

**Performance Audit  
Involuntary Collections of Business Taxes**

May 2010

**City Auditor's Office**

**City of Kansas City, Missouri**

May 26, 2010

Honorable Mayor and Members of the City Council:

This performance audit of the city's efforts to collect delinquent business taxes was initiated by the city auditor pursuant to Article II, Section 216 of the city charter. We focused on the effectiveness of Taxpayer Services' efforts in collecting outstanding profits, withholdings, and convention and tourism taxes, and business license fees from 2004 to 2008.

The slow speed at which the city identifies, notifies, and assesses delinquent taxes hampers the city's collection success. Depending on the type of tax, the city averaged between 121 days to 241 days after taxes were due to identify delinquent taxpayers. Once identified, it can take months or years for taxpayers to be notified of their potential delinquency and the case to be assigned to staff for assessment and processing.

Taxpayer Services uses inconsistent methods to assess delinquent business taxes. Taxpayer Services also sends flawed case information to the Law Department, which must be corrected before legal action can be pursued against delinquent taxpayers. Processing inconsistencies and errors waste staff time and make the city seem incompetent and unfair.

Total involuntary business tax revenues for delinquent and collection cases decreased from about \$5.2 million in 2004 to \$4.9 million in 2008, for collection efforts related to Taxpayer Services. During this time, Taxpayer Services changed some collection processes and staff duties. Analyzing the changes in methods used and collection amounts should help Taxpayer Services determine which methods are most effective.

Taxpayer Services has serious morale and work environment problems. Employee morale is low and dissatisfaction with the work environment includes perceptions of favoritism, disruptive behavior from some staff, and lack of communication from management. It is unlikely that most staff could perform optimally in this environment.

This audit includes recommendations for increasing the speed with which delinquent and collection cases are processed; improving the consistency and accuracy of tax assessments and lawsuit packets; analyzing the effectiveness of collection efforts; establishing performance standards for the city's collection agency; and improving the morale and work environment in Taxpayer Services. We also recommend the city

consider state collection of the convention and tourism tax and possibly profits and withholdings taxes to reduce collection costs and the backlog of unassigned cases.

During the course of our audit work, we noted some issues that may warrant additional work. We found that the city has approved vendors and city contractors with delinquent city tax cases at the same time they are providing services and receiving payments from the city.

We shared a draft of this report with the acting city manager and director of finance on March 29, 2010. Management's response is appended. We would like to thank staff in the Revenue Division, particularly the Taxpayer Services section, and the Information and Technology and Law departments for their assistance and cooperation. The audit team for this project was Sue Polys, Jason Phillips, and Linna Hung.

Gary L. White  
City Auditor

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# Involuntary Collections of Business Taxes

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## Table of Contents

Introduction	1
Objectives	1
Scope and Methodology	1
Background	3
Involuntary Tax Enforcement	3
Taxpayer Services Functions	3
Types of Cases	4
Business Tax Types Enforced by Taxpayer Services	5
Findings and Recommendations	9
Summary	9
Collections Are Hindered by Delays, Flawed Processes, and Poor Work Environment	10
Delays in Identifying, Notifying, and Assessing Cases Hampers Revenue Collections	10
Taxpayer Services Does Not Meet Processing Time Performance Guidelines	13
Taxpayer Services Should Use Consistent and Accurate Procedures	14
Low Morale and Poor Working Environment Is Likely Affecting Productivity	20
City Should Consider Having the State Collect Additional City Taxes	23
Recommendations	24
Other Issues	25
City Vendors and Contractors Have Delinquent City Tax Cases	25
Appendices	27
<a href="#">Appendix A: Survey Methodology</a>	27
<a href="#">Appendix B: Director of Finance’s Response</a>	31
<a href="#">Appendix C: Interim City Manager’s Response</a>	35

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# Involuntary Collections of Business Taxes

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## List of Exhibits

Exhibit 1: Taxpayer Services Organization Chart	4
Exhibit 2: Delinquent Case Processing	7
Exhibit 3: Collection Case Processing	8
Exhibit 4: Days from Date Tax Due to Date Delinquency Cases Identified	11
Exhibit 5: Number of Days to Process Delinquent Cases	13
Exhibit 6: Number of Days to Process Collection Cases	14
Exhibit 7: Example of How Different Assessment Methods Yield Varying Assessment Amounts	16
Exhibit 8: Taxpayer Services Related Involuntary Collections of Business Taxes by Calendar Years 2004 – 2008	19
Exhibit 9: Survey Statements Related to Morale, Working Environment, Teamwork, and Communication	21
Exhibit 10: Survey Statements Related to Getting Ahead by Merit and Discipline Fairness	21
Exhibit 11: Survey Statements Involving Professionalism	22
Exhibit 12: Survey Statements Related to Management Practices	23

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## Introduction

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### Objectives

We conducted this audit of involuntary collections of delinquent business taxes under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

Improving tax enforcement can increase city revenues. Enforcing taxes also conveys the city's commitment to applying tax laws uniformly and fairly. We focused on business tax and fee enforcement because the majority of involuntary collections are from unpaid business taxes and fees. The City Council has expressed improving revenue collections as one of its priorities.

A performance audit provides assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision-making, and contribute to public accountability.<sup>1</sup>

This report is designed to answer the following question:

- Are Taxpayer Services' enforcement efforts in collecting outstanding liabilities and responsibilities of profits and withholding taxes, convention and tourism taxes, and business license fees effective?

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### Scope and Methodology

Our review focuses on involuntary collection efforts of business taxes from 2004 to 2008. Our audit methods included:

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<sup>1</sup> Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office, 2007), p. 17.

*Involuntary Collections of Business Taxes*

- Reviewing policy and procedure manuals to identify Taxpayer Services expected practices.
- Interviewing city staff to determine actual practices as well as understand Taxpayer Services' work environment.
- Determining the amount of time between tax due dates and when the division generates delinquent business cases to review timeliness.
- Reviewing electronic records of delinquent and collection cases from the city's Automated Revenue System (ARS) to identify the magnitude of the backlog of delinquent and collection cases and identify bottlenecks in case flow. We did not review potential non-filer or non-filer cases.
- Reviewing a sample of collection and delinquent cases to determine the number of days it takes for taxpayer specialists to process cases compared to their guidelines.
- Reviewing tax assessments and staff notes to determine whether assessment methods used were consistent.
- Reviewing revenue collection data for delinquent and collection cases by organization code<sup>2</sup> to identify trends in delinquent business collections.
- Calculating the value of withholding and profits cases sent to the city's collection agency and the actual revenue collected in 2008.
- Surveying the Taxpayer Services staff to learn about their perceptions of the work environment and impediments to their work.
- Comparing the city's vendor data to a database of delinquent or potentially delinquent taxpayers from tax periods 2004 to 2008 to identify vendors that may have tax liabilities.
- Comparing a database of city contractors to delinquent taxpayers from tax periods 2004 to 2008 to identify contractors that may have tax liabilities.

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<sup>2</sup> Organization code is the numerical code used to designate to whom a case is assigned (taxpayer specialist, Law Department, post-legal services, etc.).

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. No information was omitted from this report because it was deemed privileged or confidential.

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## Background

### **Involuntary Tax Enforcement**

When businesses do not pay city taxes and fees, Taxpayer Services, a unit of the Revenue Division, begins the enforcement process by sending initial collection letters and identifying and assessing taxpayer liability. As part of their enforcement efforts, Taxpayer Services works with an outside collection agency and the city's Law Department.

