of Business License revenue and identify sufficient reports to gain knowledge of the Bureau's daily activities.
3. Increase efforts to collect from out-of-town businesses instead of writing off the balances due.
4. Develop a method to effectively track potential unlicensed businesses, or, at a minimum, retain sufficient documentation for an audit trail. Increased identification of independent contractors could result in additional revenue to the City.
5. Work with City management to develop a strategic policy on how the City can be business friendly and establish objectives to measure and report against.

Appendix A

Additional Billing & Collection System (Software System) Issues and Recommendation List

The Bureau uses the Software System to process business licenses. The Software System is old and has functionality and reporting limitations. It is our understanding the Bureau will be converting to a new software program in 2013 that is currently being used to process transactions such as permits for Fire, Health, and Code Enforcement. Based on our audit, we identified the following issues that should be addressed when transitioning to the new software program:

1. **Database Reliability**

The current Software System database has many duplicate accounts and other inconsistencies that require the data be thoroughly cleansed before converting to a new system. This is a critical step to ensure the new software program can process transactions accurately and not encounter errors originating from the old Software System.

2. **Reliable Reports**

- In the reports available from the Software System, we noted several problems such as columns not totaling correctly, headings not reflective of what the data actually represented, and totals amongst the reports not agreeing. For the reporting structure in the new software program, we recommend the Bureau work closely with Technology Services to customize reports to provide information that is consistent with operational needs and is reliable and accurate.
- Reporting structure should include a system edit report that records changes to key master file fields. This report provides management with the necessary tool to review and ensure system edits and changes are appropriate.

3. **Account History**

- Currently, a business may have multiple accounts in the Software System to designate which department is handling collection efforts. All transactions associated with a business should be confined to one account. This will provide an account history and consolidate all balances due.
- Bureau staff relies heavily on entries into the Software System to understand the status of an account. However, information in the Software System is

difficult to follow and understand. When setting up the account structure in the new software program, we recommend a more user-friendly forum be available to document account activity and collection efforts. If this element is not available in the new program, then management should establish a manual process to document account activity. A more transparent view of account history will provide inspectors and management with a clearer picture of actual collection efforts to date.

- The Software System is not configured to track potential unlicensed businesses. The new software program should be configured to allow for this capability. This will provide a detailed account history of when the business was first identified and how the issue was resolved.

4. User Access

In the Software System, it appears that all analysts, inspectors, and customer service representatives have the ability to create, edit and delete accounts including reversing fees, editing payments plans, and closing accounts. Not only is user access excessive and unnecessary, but there is no audit log available so management can review edits and changes. This significantly heightens the risk of fraud and error. We recommend access in the new software program be limited to meet the individual's responsibilities.

5. System Interfaces

The Business License database within the Software System is not integrated with other City related databases such as the health permit database. Therefore, manual processes are relied upon to determine that all requirements have been met before issuing a business license. Relying on manual processes not only increases risk of fraud or error but also is an inefficient use of City resources. We recommend integrating or interfacing all aspects of the business licensing process to improve workflow and streamline processes.

Appendix B

Management's Response



Date: February 11, 2013

To: Patrick H. West, City Manager *PLWest*

From: John Gross, Director of Financial Management *[Signature]*

For: Laura Doud, City Auditor

Subject: **Management Response to the Business License Audit**

Management is appreciative of the effort put into this audit by the City Auditor, for the suggestions, and for the opportunity to reply. The overall Business License Operation (Operation) has done an excellent job in addressing the priorities of the City Council given the resources that have been available. The Operation performs well at collecting revenues; the City has been able to routinely rely on about \$12 million a year, even in difficult economic times. Revenues have continued to be collected notwithstanding an outdated computer system used to generate licensing bills and to handle information for delinquent business licenses. As noted below, the computer system is scheduled for replacement.

In addition to providing a consistent level of revenue to the City, the Operation has balanced revenue collection with a number of other priority functions. The Operation also has top priorities of dealing with citizen and City Council concerns to ensure individual businesses operate within the scope of their permit and any associated entertainment or other pertinent permit constraints, all while emphasizing reducing the cost of providing services. A top priority, and one that has had substantial impact, has been addressing the enforcement of medical marijuana operation regulations and the associated serious public safety issues surrounding many of those operations. These efforts are time-consuming, and draw resources that would otherwise have been used for other services, including revenue collection. Management requested, and the City Council approved, in the FY 13 budget an additional business licensing inspector that will allow the City to increase emphasis on revenue collection. Even this audit has been a significant priority use of resources, taking well over 200 hours of staff time. Management believes the slowdown in work on medical marijuana and the addition of a business licensing inspector will allow us to improve emphasis on revenue collection.

