



ARTS TAX: Promises to voters only partly fulfilled

July 2015

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City Auditor

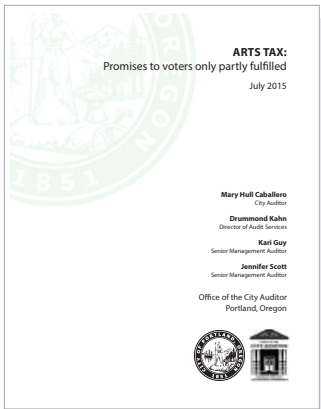
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CITY OF PORTLAND

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July 28, 2015

TO: Charlie Hales, Mayor
Commissioner Nick Fish
Commissioner Amanda Fritz
Commissioner Steve Novick
Commissioner Dan Saltzman
Fred Miller, Chief Administrative Officer, Office of Management and Finance
Eloise Damrosch, Director, Regional Arts and Culture Council

SUBJECT: Audit Report: *Arts Tax: Promises to voters only partly fulfilled* (Report #472)

The attached report contains the results of our audit work on implementation of Portland's Arts Tax. Response letters from the Revenue Division and Regional Arts and Culture Council are included.

While the Revenue Division states in its response that there is limited practical use for tracking actual costs to implement the Arts Tax, voters deserve a better accounting of how Arts Tax funds are spent and tax collection is managed. We will follow up in one year with the Mayor, Revenue Division, and Regional Arts and Culture Council for a status report detailing steps taken to address the audit recommendations.

Mary Hull Caballero
City Auditor

Audit Team: Drummond Kahn
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Attachment

ARTS TAX:

Promises to voters only partly fulfilled

Summary After three years of collections, Portland’s Arts Tax has provided funds to schools and arts organizations, but implementation has been challenging and some promises Council made to voters have yet to be accomplished. Funds collected remain below estimates, administrative costs are higher than the required cap, and oversight is fragmented.

Portland voters approved an annual arts income tax (Arts Tax) of \$35 per person in 2012. Funds received from the tax were intended to hire arts and music teachers in schools and provide grants to arts organizations. We conducted this audit to review progress to date.

Figure 1

Ballot Title Statement	Implemented	Page
Tax collection		
Income tax of \$35 for each adult income-earning Portland resident. Individuals in households below the federal poverty level pay no tax.	No	5
Estimated funds will be \$12 million annually.	No	5
Administrative costs are capped.	No	8
Tax distributions		
Arts and Music Teachers: Funds to hire arts and music teachers for kindergarten through 5th grade students at local public schools attended by Portland students. Distribution of funds based on school enrollment.	Yes, with exceptions	12
Arts Access: Remaining funds for grants to nonprofit arts organizations, other nonprofits, and schools. Will fund grants to provide high-quality arts access for kindergarten through 12th grade students and to make arts, culture experiences available to underserved communities.	Yes	15
Oversight		
Expenditures subject to oversight by citizen committee.	Yes	18
Independent financial audits of Regional Arts and Culture Council and School District expenditures.	No	20

Source: Audit Services review of Ballot title (Ballot title in Appendix 1)

We reviewed seven primary statements on the 2012 ballot to determine whether the City's implementation of the Arts Tax was consistent with promises made to voters. The statements focused on three areas: Tax collection, distributions, and oversight. Results were mixed.

As promised, the Arts Tax provided adequate funds each year to fund the six Portland-area school districts at a rate of one teacher per 500 elementary school kids, achieving a primary goal of the tax. Remaining funds were provided to the Regional Arts and Culture Council for distribution to arts organizations. A citizen committee collected information from the Regional Arts and Culture Council, school districts, and the City's Division of Revenue to provide annual reports to the City Council on tax implementation.

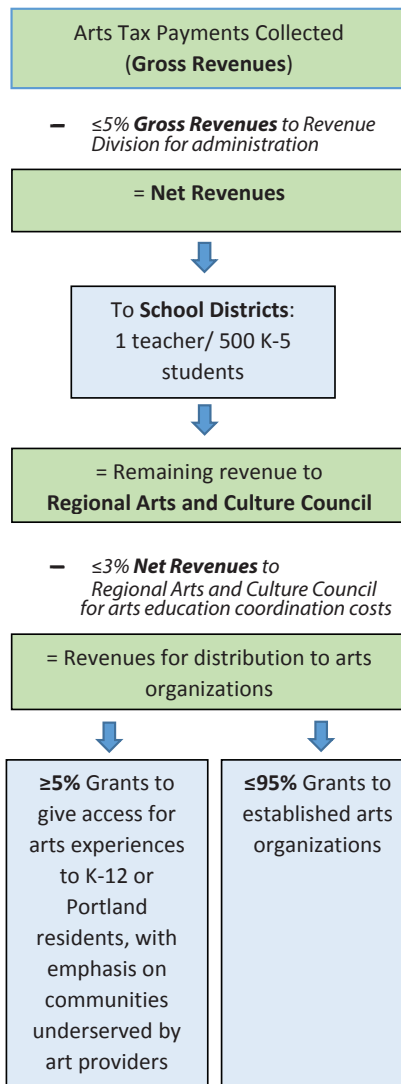
However, implementation of the Arts Tax has not been consistent with the statements to voters in a number of ways. After the vote was certified but before the first year of payments, the City Code and Rules were amended to exempt some taxpayers. Due to these changes and a low compliance rate, funds received from the Arts Tax have been below estimates. The costs to administer the tax are also higher than projected, which may decrease City funds available for other programs. Finally, oversight of the Arts Tax is fragmented, with sometimes duplicative or incomplete reporting requirements.