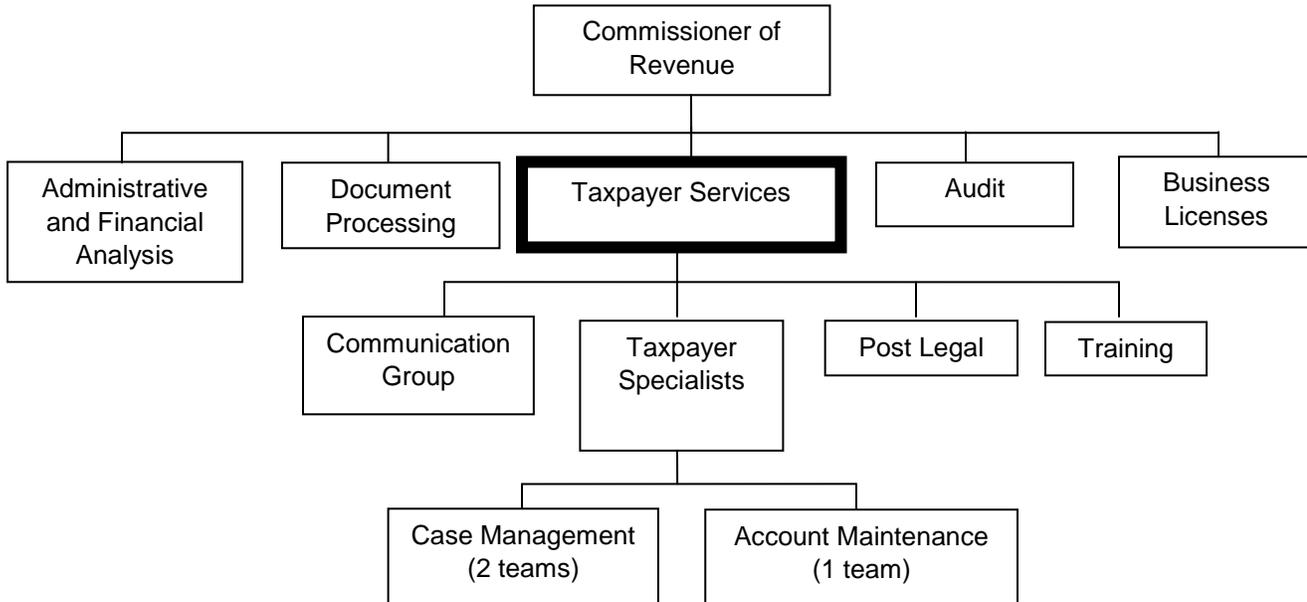
### **Taxpayer Services Functions**

As of November 2009, the 32 staff in the Taxpayer Services Unit included the manager of accounts and an administrative assistant with the rest of the staff separated into four areas of responsibility. (See Exhibit 1.)

- The communication group answers the phones, takes taxpayers' contact information, and passes the calls and information on to the staff that return calls. One supervisor and four administrative assistants work in this area.
- Post-legal staff works closely with the Law Department on collecting tax judgments and filing bankruptcy proofs of claim. Two senior administrative assistants work in this area.
- Training staff are responsible for providing training, performing special projects, and responding to emails. One supervisor and one taxpayer specialist work in this area.
- Taxpayer specialists are divided into three teams. Two teams do case management and are responsible for assisting taxpayers, researching taxpayer information, analyzing tax returns and supporting documentation, and assessing tax liability. The third

team makes account adjustments, processes refunds and correspondence, reviews the first collection notice, and corrects ARS suspense<sup>3</sup> items so transactions will be posted. Three supervisors and 18 taxpayer specialists are in the taxpayer specialist area.

Exhibit 1. Taxpayer Services Organization Chart



Source: Taxpayer Services Management and Draft Taxpayer Service Training Manual.

### **Types of Cases**

The two teams of taxpayer specialists who do case management are assigned four types of involuntary collection cases. The case types include:

- Collection cases are cases for underpaid returns. The taxpayer has submitted a return and acknowledged liability, but has not paid the liability or only paid a portion of it.
- Delinquent cases are cases for failure to file tax returns. The taxpayer has filed a return for a particular tax at least once, has

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<sup>3</sup> When an item is unable to post to the ARS system, it suspends. Suspended items sit in a queue because they need to be corrected. There are several reasons why an item suspends including an incorrect tax identification number, incorrect period dates, accounts with no addresses, no account setup, calculation errors, or incorrect account numbers.

not filed for the period in question, and has not provided a valid reason for not filing.

- Potential non-filer cases are for potential taxpayers living in Kansas City, Missouri, who have not filed a return for the tax in question. The potential taxpayer is identified by comparing the list of city taxpayers to federal taxpayers that live in Kansas City, Missouri.
- Non-filer cases are generated when potential non-filers do not respond to inquiries from the city. The taxpayer has not filed a return but lives in Kansas City, Missouri, and has not provided a valid reason for not filing.

The delinquent and collection cases have different processes. (See Exhibits 2 and 3.) The collection case has a known collection amount from the beginning, but the delinquent case is only a possible collection and the city does not know the collection amount.

#### **Business Tax Types Enforced by Taxpayer Services**

- The arena hotel/motel license fee<sup>4</sup> is on occupied rooms at all hotels, motels, and tourist courts in the city and is \$1.50 per occupied room by a guest per day.
- The arena rental car license fee<sup>5</sup> is on passenger vehicles rented or leased to a person or entity for 90 consecutive days or less. It is \$4.00 per day for each vehicle. Additionally, there is a license fee per year upon the annual gross receipts of rental car agencies in accordance with a schedule of rates.
- The convention and tourism hotel/motel tax<sup>6</sup> is on all sleeping rooms paid by the transient guests of hotels, motels, and tourist courts situated within the city, and doing business within the city. It is 7 1/2 percent of the amount of sales or charges (excluding sales tax).
- The convention and tourism restaurant tax<sup>7</sup> is on the retail sale of food by every person operating a food establishment. It is 2 percent of gross receipts.

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<sup>4</sup> Code of Ordinances, Kansas City, Missouri, Sec. 40-111.

<sup>5</sup> Code of Ordinances, Sec. 40-166.

<sup>6</sup> Code of Ordinances, Sec. 68-551.

<sup>7</sup> Code of Ordinances, Sec. 68-551.

*Involuntary Collections of Business Taxes*

- The earnings tax (withholdings)<sup>8</sup> is a one percent tax that is imposed on all earnings of resident individuals and on all earnings of nonresident individuals for services performed in the city. Employers maintaining an office or transacting any business within the city and paying any earnings subject to the tax are required to withhold the tax from employee earnings each payroll period and remit the tax to the city.
- The occupational license fee<sup>9</sup> is imposed for the privilege of doing business within the city and is required of all businesses within the city and all businesses outside the city providing services within the city. The method used for calculating the license fee is dependent upon the nature of the business. Retail/wholesale and service businesses, manufacturers, and contractors are required to pay based on gross receipts. There is no maximum fee and the minimum fee is \$25. Other businesses pay a flat fee or a fee per unit as specified by ordinance.
- The profits tax<sup>10</sup> is imposed on net profits of businesses for work conducted by residents and non-residents in the city. It is one percent of net profits.

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<sup>8</sup> Code of Ordinances, Sec. 68-386.

<sup>9</sup> Code of Ordinances, Sec. 40-1-368.

<sup>10</sup> Code of Ordinances, Sec. 68-382.