To enhance revenue collection, the Operation uses site visits, telephone calls, payment plans, review of State databases for unlicensed businesses, and delinquent collection efforts, in addition to standard billing and delinquency follow-up notices. In order to improve efficiency, the City Council approved, and management will be, replacing the City's outdated Business License computer system. As noted in the audit, there are many issues with this system that impede maximizing revenue collection efforts.

The audit and the work put into it by the City Auditor have helped us identify some potential improvements to our procedures. The audit will help us with design and implementation of our new computer system and associated procedures. However, we also want to make the following comments to provide additional or clarifying information associated with the audit that may help avoid potential misinterpretation of the results and recommendations as reported in the audit.

- The audit refers to \$2.4 to \$2.6 million in receivables; a better number may be \$655,000. While the \$2.4 to \$2.6 million is the grand total, the audit indicates in Table 2 that only about \$655,000 is currently the responsibility of the Business Licensing operations and is over 30 days old.
- The audit, using a 10 percent sample, states that the average outstanding time period for a bill was 13 months. Management reviewed the same data (unmodified) but used a 20 percent sample. The 20 percent sample showed that a more accurate indication of the outstanding time period was 6 months. While 6 months is still longer than desirable, that time will be reduced in the future due to the enforcement decrease in medical marijuana activity, the pending hiring of a new inspector, and other steps management will take.
- The audit report states that “1 in 4 businesses that we sample is over a year late in paying their business license tax.” This statement is potentially misleading because the audit methodology (as reported in the audit) only sampled delinquent businesses, not all businesses. Thus, the 1 in 4 businesses appears to refer to 1 in 4 delinquent businesses being over a year late, not 1 in 4 businesses. Those are materially different statements and the actual situation is not particularly problematic. However, it will be improved with more resources expected to be available as elsewhere described by these comments.
- The audit contains phrases such as “insufficient policies” and “should establish adequate policies.” This appears to refer to the lack of written documentation of policies and not to the flaws in actual policies. There is no indication in this audit (or elsewhere) that the policies that the Operation has and uses are materially flawed. Management plans to review policies for updating and document more of them, as part of designing and installing a new system.
- The audit references \$549,000 in closed accounts for out-of-town businesses. This is misleading as the amount includes substantial amounts that were computer system errors - system incorrectly bills out-of-town businesses. Management could not verify the exact amounts because the audit information was generated using results from ad hoc programming that we could not compare to the system’s standard reports.

- The audit implies unlicensed businesses could be better identified by using a State database to match with the City database to find missing businesses. The City is already using a State database-sharing program that was a result of State legislation AB 63. However, as the audit indicates, there are problems with the use of these databases since mismatches due to data anomalies are common. The databases are, therefore, of limited use. The City is also using alternate methods to identify unlicensed businesses. While these methods could probably be improved with more resources, review for unlicensed businesses is currently done and a State database is currently used.

The following are our comments with regard to the specific recommendations contained in the audit.

1. Establish policies and procedures

The Operation has worked for many years using informal procedures, relying on historical practices that have worked, and on verbal direction. The Operation has functioned effectively and licensing revenue has been collected while maintaining overall reasonable collection levels. However, documentation is a positive improvement that will help the operations, and management has already begun to document current procedures. Most of the documentation will probably be done with the implementation of the new licensing system.

2. Improve oversight of collections

The current level of oversight has been sufficient to maintain revenues and provide an appropriate collections effort considering that substantial staffing had been diverted to the enforcement efforts of medical marijuana. We have purposefully used a low level of direct supervision to minimize supervisory costs, an important goal of the City Council. We believe that the current level has worked and has been effective. However, Management is currently reviewing, for potential revision, the level of supervisory and management oversight of the Operation.