Council should act to reconcile its intentions as stated on the ballot with the realities of implementation. We include recommendations to Council related to compliance, administration, and ongoing oversight.

Arts Tax Overview

In addition to the statements in the ballot measure, administration of the Arts Education and Access Fund (Arts Tax) is defined in City Code, City Administrative Rules, and agreements City Council approved with the school districts and with the Regional Arts and Culture Council. These documents define how Arts Tax funds will be collected and distributed, as shown in Figure 2.

Figure 2 Arts Tax funding process



Source: Audit Services Division based on City Code

The City's Revenue Division of the Bureau of Revenue and Financial Services is charged with collecting the tax, and distributing revenues according to the requirements of City Code and agreements. After Revenue Division administrative costs are deducted, funds are distributed to school districts to hire certified arts or music education teachers at a ratio of one teacher for every 500 students in kindergarten through fifth grade.

Remaining funds are distributed to the Regional Arts and Culture Council, a nonprofit funded by public and private entities to expand the arts in Clackamas, Multnomah, and Washington counties. The Regional Arts and Culture Council may use up to 3 percent of the net tax revenues for arts education coordination costs. These costs are defined in the contract as the costs to coordinate and work with school districts to provide arts education from kindergarten through grade 12, as well as costs of oversight of school districts and other grant recipients.

After arts education coordination costs are removed, remaining funds are granted in two grant programs: one to established arts organizations for general support; and one to expand access to arts for students in kindergarten through 12th grade and underserved communities.

Tax Collection

Ballot Title Statement	Implemented
Income tax of \$35 for each adult income-earning Portland resident. Individuals in households below the federal poverty level pay no tax.	No
Estimated funds will be \$12 million annually.	No

Planned The ballot measure and City Code required the City to collect \$35 from every income-earning adult living in a household above the poverty level. The Revenue Division estimated that more than 400,000 taxpayers would be eligible to pay the tax for the 2012 year, based on U.S. Census and household income data. Revenue estimated an 85 percent compliance rate, resulting in 343,000 actual taxpayers paying close to \$12 million dollars. All income-earning adults would be required to file a form with Revenue -- either to accompany their tax payment or to claim an exemption.

Actual Before the first year of tax collection, there were legal questions raised regarding taxable income. In response, City Council and the Revenue Division made two changes to City Code and Rules to exempt additional residents from paying the tax:

- City Council amended City Code to exempt people earning less than \$1,000 from paying the tax. This meant that a person living in a household above the poverty level who earns less than \$1,000 as an individual would not pay the tax, such as the spouse of a primary wage-earner or an adult child living at home.
- The Revenue Division adopted an Administrative Rule with a definition of "income" that specified certain forms of income that the City could not tax under state or federal laws, such as Social Security benefits, Public Employee Retirement System benefits, and federal pension benefits.

Arts tax collections	
FY 2013	\$7.8 million
FY 2014	\$7.2 million
FY 2015	\$10.5 million <i>(as of June 16, 2015)</i>
Total:	\$25.5 million

The result of these changes was to decrease the number of eligible taxpayers. The Revenue Division estimated a reduction in tax collections of between \$1.25 million and \$2.1 million. In fact, Arts Tax revenues were even lower. The first fiscal year, collections were \$7.8 million, declining to \$7.2 million in the second year. In the third year, revenues have grown to \$10.4 million, including both current year taxes and late payment of taxes from 2012 and 2013.

Collection in all years is well below the estimated 85 percent compliance rate. As of June 2015, the Revenue Division estimates that close to 72 percent of eligible taxpayers have complied with paying the Arts Tax for tax year 2012 after the third year of collection. Compliance increases after more years of collection. The compliance rate for tax year 2013 is 68 percent, and for 2014, 61 percent.

The Revenue Division's Arts Tax database includes information on approximately 350,000 Portland taxpayers. With an estimated adult population of 482,000, many taxpayers have not yet been identified. Fewer than 8,000 of the more than 75,000 taxpayers who are likely exempt from payment have submitted exemption forms.