Exhibit 2. Delinquent Case Processing

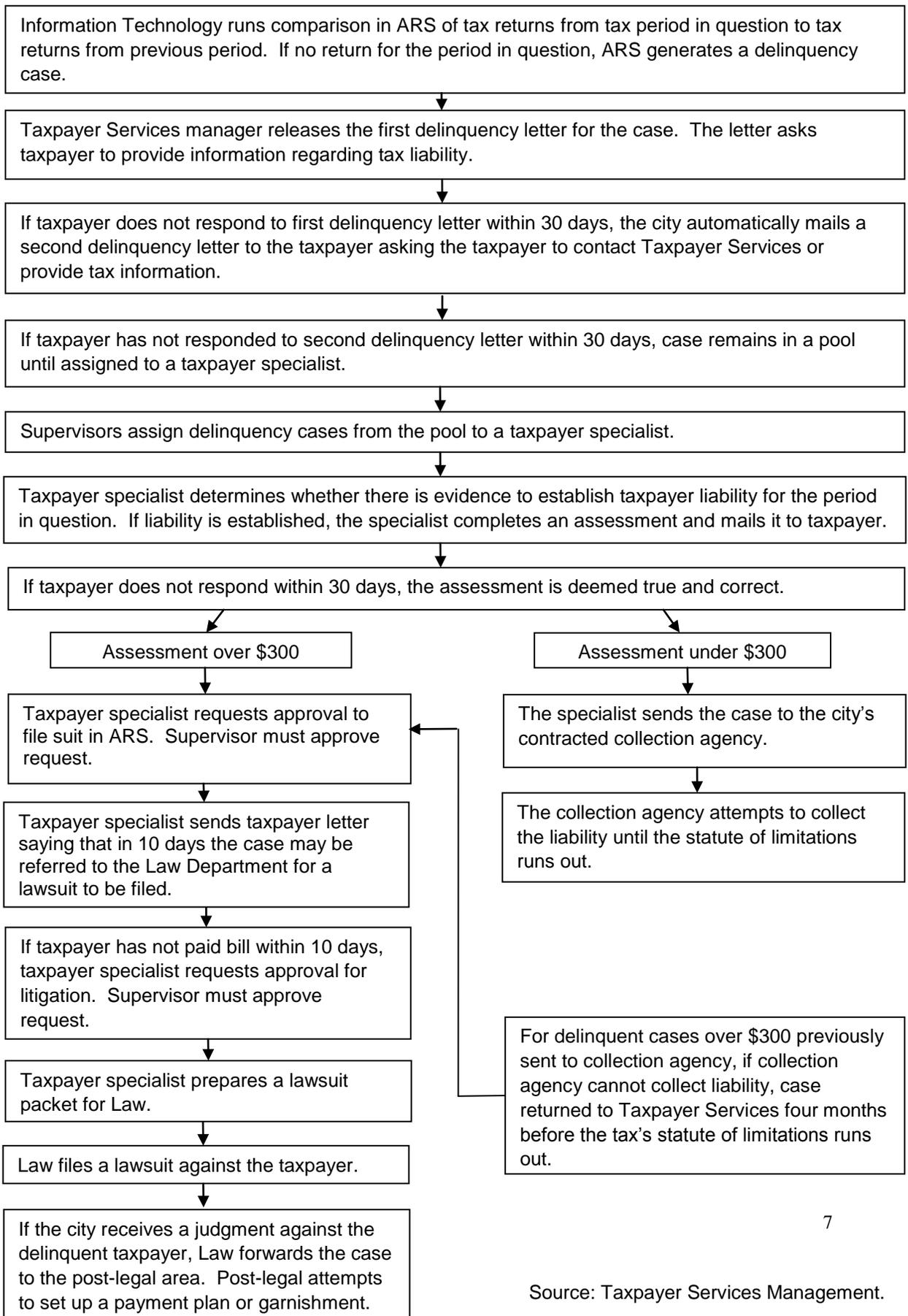
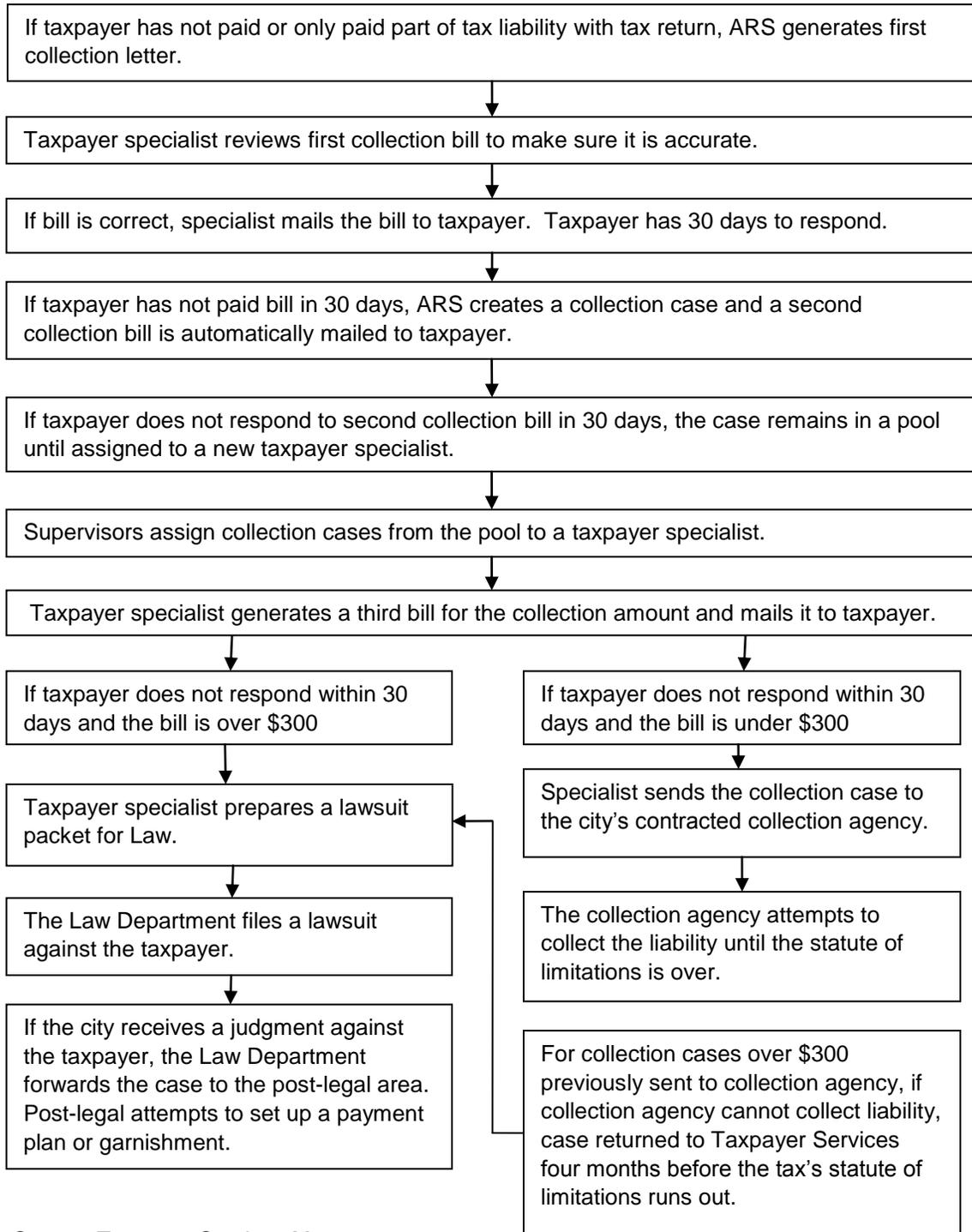


Exhibit 3. Collection Case Processing



Source: Taxpayer Services Management.