3. Increase efforts to collect from out-of town businesses

Much of the out-of-city "receivables" entries reported in the audit are not, in fact, receivables. The entries are the result of incorrect computer generated postings of amounts never owed. Due to a computer system flaw associated with out-of-city businesses, the incorrect receivables must be manually removed from time-to-time. The actual out-of-city receivables are smaller than reported in the audit. In addition, the City has limited enforcement options for out-of-city businesses. An option that will be explored, based on the audit, is turning over valid out-of-city account balances to external collections processing earlier than we have done in the past. We appreciate the audit drawing attention to this option.

4. Develop a method to effectively track potential unlicensed businesses

Management has processes in place to identify unlicensed businesses. These processes include: review of State data, physical inspection of business areas to identify unlicensed businesses, working with the City's Business and Improvement Districts, and visiting retail operations where independent contractors work (e.g., realtor offices and hair salons, etc.). Efforts have been limited recently due to the emphasis on medical marijuana enforcement efforts and addressing licensing issues for existing businesses. Because less time is now being required on medical marijuana enforcement efforts, and a new licensing inspector is expected to be hired prior to the end of the year, management anticipates that more time can be spent on identifying unlicensed businesses. Management has done some testing of the audit's specific recommendation to record unlicensed businesses on the current computer system. Preliminarily, it appears this suggestion will be helpful. We appreciate the audit making this suggestion.

5. Develop a strategic policy on being business friendly

The Operation has a long-standing practice of trying to avoid putting a firm out-of-business as a direct result of an overly aggressive collection practice. To that end, the policy is to offer payment plans in a number of cases. The Operation's practices in this area have been in place for years and Management believes that it is appropriate to review these practices for potential update, and will do so. The intent will remain on collecting funds while being supportive of the fact that businesses sometimes go through difficult times.

K:\EXEC\JOHN GROSS\TFF RE MANAGEMENT RESPONSE TO BUSINESS LICENSE AUDIT V5.DOC

CC: SUZANNE FRICK, ASSISTANT CITY MANAGER

Appendix C

City Auditor Comments on Management's Response



Date: February 25, 2013
To: John Gross, Director of Financial Management
From: Laura L. Doud, City Auditor *ld*
Subject: **Comments on Management's Response to the Business License Audit**

Management's response to the findings and recommendations of the Business License Audit needlessly defends flawed collection practices and procedures. A concrete step-by-step plan from management to implement the audit report's recommendations would have been of more interest and relevance to the objective of collecting the maximum amount of money owed to the City.

To repeat our findings:

Management of the Business Relations Bureau could not provide any reports, documentation or verbal information concerning what the balance of outstanding receivables was when the audit was initiated in April 2012. The Bureau simply did not know. Additionally, management could not provide any evidence that it was monitoring the collection process or had provided adequate direction to the staff. The "policies", such as they were and whether written or informal, did not provide clear guidance on how receivables were to be collected or how they should be monitored.

The receivables balance for outstanding business licenses is between \$2.4 and \$2.6 million. It does not matter whether an account is under the control of the Business Relations Bureau or has been forwarded to the Billing and Collection Section. If the Business Relations Bureau had performed more timely and thorough collections of delinquent business licenses, then Billing and Collection would not have received as many stale accounts. It should also be noted that, according to information provided by staff, over 95% of the \$11.7 annual business license revenue was paid to the City without any collection efforts by Bureau staff, because payment was made by business owners upon receipt of their annual notice.

After the audit was initiated, management and staff began reviewing accounts, making adjusting entries, and moving stale accounts to the Billing and Collection Section. We assume this is how the Bureau's staff spent over 200 hours and why management now indicates accounts have been transferred more quickly to Billing and Collection. Our contact with the staff was limited due to a lack of actual documentation to audit and the difficulty and delays in gaining access to staff for questioning. Since management was not actively monitoring collection efforts, spending 200 hours bringing operations current appears more than reasonable. If not for the initiation of the audit, it is doubtful the delinquent accounts would have received this level of attention.

We have acknowledged the aging software and its problems, but management chose not to mitigate any of these problems through other monitoring processes. We have also acknowledged that staff's priorities and resources have been directed elsewhere. The audit highlights the cost of redirecting those resources. We stand behind the findings presented in the audit report and believe it offers a transparent view of actual City operations. We urge management to develop a plan for implementing its recommendations.