The Revenue Division has taken a number of steps to increase compliance and collections, including:

- Initial data matches to identify taxpayers, such as through voter registration rolls or the water billing database
- Use of online payment portal to simplify collections
- Use of email lists to remind taxpayers of payment deadline
- Mailing of tax forms, and use of mail-forwarding service
- Making tax information available in tax preparer software
- Translating tax information into ten languages
- Contracting with Elders-in-Action to provide outreach to seniors
- Hiring temporary employees during arts tax season to answer phone calls and process returns

However, Revenue Division management has not yet instituted enforcement action other than imposing late fees. Revenue officials told us that they plan to begin referring non-compliant taxpayers to a collection agency in 2016, after the 2015 tax year collections deadline of April 15, 2016. Of the estimated 482,000 adults in Portland, approximately 283,000 have either paid taxes or filed for an exemption for the 2012 tax year. This leaves the potential for a large number of residents to be referred to a collection agency. Revenue Division managers told us they believe they can reduce the number sent to collections to around 20,000 people through new mailings to residents with delinquent accounts.

Conclusion

It appears that City Council, City Attorney, and Revenue Division underestimated both the legal complexity of creating a new income tax and the challenge of identifying all eligible taxpayers and persuading them to pay. Early changes to City Code and rules exempting certain taxpayers from paying increased the complexity of collection. The City is relying heavily on a system of voluntary compliance. If taxpayers do not have confidence in the tax system or believe it is not easy to understand and does not treat everyone fairly, voluntary compliance may decline.

The City Council and the Revenue Division will have to carefully balance the benefits of enforcement with the potential effects on the City's residents. Enforcement could increase Arts Tax collections from non-compliant taxpayers and may promote voluntary compliance by assuring taxpayers that everyone required to pay is paying. But enforcement action could have negative effects on many Portland residents, such as impacting their credit scores.

When City Council considers new taxes and fees in the future, both the legal basis for the tax and the ease of collection should be key considerations. Before initiating collection actions against Portland residents for Arts Tax payment, Revenue should report to City Council on collection and compliance to date and options for increasing compliance.

Tax Collection: Administration

Ballot Title Statement	Implemented
Administrative costs are capped.	No

Planned The City Code section implementing the Arts Tax provides two restrictions on administrative costs:

- *Revenue Division* administrative costs are capped at an average of 5 percent or less of total revenues over a five-year period (after up to \$600,000 in start-up costs).
- *Regional Arts and Culture Council* arts education coordination costs are limited to 3 percent of net revenues.

Actual *Revenue Division* costs to implement the Arts Tax are above the 5 percent cap for reported costs, and many Division costs are not reported. Costs to implement the Arts Tax not currently being charged to the Arts Tax fund include:

- Personnel costs for supervision, including costs of the Arts Tax Supervisor and the Deputy Director. The Deputy Director is responsible for program oversight, allocations to school districts, and allocations to the Regional Arts and Culture Council.
- Personnel costs for Arts Tax work during the tax season, when business license tax staff are required to answer Arts Tax phone calls and process Arts Tax payments. While the direct phone time is charged to the Arts Tax fund, time costs to mail documents or update taxpayer information is not.
- Personnel costs for front desk staff who answer questions and accept payments at the Revenue Division office.
- Some technology costs to program and update the Arts Tax database, which were intended to be charged to the Arts Tax fund but were not due to an accounting error.
- Outreach provided through Elders in Action, and translation services, both funded from the City's General Fund.

The personnel costs are not new costs to the City’s General Fund, but a shift in responsibilities for existing staff to the Arts Tax. Diverting staff resources to Arts Tax collection may result in delays in processing business license tax returns, which could cause delays in audit, collection, and enforcement action. We observed business license tax staff answering arts tax calls during our audit fieldwork, and updating associated records. However, Revenue Division managers told us that the time spent by business license tax staff is decreasing each year and is now minimal both in staff time spent and potential impact to business license tax collections. Even at a minimal level these costs should be recognized as an Arts Tax administrative cost.

Revenue Division management has informed the City Council that the 5 percent cap may not be achievable. Even with only a portion of direct staff time included, Revenue is unlikely to stay below the 5 percent administrative cost cap, as shown in Figure 2.

Figure 2 Revenue Division Reported Administrative Costs
(as of June 16, 2015)

Fiscal Year	Administrative cost	Administrative cost percent
2013*	\$ 174,605	2.2%
2014*	619,370	8.6%
2015	792,179	6.8%
Total:	\$ 1,586,154	5.9%

Source: Audit Services analysis of City SAP system and Revenue Division records

* First and second year administrative costs low because start-up costs are not included

We found that Revenue's process and costs to collect the Arts Tax appear reasonable. Decreasing administrative costs – for example reducing staff available to answer calls and process payments or limiting outreach to taxpayers – may further decrease collections.