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## Findings and Recommendations

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### Summary

The city takes too long to identify, notify, and assess tax delinquent businesses. For tax years 2004 to 2008, it took the city an average of 121 days to identify delinquent convention and tourism taxes and 241 days to identify delinquent occupational license fees. It can then take Taxpayer Services months or years to send notices of the delinquencies. After notification, it can take additional months or years for cases to be assigned to taxpayer specialists so they can establish liability and assess taxes. The city's chances of collecting delinquent taxes decreases with time.

Taxpayer Services does not process delinquent and collection cases consistently and accurately. It uses inconsistent methods to assess delinquent business taxes, which creates differing assessment amounts depending on which staff prepares the assessment. Taxpayer Services sends flawed case information to the Law Department, which results in inefficient use of staff time and delays collections. Taxpayer Services needs comprehensive written procedures and on-going training to ensure all staff is technically competent and able to do their job consistently and accurately.

Taxpayer Services' revenue collections for involuntary business taxes have decreased, despite changes in Taxpayer Services' responsibilities. Taxpayer Services management needs to analyze their collection efforts to determine their effectiveness and identify any needed strategic changes. The Revenue Division should establish performance standards for the collection agency the city uses to collect delinquent city taxes.

Taxpayer Services employee morale is low. There is dissatisfaction with the work environment including perceptions of favoritism and disruptive behaviors from some staff. To address staff concerns and improve morale and productivity, management should obtain management skills training.

As an alternative to current collection practices, the city could explore state collection of the convention and tourism tax and possibly the profits and withholdings taxes. The city manager would have to explore the state's willingness and analyze the cost-benefits.

## **Collections Are Hindered by Delays, Flawed Processes, and Poor Work Environment**

The city takes too long to identify, notify, and assess delinquent businesses. Once cases are assigned for research and tax assessment, taxpayer specialists meet processing time guidelines less than 10 percent of the time. In addition, Taxpayer Services' assessment of business taxes is inconsistent and lawsuit packets contain errors. In order to improve assessments and lawsuit packets, Taxpayer Services needs comprehensive written procedures and on-going training to ensure all staff is competent and able to do their jobs consistently and accurately.

Changes Taxpayer Services makes to its collection processes need to be strategic. In order to determine which methods are most effective, it is important for the unit to analyze how changes in process affect collection amounts.

Poor morale and poor work environment are likely negatively affecting Taxpayer Services performance and productivity. In order to address morale and poor work environment, supervisors need management skills training in creating an environment where staff perceives equal treatment, effectively addressing disruptive behavior, and communicating effectively with staff. To reduce the workload on Taxpayer Services and improve collection effectiveness, the city could consider asking the state of Missouri to collect other city taxes in addition to its current collection of city sales tax.

### **Delays in Identifying, Notifying, and Assessing Cases Hampers Revenue Collections**

It takes too long to identify, notify, and assess delinquent taxpayers. The Revenue Division waits an average of 121 to 241 days after the tax due date to identify potential delinquent taxpayers. Even after the division identifies potential tax delinquencies, it can take months or years to notify taxpayers of their potential delinquency. If the taxpayer does not resolve the matter after the first two delinquent notifications, the case may wait additional months or years to be assessed taxes and finally forwarded to a collection agency or the Law Department for additional collection procedures. The probability of collecting overdue accounts diminishes as time passes.

**The Revenue Division takes a long time to identify delinquent taxpayers.** For tax years 2004 to 2008, the division identified potential

tax delinquencies between an average of 121 days and 241 days after the taxes were due. (See Exhibit 4.) The collection industry stresses the need to quickly and regularly follow up with customers whose accounts have become delinquent. A survey of commercial collection agencies shows the chances of collecting delinquencies going from 90 percent at 30 days past due to 52 percent at six months and down to nine percent at two years. As more time passes, it becomes more difficult for the city to find delinquent taxpayers that have moved or gone out of business. In addition, the longer a taxpayer is delinquent, the higher the tax bill becomes and the harder it is for the taxpayer to catch up.

Exhibit 4. Days from Date Tax Due to Date Delinquency Cases Identified

Tax Type	Frequency of Tax Due Dates	Tax Periods	Average Days Elapsed From Due Date
Profits	Annually	2004 - 2008	200
Occupational License	Annually	2004 - 2008	241
Withholdings <sup>11</sup>	Quarterly	2004 - 2008	145
Convention and Tourism	Monthly and Quarterly	2004 <sup>12</sup>	121

Source: Information Technology Department, September 2009 to February 2010 and City Auditor's Office calculations.

The longer the division waits to identify the delinquent taxpayers, the less chance they will have of collecting the overdue taxes. Other governments are quicker to identify their delinquent taxes. For example, the revenue department for Texas identifies delinquent tax filers between 14 and 60 days after their due date.

In order to improve revenue collections, the director of finance should ensure the Revenue Division identifies delinquencies as quickly as possible following the tax due date.

**Taxpayer Services takes a long time to release delinquency notices.**

In May 2009, Taxpayer Services had not sent the first notice of potential delinquency for 2007 profits taxes to about 16,000 businesses. Another 100 first delinquency notices had not been sent for delinquent tax returns from tax periods 2004 to 2006. Once the city identifies potentially delinquent taxpayers, it sends notices asking the business or organization whether they are currently filing a return, to prove they do not owe taxes, or to provide the city with evidence that they are not required to submit a tax return. However, it is the city's current practice to keep those delinquency cases in a pool and slowly release the first delinquency

<sup>11</sup> One of the quarterly withholding dates is an estimate and three dates were not available.

<sup>12</sup> The 2004 convention and tourism creation dates were estimates and 2005 to 2008 dates were not used because they were unreliable.

notices. The Taxpayer Services manager said she releases the first delinquency notices in increments, based on staff resources and the workload she thinks they are available to handle.

The slow release of notices results in some delinquent taxpayers being notified a year or more after the city knew they were potentially delinquent. Waiting months or years to notify delinquent taxpayers reduces the city's chances of collecting overdue revenue. Collection literature emphasizes beginning collection efforts immediately after a debt is past due and making frequent ongoing contacts in order to have the best chance at collection.

**Taxpayer Services sometimes takes years to assess tax liability.** In the summer of 2009, there were about 23,000 business delinquency cases, with tax periods from 2004 to 2008, waiting to be assigned to taxpayer specialists for assessment or closure. Once the statute of limitations<sup>13</sup> runs out, the city loses the opportunity to collect.

Until the city makes an assessment (i.e. estimates taxes owed) the amount of the tax liability is unknown. Once the specialist calculates and mails the assessment letter, the business can still explain and prove that they do not need to file a return. The business may have a good explanation. For example, the business may not have done business in the city that year, or the business may no longer have employees who need to have earnings tax withheld. If the business does not respond to the assessment letter within 30 days, then the assessment amount is deemed true and correct.<sup>14</sup>

**Delinquent taxpayers perceive the slow assessment and notification process as unfair.** Delinquent taxpayers complain that it is not fair for the city to assess them for several years of delinquent taxes at one time, rather than notifying them in an earlier year. Taxpayers can receive tax assessments from several years prior, which, by then, include penalties and accrued interests. While it is the delinquent taxpayer's responsibility to pay their taxes, if the city knows of the delinquency, it should notify the taxpayer sooner. Doing so should improve both collections and address concerns of fairness.

In order to improve revenue collections and reduce bad will of delinquent taxpayers, the director of finance should ensure management

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<sup>13</sup> The statute of limitations is five years from the tax due date for withholding and profits taxes and occupational license fees. Convention and tourism taxes can be assessed for up to three years following their due date, while lawsuits can be filed for up to five years from the convention and tourism tax due date.

<sup>14</sup> Code of Ordinances, Sec. 68-395 and Sec. 68-570.

improves the timeliness of sending delinquency notices and develops procedures to assess taxes more quickly.

### **Taxpayer Services Does Not Meet Processing Time Performance Guidelines**

The majority of delinquent and collection cases taxpayer specialists are being assigned are taking much longer to process than management's guidelines. The slow processing times negatively affect Taxpayer Services' ability to collect revenue and process the backlog of cases. Management could eliminate or reduce some of the steps in the case flow for both delinquent and collection cases.

**Specialists are taking longer to process delinquent and collection cases than guidelines.** According to the Taxpayer Services manager, the guideline is for taxpayer specialists to complete their processing of delinquent cases within 80 days of assignment. We randomly sampled delinquent<sup>15</sup> cases for how long it took specialists to process them. Specialists processed only 8 cases (out of 147) in the 80 days. (See Exhibit 5.)

Exhibit 5. Number of Days to Process Delinquent Cases

Number of Days	Delinquent Cases
0 – 80 (Guideline)	8
81 – 130	55
131 -180	52
181 – 230	20
> 230	12
Total	147

Source: Automated Revenue System, October 23, 2009.

Taxpayer Services' time guideline for processing collection cases is 60 days from assignment to a specialist. We randomly sampled collection<sup>16</sup> cases for how long it took to process them. Specialists processed only 24 cases (out of 134) in the 60 days. (See Exhibit 6.)

<sup>15</sup> The random sample included 196 delinquent cases that were on taxpayer specialists' caseloads on 5/27/09 or 7/30/09. When we reviewed case histories on 10/23/09, some of the cases were still in the specialists' possession and some cases were closed or moved to another phase of the collection process.

<sup>16</sup> The random sample included 242 collection cases that were on taxpayer specialists' caseloads on 5/27/09 or 7/30/09. When we reviewed case histories on 10/23/09, some of the cases were still in the specialists' possession and some cases were closed or moved to another phase of the collection process.

**Exhibit 6. Number of Days To Process Collection Cases**

Number of Days	Collection Cases
0 – 60 (Guideline)	24
61 – 120	40
121 – 180	38
> 180	32
Total	134

Source: Automated Revenue System, October 23, 2009.

**Taxpayer Services could reduce processing time.** Management could eliminate or reduce some of the steps in the case flow for both delinquent and collection cases. The delinquent case flow includes a letter informing the taxpayer that they are sending their case to the Law Department in 10 days. City code does not require the letter and eliminating it would reduce processing time by 10 days.

The collection case flow includes a step for the taxpayer specialist to send the taxpayer their third bill and gives the taxpayer 30 days to respond. Since the taxpayer already received two bills before their case was assigned to a taxpayer specialist, management could consider eliminating the third collection case bill and sending the case directly to the Law Department or collection agency.

The speed the city uses to pursue collections affects success. The longer it takes to pursue the money owed, the more risk that it will be uncollectable. To increase the number of cases processed and revenue collected, the director of finance should evaluate the case flows for delinquent and collection cases and consider how steps in the process could be shortened or eliminated.

### **Taxpayer Services Should Use Consistent and Accurate Procedures**

Taxpayer Services assesses business taxes inconsistently, resulting in differing assessment amounts depending on the staff person doing the assessment. Although assessments are estimates, there are times when the taxpayer pays the assessed amount rather than submitting a return, so taxpayers may end up overpaying or underpaying. Taxpayer Services sends the Law Department lawsuit packets with assessment errors and inadequate research, which wastes staff time and slows the collection process. Staff needs comprehensive written procedures as well as training to ensure assessments and lawsuit packets are consistent and accurate.

**Taxpayer specialists use inconsistent methods to assess business taxes.** In a review of business tax assessments by taxpayer specialists

between November 2007 and December 2009, we found the assessment methods for the same business taxes varied depending on the staff person generating the assessment. For example, four specialists used different methods to assess profits taxes when each had the same information including gross receipts and the profit taxes paid for a different year. None of the four specialists used the method described by the Taxpayer Services manager as the preferred method.

**Inconsistent assessment methods could result in differing assessment amounts.** Given the same information, staff can generate vastly different assessment amounts depending on the assessment method used. (See Exhibit 7.) If taxpayers pay their taxes based on the assessment, they may be overpaying or underpaying. Taxpayers have the opportunity to submit a return to establish their actual liability. However, taxpayers can pay the assessment rather than submit a tax return. If a taxpayer owes more than the city assessed, they could pay the assessed amount and not submit a return. That would satisfy their tax obligation. A taxpayer could also underpay or overpay taxes if the city sues the taxpayer using the assessment when it seeks a judgment from the court. If the delinquent taxpayer does not show up for court then the assessed amount becomes the judgment amount.

Exhibit 7. Example of How Different Assessment Methods Yield Varying Assessment Amounts

<u>Information available to assess 2007 profits tax for business X</u>	
Business Gross Receipts for 2006	\$1,638,600
Profits tax for 2006	\$337
<u>Method preferred by management:</u> Compute the net profit by multiplying previous year's profit tax by 100, take one percent of net and add 5% to the net for each subsequent year.	
a.	$\$337 \times 100 = \$33,700$
b.	$\$33,700 \times 1\% = \$337$
c.	$\$337 \times 5\% = \$16.85$
d.	Profits tax = $\$337 + \$16.85$
e.	<b>Profits tax for 2007 = \$353.85</b>
<u>Four methods used by taxpayer specialists. Each result in a different assessed tax liability.</u>	
Method 1: One percent of gross receipts	
a.	$\$1,638,600 \times 1\% = \$16,386$
b.	<b>Profits tax for 2007 = \$16,386</b>
Method 2: Previous year's profits tax plus incremental increases of 10% per year	
a.	$\$337 \times 10\% = \$33.70$
b.	Profits tax for 2007 = $\$337 + 33.70$
c.	<b>Profits tax for 2007 = \$370.70</b>
Method 3: One percent of gross receipts plus incremental increases of 5% for each year	
a.	$\$1,638,600 \times 1\% = \$16,386$
b.	$\$16,386 \times 5\% = \$819.30$
c.	Profits tax for 2007 = $\$16,386 + \$819.30$
d.	<b>Profits tax for 2007 = \$17,205.30</b>
Method 4: 10% of prior year's profits tax liability	
a.	$\$337 \times 10\%$
b.	<b>Profits tax for 2007 = \$33.70</b>

Source: Automated Revenue System, Taxpayer Services Management, and City Auditor's Office calculations.

**Unrealistic assessments reflect poorly on the city.** Management regards assessments as estimates that the taxpayer will correct when they submit a return and prove their obligation to be something different. However, some staff sends assessments that are clearly unrealistic, and it reflects poorly on the city's competence. For example, a taxpayer specialist sent a profits tax assessment for over \$253,162 to a taxpayer in October 2009 for the years 2004 to 2007. The specialist calculated the assessment based on 10 percent of gross, however, profits taxes should be assessed based on net. The taxpayer did not owe any profits taxes for 2003. Seeing that the taxpayer did not have a tax liability in 2003 should have alerted the specialist that it was unlikely their assessed profits taxes

for four years would be \$253,162. If the specialist had used management's preferred method, the assessed amount would be \$0.