However, Revenue Division collection practices have changed each year as they identify improvements based on the prior year. Because of the frequent changes, they do not have written procedures for staff to follow. Instead they rely on emails and staff meetings to communicate changes. With both short-term temporary staff and business license tax staff that do not routinely work on Arts Tax collections, the lack of documented procedures creates a risk that collection rules will not be uniformly applied. Revenue Division managers told us that they are working on developing an online set of procedures that can be easily updated.

The *Regional Arts and Culture Council* is well below the cap of 3 percent of net revenues for arts education coordination for a number of reasons:

- When Arts Tax revenues were lower than projected, the Regional Arts and Culture Council prioritized grants to arts organizations over its education coordination function. Staff was not hired to implement the education coordination requirements of the 2012 contract until August of 2014, and many contract requirements were just starting at the time of our audit.
- As defined in the organization's contract, the cap only applies to education coordination costs and not to other costs to administer the Arts Tax grant programs. Grant administration and oversight is paid for with other Regional Arts and Culture Council funds.
- The cap is calculated based on net revenues, not the revenues Regional Arts and Culture Council receives.

The Regional Arts and Culture Council staff we spoke with told us it is unlikely they will ever spend up to the cap of 3 percent of net revenues. However, the organization's costs may increase as they fully implement the oversight responsibilities in the contract. If they spend below the cap, remaining funds are granted to arts organizations.

Conclusion After three years of tax collection, it appears that the Revenue Division's cost cap is not realistic. Revenue should review current administrative activities and report to City Council on the true costs needed to administer the program. Council must then decide whether to decrease administrative activities to meet the cap, explicitly provide General Funds to administer the tax, or raise the cap on Arts Tax administrative expenses.

Regional Arts and Culture Council told us they are working to clarify the education coordinator activities in their contract, and estimate the costs needed to implement these activities. Based on this information, City Council should review these arts education coordination activities and revise the cap as needed.

Tax Distributions: Arts and Music Teachers

Ballot Title Statement	Implemented
Arts and Music Teachers: Funds to hire arts and music teachers for kindergarten through 5th grade students at local public schools attended by Portland students. Distribution of funds based on school enrollment.	Yes, with exceptions

Planned The City Code requires that funds will be distributed based on a ratio of one teacher for every 500 kindergarten through fifth grade students. All schools that have Portland students and whose catchment area overlaps with the jurisdiction of the City of Portland are eligible for funds, including charter schools. Funds are to be distributed by the Revenue Division to Portland’s six school districts.

Actual Arts Tax funds have been sufficient to fully fund the school districts at one teacher per 500 students, as shown in Figure 3. The Revenue Division developed an allocation process that verifies the actual teacher salaries and kindergarten through fifth grade enrollment in each school district. The first school district payments were made for the 2013-14 school year.