**Lawsuit packets should be complete and error free.** Taxpayer Services sends delinquent cases with assessments over \$300 and collection cases over \$300 to the Law Department so the city can sue for the unpaid taxes. Taxpayer Services staff, supervisors, and the manager have signed off on case files with errors before they sent them to the Law Department. City attorneys have identified problems, which include Taxpayer Services not completing assessments for all applicable periods; assessing for periods that simple research shows the taxpayer has already paid; closing tax periods that need to be reopened and included in the suit; and including cases of delinquent taxpayers already in bankruptcy.<sup>17</sup> Because of past errors, city attorneys cannot rely on the accuracy of the lawsuit packets and must check the accuracy themselves. When the city attorneys identify errors, they have to return lawsuit packets to Taxpayer Services or ask them to make changes to the files so the Law Department can proceed with legal action against the delinquent taxpayer. Inaccurate and incomplete lawsuit packets result in wasted staff time and a delay in collection efforts.

**Comprehensive written procedures could help ensure consistency and accuracy.** Before December 2009, Taxpayer Services was assessing taxes without written procedures. In December, management gave supervisors a written assessment schedule, however, the schedule does not cover how to assess convention and tourism taxes. In order to ensure consistency of tax assessments and efficient use of staff time, the director of finance should ensure Taxpayer Services management establishes comprehensive written policies including written assessment methods for all business taxes and procedures to ensure the accuracy of lawsuit packets.

**Staff needs additional training in order to perform their jobs.** Taxpayer Services management reports that training is done on an as needed basis by immediate supervisors. Inconsistent assessments and other technical errors show there is a need for training in Taxpayer Services. In our survey<sup>18</sup> of Taxpayer Services staff, 23 percent of staff responding disagreed when asked whether they have enough training to do their job successfully. A number of survey responses specifically

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<sup>17</sup> Federal law prohibits the city from pursuing legal action against delinquent taxpayers that are already in bankruptcy.

<sup>18</sup> We surveyed Taxpayer Services staff in November 2009, asking their perceptions of assigned work, customer service and community relations, working environment, professionalism, leadership and managerial effectiveness, and communication.

addressed training issues. These statements indicate a desire among staff for more periodic training, including greater emphasis on initial training of new staff.

When asked what changes they would recommend to improve operations for Taxpayer Services, survey responses included:

- Complete overhaul, starting with all TSS being trained fully and complete along with the manager and supervisors.
- Need to make training a mandatory deal every 3 months if that will get taxpayer services to really know their job and not forget it.
- Training would be on a weekly basis because things in Finance contently [sic] change.
- Detail and training from the beginning.
- More training for employees who were not trained properly and also customer service classes to help with internal respect for each other.
- Make sure everyone is trained the correct way.
- I think there should be at least a 5-8 week training on case management when you first get hired.

To give Taxpayer Services staff the knowledge to do their job competently, to achieve the most efficient use of time, and to avoid delays in collection efforts, the director of finance should ensure management provides on-going training on assessment methods, preparing lawsuit packets, and other technical skills.

### **Collection Efforts Should Be Analyzed for Effectiveness**

Taxpayer Services' revenue collections for involuntary business taxes have decreased, despite changes in Taxpayer Services' responsibilities. Management needs to analyze their collection efforts to determine their effectiveness and identify any needed strategic changes. The Revenue Division should also set performance standards and monitor performance of the city's collection agency.

**Taxpayer Services should analyze its collection efforts.** Total involuntary business tax revenues decreased from about \$5.2 million in 2004 to about \$4.9 million in 2008, for collection efforts related to Taxpayer Services.<sup>19</sup> (See Exhibit 8.) Taxpayer Services switched the case flow of delinquent and collection cases back and forth between the collection agency and the Law Department. In 2007, taxpayer

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<sup>19</sup> Our audit scope limited analysis of collections to delinquent and collection case types. There were additional business taxes collected by Taxpayer Services that are not included in our numbers.

specialists' duties increased and some of their time shifted away from processing cases. Taxpayer Services management also changed the duties of the call center staff from assisting callers to simply taking a message and passing the caller's concern on to others.

Exhibit 8. Taxpayer Services Related Involuntary Collections of Business Taxes by Calendar Years 2004 – 2008.

Collection Method	2004	2005	2006	2007	2008
First Delinquency Letter	\$1,013,014	\$1,819,089	\$1,042,425	\$1,217,865	\$1,776,937
Second Delinquency and Second Collection Letter	836,543	1,189,759	627,247	903,013	1,974,475
Law Department	1,216,425	254,296	360,201	468,177	102,680
Collection Agency	380,021	550,452	371,406	347,697	501,371
Post Legal	46,653	172,395	32,330	5,577	387
Taxpayer Specialists	1,755,488	1,837,265	3,839,939	1,535,102	507,610
<b>Totals</b>	<b>\$5,248,144</b>	<b>\$5,823,256</b>	<b>\$6,273,548</b>	<b>\$4,477,431</b>	<b>\$4,863,460</b>

Source: Automated Revenue System, Information Technology Department, October 15, 2009.

As additional changes are made to revenue collection methods, analyzing the changes in collection amounts and the methods used should help Taxpayer Services determine which methods are most effective. For example, if the notices allowing 30-day responses for collection cases are eliminated or the response days are reduced, identifying revenues by collection method would allow Taxpayer Services to examine the impact of the change on collections.

In order to identify problems and ensure changes to processes are effective, the director of finance should ensure Taxpayer Services analyzes its collection efforts annually.

**The Revenue Division should establish performance standards for the collection agency.** Currently, the Revenue Division does not include performance standards or measureable outcomes in the city's contract with the collection agency. Setting performance standards will help hold the contractor accountable for providing quality service. By reviewing the files sent to the collection agency during 2008, we determined that the city gave the collection agency \$3.8 million in potential profits and withholding tax cases to pursue. The collection agency collected about \$151,000 or 4 percent of the value of those cases. Taxpayer Services needs clearly identified standards and measures to determine whether the collection agency is achieving the division's desired results.

The Government Accountability Office identified critical success factors for the IRS to use when working with private collection agencies in

collecting delinquent federal taxes.<sup>20</sup> The success factors include establishing performance evaluation standards and collecting data to monitor and assess performance. The Florida Department of Revenue's invitation to negotiate contractual services for a collection agency outlined minimum acceptable standards of collection activity, including notification of the taxpayer within 5 business days of the receipt of the account and at least one mailing and one phone contact within 10 days that each debt has been referred to the contractor. The collection agency will, within 90 days of assignment, send debt notices and attempt phone calls a specific number of times, based on the amount due.

In order to measure the collection agency's effectiveness, the director of finance should include performance standards in the city's contract with the collection agency.

### **Low Morale and Poor Working Environment Is Likely Affecting Productivity**

Taxpayer Services employee morale is low. There is dissatisfaction with the work environment including perceptions of favoritism and disruptive behaviors from some staff. The section's sick leave is increasing. Taxpayer Services supervisors and manager need managerial training to improve employee motivation and productivity and create a work environment conducive to staff focusing on their work.

**Morale is low in Taxpayer Services and employees are dissatisfied with their work environment.** About 77 percent of Taxpayer Services employees responding to our survey disagreed that morale in the Taxpayer Services Section is good, while over half of the respondents reported they are not satisfied with their working environment. More than a third disagree the staff works together as a team. When asked whether staff was satisfied with the quality of communications within the section, only 20 percent agreed, while 50 percent disagreed. (See Exhibit 9.)

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<sup>20</sup> *Tax Debt Collection: IRS Is Addressing Critical Success Factors for Contracting Out but Will Need to Study the Best Use of Resources*, GAO-04-492, Government Accountability Office, May 2004.

Exhibit 9. Survey Statements Related to Morale, Working Environment, Teamwork, and Communication

Statement	Agree/Strongly		Disagree/Strongly		Don't Know
	Agree	Neutral	Disagree		
The morale in Taxpayer Services is good.	6.7%	16.7%	76.7%	0.0%	
Overall, I am satisfied with the working environment in Taxpayer Services.	16.7%	26.7%	56.7%	0.0%	
Taxpayer Services employees work together as a team.	27.6%	34.5%	37.9%	0.0%	
Overall, I am satisfied with the quality of communications within Taxpayer Services.	20.0%	30.0%	50.0%	0.0%	

Source: City Auditor's Office Survey of Taxpayer Services Employees, November 2009.

**Staff perceive work assignments, rewards, and discipline as unfair.**

Approximately 40 percent of staff responding to our survey disagreed with the statement that “work assignments in my department are fair.” Staff comments on the survey also show a disparity in how staff perceives their workload. To the survey question, “What is the greatest hindrance to you in the routine performance of your job?” one staff replied, “not having enough work to fill my day up” and other staff replied, “when I take off for a day or two, its extremely hard to catch up unless I extend my services upon Hour, [sic] etc.” Another replied, “Sometimes our team is given too much work that needs to be completed in a short amount of time.” Sixty-three percent of survey respondents disagreed with the statement “Taxpayer Services employees get ahead primarily on the merits of their work”. Similarly, 63 percent of survey respondents disagreed that discipline was fair in Taxpayer Services. (See Exhibit 10.)

Exhibit 10. Survey Statements Related to Work Assignment Fairness, Getting Ahead by Merit, and Discipline Fairness

Statement	Agree/Strongly		Disagree/Strongly		Don't Know
	Agree	Neutral	Disagree		
Work assignments in my department are fair.	30.0%	20.0%	40.0%	10.0%	
Taxpayer Services employees get ahead primarily on the merits of their work.	13.3%	13.3%	63.3%	10.0%	
In Taxpayer Services, discipline is fair.	26.7%	10.0%	63.3%	0.0%	

Source: City Auditor's Office Survey of Taxpayer Services Employees, November 2009.

During interviews, staff expressed frustration that management would overlook or ignore inappropriate behavior from some staff. Written survey comments also indicated a perception of favoritism. One staff member said, “Everyone should receive the same disciplinary actions, not just a few.” According to human resource literature, even the perception of favoritism can affect both morale and productivity.

**Disruptive behavior from some staff affects work environment.**

Based on interviews and survey comments, some staff in Taxpayer

Services participates in disruptive behavior. Some staff reported incidences of shouting arguments between staff, antagonistic behaviors from some employees toward others, and offensive and/or inappropriate language. Approximately 38 percent of staff agreed that staff use offensive or inappropriate language. About 37 percent disagreed that co-workers treat each other with respect, while a third agreed that they have witnessed or were threatened by another co-worker. (See Exhibit 11.)

Exhibit 11. Survey Statements Involving Workplace Professionalism

Statement	Agree/Strongly Agree	Neutral	Disagree/Strongly Disagree	Don't Know
Taxpayer Services employees use offensive or inappropriate language.	37.9%	34.5%	24.1%	3.4%
My co-workers treat each other with respect.	23.3%	40.0%	36.7%	0.0%
I have been, or have seen, a Taxpayer Services employee being threatened by a co-worker.	33.3%	20.0%	40.0%	6.7%

Source: City Auditor's Office Survey of Taxpayer Services Employees, November 2009.

Interviews with staff reveal that some employees are miserable in Taxpayer Services, find it difficult to go to work, and want to find new jobs. Open-ended survey responses which indicate work environment frustrations, include comments about the lack of communication with management, the environment being a "joke," social networking on the job instead of work, daily fighting in the office, and the office's noise level.

"I just want to say I hope that whatever changes are being done will help the moral (sic) in the taxpayer services section of Revenue. Thank you."

Quote from Taxpayer Services employee survey

**Sick leave usage increased 44 percent over a three-year period.**

Collectively, the total number of sick leave hours used by staff increased 44 percent from 2007 through 2009. Human resources literature identifies absenteeism as a symptom of organizational problems. While some level of absences is inevitable, literature identifies a link between high absenteeism rates and low employee morale, which can be costly to an organization in terms of wages and lost productivity.

Management can address low morale and subsequent poor workplace environment by improving communication channels, listening to employee concerns, offering periodic feedback for staff, and showing greater appreciation for staff achievements.

**Supervisors need management skills training.** Staff reported that some supervisors ignore staff concerns and problems, fail to keep personnel issues confidential, and do not maintain a professional relationship with their employees. Over half of staff disagreed that Taxpayer Services management addresses problems in the workplace (56.7%), while approximately one third of staff disagrees that their immediate supervisor gives them helpful feedback about their performance. Half of the staff disagreed with the survey statement that they could report questionable behavior without fear of retaliation. When asked about whether management keeps staff informed about changes in a timely manner, the results were evenly divided among those who agreed and those who did not agree (37%). (See Exhibit 12.)

Exhibit 12. Survey Statements Related to Management Practices

Statement	Agree/Strongly Agree	Neutral	Disagree/Strongly Disagree	Don't Know
Taxpayer Services managers and supervisors address problems.	16.7%	23.3%	56.7%	3.3%
My immediate supervisor gives me helpful feedback about my performance.	63.3%	3.3%	33.3%	0.0%
I can report questionable behavior without fear of retaliation.	30.0%	16.7%	53.3%	0.0%
Taxpayer Services management keeps me informed about changes in a timely manner.	36.7%	26.7%	36.7%	0.0%

Source: City Auditor's Office Survey of Taxpayer Services Employees, November 2009.

Literature identifies the stress in an employee's relationship with their manager as a cause of low employee morale. Developing management skills in the areas of creating an environment where staff perceives equal treatment, effectively addressing disruptive behavior, and communicating effectively with staff could improve Taxpayer Services' work environment and employee morale. In order to improve the work environment and staff productivity, the director of finance should require Taxpayer Services management to receive management skills training.

### **City Should Consider Having the State Collect Additional City Taxes**

The city should consider having the state collect convention and tourism taxes and possibly profits and withholdings taxes to ease the Revenue Division's workload and reduce the city's administrative costs. Centralization of tax collection and enforcement at the state level could reduce collection costs. The state of Missouri currently collects and remits sales tax for Kansas City, Missouri, for 1 percent of revenues.<sup>21</sup>

<sup>21</sup> Mo. Rev. Stat. § 94.550.

Kansas City has also been considering replacement of its automated revenue system at an estimated cost of \$30 million. Having the state collect more taxes for the city could affect the need for such a costly system.

Missouri law already allows for state collection of the convention and tourism tax.<sup>22</sup> State law does not prohibit state collection of the city earnings and profits tax, but specific language should probably be added to state statutes to explicitly allow it. Both the states of Maryland and Indiana collect income taxes for local jurisdictions. Maryland collects local income taxes for the city of Baltimore and Maryland counties. Indiana collects for counties within the state.

If the city wants to consider having the state collect additional city taxes, the city manager would need to discuss with the Missouri Department of Revenue its willingness to do so and would need to perform a cost-benefit analysis. As a tool to address the city's revenue collection problems and reduce administrative costs, the city manager should consider having the state collect convention and tourism taxes and other city taxes.

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## **Recommendations**

1. The director of finance should ensure delinquent taxpayers are identified as quickly as possible following the tax due date.
2. The director of finance should ensure management improves the timeliness of sending delinquency notices and develops procedures to assess taxes sooner.
3. The director of finance should evaluate the case flows for delinquent and collection cases and consider how steps in the process could be shortened or eliminated.
4. The director of finance should establish comprehensive written policies including written assessment methods for all business taxes and procedures to ensure accuracy of lawsuit packets.
5. The director of finance should ensure management provides on-going training on assessment methods, preparing lawsuit packets, and other technical skills.

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<sup>22</sup> Mo. Rev. Stat. § 92.338.