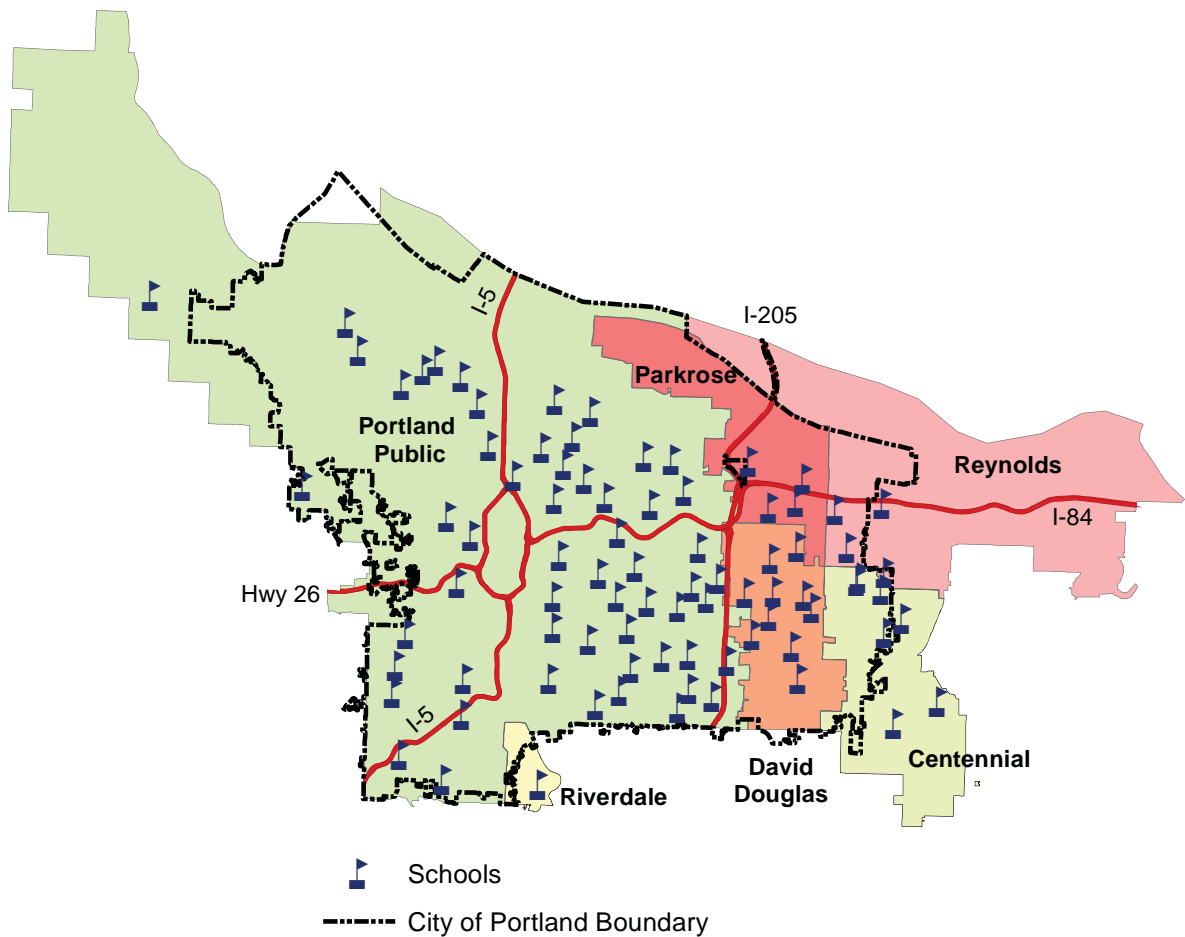
Figure 3 School District Distributions

School District	2013-14	2014-15
Centennial	\$ 539,956	\$ 535,985
David Douglas	965,118	981,600
Parkrose	294,264	316,999
Portland Public	4,512,239	4,479,659
Reynolds	357,942	388,310
Riverdale	40,429	42,180
Total:	\$ 6,709,948	\$ 6,744,733

Source: City SAP system

According to documents provided by the school districts to the Arts Oversight Committee, the Arts Tax has resulted in an increase in arts and music teachers in Portland schools, from 31 prior to Arts Tax funding to 83 teachers in the 2014-15 school year. Teachers funded by the arts tax taught in 85 elementary schools across the six school districts, as shown in Figure 4 below.

Figure 4 Schools with teachers funded by Arts Tax



Source: Audit Services, based on Arts Oversight Committee reports

While charter schools are specifically authorized for funding in City Code, the Code also directs that funds be provided to school districts. There are two charter schools in the City that are chartered by the state, and not by a Portland school district. Because Arts Tax funding is provided through school districts, these two charter schools did not receive Arts Tax funding. Excluding these two schools from funding appears inconsistent with the ballot title statement that funds will be used to hire arts and music teacher at local public schools attended by Portland students.

Conclusion

The Revenue Division developed effective processes for validating school district salary costs and student enrollment to ensure allocations were consistent with ballot measure language and implementing code and agreements. However, two charter schools were not funded due to conflicting language in the City Code. City Council should clarify the City Code to ensure funding for these two Portland charter schools.

Tax Distributions: Arts Access

Ballot Title Statement	Implemented
Arts Access: Remaining funds for grants to nonprofit arts organizations, other nonprofits, and schools. Will fund grants to provide high-quality arts access for kindergarten through 12th grade students and to make arts, culture experiences available to underserved communities.	Yes

Planned The City Code implementing the Arts Tax provided further direction on distribution of funds by the Regional Arts and Culture Council. Funds must be allocated as follows:

- Up to 95 percent of funds to support non-profit Portland arts organizations that demonstrate artistic excellence and provide a wide range of high-quality arts programs to the public (referred to as General Operating Support);
- A minimum of 5 percent to non-profit arts organizations, other nonprofits and schools that will give access to high-quality arts experiences to K-12 students and expand arts access to underserved communities. (referred to as Access Grants).

In 2012, City Council amended a contract with the Regional Arts and Culture Council to specify Arts Tax responsibilities. The agreement added the goal to provide General Operating Support organizations with funds equal to 5 percent of their operating income. The Regional Arts and Culture Council selects General Operating Support organizations based on artistic excellence, proven service to the community, and administrative and fiscal competence.

Actual The Regional Arts and Culture Council has provided \$1.3 million in General Operating Support and Access Grants from Arts Tax funds, and an additional \$600,000 from a Special Appropriation from Council. As of June 2015, the Regional Arts and Culture Council had spent 3.6 percent of revenues on Access Grants, but they have reserved the full 5 percent of funds to allocate in the next grant cycle.