6. The director of finance should ensure Taxpayer Services analyzes its collection efforts annually.
7. The director of finance should include performance standards for delinquent tax collections in the city's contract with the collection agency.
8. The director of finance should ensure that Taxpayer Services management receives management skills training.
9. The city manager should consider having the Missouri Department of Revenue collect convention and tourism taxes and possibly earnings and profits tax for the city.

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## Other Issues

During the course of our audit work, we identified issues that may warrant additional work.

### **City Vendors and Contractors Have Delinquent City Tax Cases**

Some city vendors and city contractors have open city tax cases at the same time they are providing services and receiving payments from the city.

**Some approved city vendors may be delinquent on city taxes.** Our analysis of the city's vendor file and PeopleSoft financial records shows the city pays vendors for services while they have delinquent city tax cases. City code does not require vendors to submit a tax clearance letter before becoming an approved vendor, although the city's vendor application states that the city could deny a vendor approval if delinquent on city taxes. In practice, the staff processing a vendor application does not require a tax clearance letter.

The acting commissioner of revenue told us that Revenue's Audit section maintains a data warehouse, which they use to match city vendors with delinquent taxpayers. While this process is helpful in identifying vendors owing a tax liability, the city could be more proactive and determine whether the vendor owes a tax liability before the city approves them as a vendor. The city could deny the delinquent vendor's approval until the delinquency is resolved. However, this practice would not address current vendors that become delinquent with city taxes.

**The city pays contractors despite city tax issues.** In comparing a database of city contractors to a database of delinquent city taxpayers, we identified 16 contractors that had delinquent city tax cases during the time they worked for the city. City code<sup>23</sup> requires tax clearance letters for city contractors with contracts over a dollar threshold<sup>24</sup> as a precondition to the city making the first payment. Three of the contractors failed to get the required tax clearance letters from the city before they were paid. The Revenue Division issued one clearance letter inappropriately to another contractor with an open delinquency case. Twelve of the contractors who had delinquent city tax cases were under the threshold requiring tax clearance letters.

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<sup>23</sup> Code of Ordinances, Sec. 2-1599.

<sup>24</sup> The city contracting threshold for tax clearance letters for fiscal year 2010 was \$123,500.

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## **Appendix A**

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### **Survey Methodology**

*Involuntary Collection of Business Taxes*

## Survey Methodology

We surveyed Taxpayer Services staff to determine their perception of employee morale and the workplace environment. We developed our survey primarily based on questions from our *Listening to the Workforce 2008 Employee Survey*.<sup>25</sup> We made minor modifications to some of the questions by inserting the title Taxpayer Services to ensure staff was answering questions related to their work section. We added some questions addressing specific concerns we heard from staff. The survey instrument contained no identifying information to ensure anonymity of respondents.

We administered our survey on November 19, 2009 for each work group within the section. Staff for each workgroup completed the survey separately and without the presence of their supervisors. Staff from each workgroup was told that all responses would remain anonymous and were also told that if they wanted to meet with audit staff, they were encouraged to contact us. Staff was also told that they may be contacted for interviews to obtain further information. The five supervisors and the manager of the Taxpayer Services Section completed the survey separately from staff.

A total of 32 staff members were working for the section at the time of the survey administration. We obtained responses from 30 of these staff members, representing approximately 94 percent of staff. We combined responses which indicated strongly agree/agree and strongly disagree/disagree. Questions 38, 39, and 40 were open-ended questions and asked staff to identify the greatest hindrance to their job, what changes would they recommend to improve operations to the Taxpayer Services Section, and whether there was anything else staff felt the audit team should know.

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<sup>25</sup> *Performance Audit: Listening to the Workforce 2008 Employee Survey*, Office of City Auditor, Kansas City, Missouri, April 2009.

*Involuntary Collection of Business Taxes*

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## **Appendix B**

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### **Director of Finance's Response**

*Involuntary Collection of Business Taxes*



# Finance Department



**DATE:** April 19, 2010  
**TO:** Gary L. White, City Auditor  
**FROM:** Randall J. Landes, Director of Finance *RJL*  
**RE:** Response to the Draft Report on Involuntary Collection of Business Taxes

My staff and I have reviewed the recommendations in the draft report on Involuntary Collection of Business Taxes. The responses to the recommendations are outlined below.

1. The director of finance should ensure delinquent taxpayers are identified as quickly as possible following the tax due date.

**Agree.** Revenue Division management will meet on a monthly basis to review the status of processing and posting tax returns to taxpayer accounts. Once all tax returns for a specific tax type and tax period have been processed, delinquent taxpayers will be identified. Staff will also set goals for identifying delinquent taxpayers and compare results to completed tasks to resources available to complete.

2. The director of finance should ensure management improves timeliness of sending delinquency notices and develops procedures to assess taxes sooner.

**Agree.** Staff has discussed ways to improve timeliness including automating processes to remove false cases for each tax type before the first delinquency notice is released. Staff will also set goals for sending delinquency notices and compare time to complete tasks to resources available to complete. In addition, staff will continue to combine cases for all tax types before assigning.

3. The director of finance should evaluate the case flows of delinquent and collection cases and consider how steps in the process could be shortened or eliminated.

**Agree.** Staff has reviewed the time currently allotted for each task and has identified certain tasks that can be eliminated, shortened or automated. Time allotted for delinquency notices will be shortened. Time allotted for collection cases will be reviewed with the intent of shortening and/or eliminating certain steps.

4. The director of finance should establish comprehensive written policies including written assessment methods for all business taxes and procedures to ensure accuracy of lawsuit packets.

**Agree.** Staff has rewritten some of the policies and has reinforced the policy regarding written assessments. Staff will codify all policies and procedures and establish an annual review or more frequently if needed. Any policy and procedural changes will undergo a review and approval by the Director of Finance or his designee.

5. The director of finance should ensure management provides on-going training on assessment methods, preparing lawsuit packets and other technical skills.

**Agree.** To ensure all staff members are provided adequate training, management will provide mandatory training sessions on specific topics covered in the policies and procedures. In addition, training will be required on an as needed basis for the Taxpayer Services section.

6. The director of finance should ensure Taxpayer Services analyzes its collection efforts annually.

**Agree.** Staff will analyze its collection efforts on both a quarterly and annual basis initially to determine if changes implemented are successful.

7. The director of finance should include performance standards for delinquent tax collections in the City's contract with the collection agency.

**Agree.** Performance standards will be developed for inclusion in the collection agency contract.

8. The director of finance should ensure that Taxpayer Services management receives management skills trainings.

**Agree.** The Finance Department will work with the Human Resources Department to determine if existing or new training initiatives are needed to address issues presented in the audit.

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## **Appendix C**

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### **Interim City Manager's Response**

*Involuntary Collection of Business Taxes*

CITY OF FOUNTAINS  
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## Office of the City Manager

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APR 21 2010

CITY AUDITOR'S OFFICE

**DATE:** April 19, 2010

**TO:** Gary L. White, City Auditor

**FROM:** Troy Schulte, Interim City Manager

**RE:** Draft Report on Involuntary Collection of Business Taxes



Attached is the response to recommendation nine in the draft Report on Involuntary Collection of Business Taxes.

**Recommendation 9:**

The city manager should consider having the Missouri Department of Revenue collect convention and tourism taxes and possibly earnings and profits tax for the city.

**Agree.** Staff will explore the options of the state collecting additional tax types on behalf of the City, as well as making improvements to the City's current collection processes. The two options should be weighed from the standpoint of total impact. As a starter, I have asked staff to collect data on how other cities manage the collection processes that have taxes similar to the earnings and profits and convention and tourism taxes.