In the first fiscal year after the tax was implemented, revenues to Regional Arts and Culture Council were lower than initially projected due to changes in the required taxpayers and low compliance rate. The organization requested and received a \$600,000 Special Appropriation from the City Council to supplement Arts Tax funds directed to General Operating Support organizations. The receipt and use of Arts Tax funds and the Special Appropriation through June 16, 2015 is shown in Figure 5.

Figure 5 Regional Arts and Culture Council Arts Tax
(FY 2014 and FY 2015, as of June 16, 2015)

Revenues	
Arts Education and Access Fund	\$ 2,205,000
General Fund – Special Appropriation	600,000
Total Revenues	\$ 2,805,000
Committed Expenditures	
Arts Education Coordination Costs	\$49,522
General Operating Support Grants	1,822,581
Access Grants	79,813
Total Expenditures:	\$ 1,951,916
Reserved Funds*	\$ 853,084

Source: City SAP system and Regional Arts and Culture Council

* Regional Arts and Culture Council committed an additional \$215,886 in General Operating Support grants after our field work was complete.

General Operating Support Grants: Due to the contract goal of providing 5 percent of a recipient organization’s operating income, organizations with higher operating income receive the majority of General Operating Support funds. These operating grants are unrestricted, meaning the organizations can spend them for any aspect of their operations. Once an organization is approved as a General Operating Support organization, it will continue to receive general financial support as long as it remains eligible. Five organizations have received 80 percent of General Operating Support funds to date. Those five are listed below in Figure 6, and a full list of grantees is included in Appendix 2.

Figure 6 General Operating Support Grants

(FY 2014 and FY 2015, as of June 16, 2015)

Portland Art Museum	\$ 490,676
Oregon Symphony	415,061
Portland Center Stage	216,620
Portland Opera	208,799
Oregon Ballet	128,745
41 other organizations	362,680
Total:	\$ 1,822,581

Source: Regional Arts and Culture Council

Access Grants: Access Grants have been provided in two cycles; May 2014 and May 2015. Unlike the unrestricted General Operating Support Grants, the Access Grants are for specific programs that expand access to the arts to underserved communities and students in kindergarten through 12th grade. Grants have been provided to 27 organizations, with total grant amounts to an organization ranging from \$1,000 to \$5,900.

In the most recent funding round the Regional Arts and Culture Council received applications from 53 organizations for over \$350,000. They approved grants for 20 organizations, for a total of \$54,118. A list of grantees for both Access Grant cycles is included in Appendix 2.

The amount allocated to Access Grants is 3.6 percent of funds received by the Regional Arts and Culture Council as of June 2015, currently below the 5 percent minimum required by City Code. Regional Arts and Culture Council staff told us they set aside the full 5 percent of funds as they receive them from the Revenue Division, and will allocate the remainder in the FY 2015-16 grant cycle. There are no requirements in City Code or the organization's contract specifying the timeframe for offering grants or meeting the 5 percent minimum.

Conclusion

The Regional Arts and Culture Council has provided the majority of Arts Tax funds to support established arts organizations, as required by City Code. To date, only a small portion of funds received have been used for Access Grants to make arts and culture experiences available to underserved communities, but the Regional Arts and Culture Council reserved funds for the FY 2015-16 grant cycle.

Oversight: Citizen Committee

Ballot Title Statement	Implemented
Expenditures subject to oversight by citizen committee.	Yes

Planned City Code requires the City to appoint a citizen oversight committee to ensure the Arts Fund is implemented as required, review expenditures made, and report their findings to Council on an annual basis. In addition, the City Code requires Revenue to report to City Council on all funds received and directed to the school districts and Regional Arts and Culture Council. In agreements with the school districts and Regional Arts and Culture Council, the City Council specified further oversight and reporting requirements.

Actual A proactive citizen oversight committee has been diligent in collecting information from school districts, the Regional Arts and Culture Council, and the Revenue Division for an annual report to the City Council. The committee, referred to as the Arts Oversight Committee, created a working agreement and developed a set of uniform metrics by which the committee would collect and evaluate information. There is no staff support for the committee specified in City Code. The volunteer members of the committee did most of the work themselves, including analyzing submittals from school districts and the Regional Arts and Culture Council. Staff from the Commissioner-in-Charge of Arts and Culture and the Revenue Division provided support as needed with agendas and document production.

The committee's two annual reports are available on the Revenue Division's website. The reports document dollars spent at school districts and Regional Arts and Culture Council, and the teachers and grants funded. Moving forward the committee is increasing the focus on qualitative impacts of arts funding on children and communities. In each report the committee noted both successes and challenges with Arts Tax implementation, some of which are reflected in this audit.

City Oversight of Arts Tax: Other oversight functions have been less successful, in part because responsibilities are duplicative or unclear. These responsibilities are not referenced in the ballot title, but in City Code or agreements with the school districts and Regional Arts and Culture Council.

For example, the Regional Arts and Culture Council contract specifies that they require funded programs, including school districts, to report on programs provided, students served, and the type of expenditures. The Regional Arts and Culture Council requires this reporting from arts organizations it funds. They did not request this information from school districts because the school districts' agreements require that the districts provide this information to the Revenue Division or the Arts Oversight Committee, which school districts have done.

Separately, the school districts are required to submit annual audits to Revenue, so that Revenue can track compliance with the school district agreements. This implies Revenue has an oversight role over the school districts that may be inconsistent with other statements in the Regional Arts and Culture Council contract.

In addition, both school district and Regional Arts and Culture Council agreements require annual, high-level meetings convened by the Commissioner-in-charge of Arts and Culture and quarterly meetings convened by the Regional Arts and Culture Council. None of these meetings had occurred at the time of our audit.

Conclusion

The Arts Oversight Committee fully realized the promise on the ballot to provide oversight by a citizen committee. But relying on a committee of volunteers with limited City staff support as the central point for oversight may present longer term risks to the City. As committee members' terms expire, a new set of volunteers may be less able or willing to put in the hours of work required to collect and analyze information from all parties and produce an extensive annual report. A single point of contact within the City could provide staff support to the committee and help ensure all aspects of the Arts Tax are implemented as required by the ballot, City Code, and implementing agreements.

Council should clarify the roles, responsibilities, and reporting for school districts, Regional Arts and Culture Council, Revenue, and Commissioner-in-Charge, and revise the school district and Regional Arts and Culture Council agreements as needed to reflect those amended roles.

Oversight: Financial Audits

Ballot Title Statement	Implemented
Independent financial audits of RACC and School District expenditures.	No

Planned City Code specifies that the City will receive copies of annual independent audits of expenditures by Regional Arts and Culture Council and the school districts each year, and these will be made available to the public. Agreements with the school districts and Regional Arts and Culture Council require that the audits specifically identify Arts Tax funds received and expended.

Actual Only Portland Public Schools specifically identified Arts Tax funds received and expended in their annual financial audit. David Douglas School District identified funds received. All other school districts and the Regional Arts and Culture Council did not include this information in their annual financial audits.

Conclusion Without audited financials, the City has no independent verification of how Arts Tax dollars were spent. As part of the oversight function, the City should ensure this information is included in future school district and Regional Arts and Culture Council financial audits.

Conclusion and Recommendations

After three years of Arts Tax collections, a number of statements in the Arts Tax ballot language have not been met. Compliance remains low, administrative costs are higher than the required cap, and oversight is fragmented. Moving forward, City Council will need to reconcile its intentions as stated on the ballot with the realities of tax implementation.

To improve tax collection, administration, and oversight, we recommend:

- 1) The Revenue Division should provide a report to City Council that includes:
 - a. A review of payment and exemption filing compliance. The review should attempt to identify taxpayers who may be impacted by enforcement actions, possibly by income level or geographic area. Revenue should provide alternatives for Council consideration to improve compliance, including increased funding for education and outreach or expanding enforcement actions.
 - b. An estimate of total Revenue Division costs to implement the Arts Tax. This should include costs of all Revenue staff time for collection and allocation. Revenue should identify alternatives for City Council consideration to either reduce its activities to stay below the cost cap, or to increase to the administrative cap.
- 2) The Regional Arts and Culture Council should review the education coordination and oversight responsibilities specified in its contract with the City. With input from the school districts and Revenue Division, it should clarify its administrative, coordination, and oversight role. Based on this review it should provide a report to the City Council with recommendations for contract changes and revisions to the coordination cost cap.

- 3) The Mayor should review the reports from Revenue Division and the Regional Arts and Culture Council and develop a proposal to City Council to revise the City Code and school district and Regional Arts and Culture Council agreements to accomplish the following:
 - a. Provide direction to Revenue on Council's intent related to Arts Tax compliance and enforcement.
 - b. Clarify Revenue Division's administrative cost cap by directing Revenue to decrease collection activities, identifying the General Fund subsidy, or increasing the administrative cost cap.
 - c. Revise the arts education coordination and administrative activities of the Regional Arts and Culture Council as needed and establish a spending cap consistent with those activities.
 - d. Clarify the roles, responsibilities, and reporting for school districts, Regional Arts and Culture Council, Division of Revenue, and Commissioner-in-Charge, to ensure a central point of contact responsible for ensuring all Arts Tax provisions are met, including the requirement for audited financial statements.

To clarify allocations of tax funds to charter schools we recommend:

- 4) The Mayor should develop a proposal for City Council to clarify how public schools in Portland that have been chartered by the State will be funded.

Objective, Scope and Methodology

The objective of this audit was to determine whether the City's implementation of the Arts Tax is consistent with ballot measure language and City policy.

To accomplish this objective, we reviewed ballot measure statements, City Code, City administrative rules, and agreements between the City and Portland's school districts and the Regional Arts and Culture Council. We interviewed staff and managers at the Division of Revenue, Regional Arts and Culture Council, and school districts. We reviewed Revenue's process for Arts Tax collections and distributions and observed staff processing Arts Tax payments at the Revenue Division.

For revenue and expenditure data we relied primarily on the City's Enterprise Resource Planning system, SAP, supplemented by information from the Regional Arts and Culture Council on grant allocations.

We conducted this 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.

Ballot title and explanatory statement

APPENDIX A

CITY OF PORTLAND

Measure 26-146

BALLOT TITLE

RESTORE SCHOOL ARTS, MUSIC EDUCATION; FUND ARTS THROUGH LIMITED TAX.

QUESTION: Shall Portland restore arts, music for schools and fund arts through income tax of 35 dollars per year?

SUMMARY: This measure creates a limited income tax of \$35 for each adult income-earning Portland resident. Individuals in households below federal poverty level pay no tax.

Tax can only be used for:

- Arts and Music Teachers: Funds to hire arts and music teachers for kindergarten through 5th grade students at local public schools attended by Portland students. Distribution of funds based on school enrollment.

- Arts Access: Remaining funds for grants to nonprofit arts organizations, other nonprofits and schools. Will fund grants to provide high-quality arts access for kindergarten through 12th grade students and to make arts, culture experiences available to underserved communities. Funds administered by Regional Arts and Culture Council (RACC).

Accountability measures include:

- Administrative costs are capped.
- Expenditures subject to oversight by citizen committee.
- Independent financial audits of RACC and School District expenditures.

Estimated funds raised will be \$12 million annually. The tax is effective beginning with 2012 tax year, with payment due when state taxes are due.

Remaining funds will be awarded as grants to non-profit organizations and schools to provide high-quality arts access for Kindergarten through 12th grade students and to make arts and culture experiences available to underserved communities. Administered by the Regional Arts & Culture Council, grants will be made to qualifying Portland-based non-profit arts organizations that demonstrate artistic excellence, provide service to the community, show administrative and fiscal competence and provide a wide range of high quality arts programs to the public. Grants will also be awarded to schools and non-profits that provide arts programs specifically for schoolchildren and underserved communities.

Measure 26-146 will generate the revenue to support the Arts Education and Access Fund through an income tax of \$35 per adult, income-earning resident of Portland. Residents living in households at or below the federal poverty limit will be exempt: they will not pay this tax.

ACCOUNTABILITY

An Independent Citizen Oversight committee that is representative of the City's diverse communities will be formed to annually review Fund expenditures and report the impact of the Arts Education and Access Fund to the public. Audits will be made available to the public annually.

After the expenditure of capped start-up costs, administrative costs of this Fund are limited to 5 percent or less of Gross Revenues over a five year period.

EXPLANATORY STATEMENT

BACKGROUND

Research shows that art and music are an essential part of a basic curriculum for students, especially in the elementary school years. Studies link access to arts education to improved attendance, increased participation in math and science, higher test scores, increased graduation rates and college admittance. The impact is even greater among low-income students and students of color.

Access to arts education for public school students in the City of Portland has declined steeply. For example, over the last five years Parkrose and Centennial School Districts have cut their art and music teaching staff by half. Portland Public Schools has dropped all arts instruction in 22 schools in just two years.

- In 2011, 18% of Portland elementary schools provide art instruction compared to 83% nationally.
- 58% of Portland elementary schools provide music instruction compared to 94% nationally.
- 28% of all Portland schools provide no arts instruction of any kind including music, drama, dance or visual arts. This is compared to just 3% of schools nationally.
- There are 11,596 Portland children attending schools that do not have any art, dance, drama, or music instruction.

HOW MEASURE 26-146 WORKS

The Arts Education and Access Fund will first go to all schools that serve Portland students within the six Portland school districts (Centennial, David Douglas, Parkrose, Portland Public, Reynolds, and Riverdale) to pay for certified arts education teachers for Kindergarten through 5th grade (K-5). Districts will receive the funds required to hire and maintain one certified arts teacher per every 500 students so that every K-5 student within the City of Portland will have access to arts education.

Submitted by
Sam Adams
Mayor
City of Portland

BALLOT TITLE mailed to voters with ballot.

EXPLANATORY STATEMENT included in voter's guide.

**Full Regional Arts and Culture Council
funding lists**

APPENDIX B

Regional Arts and Culture Council grant allocations (FY 2014 and FY 2015 to June 16)

General Operating Support Grants*	Total Amount
Portland Art Museum	\$ 490,676
Oregon Symphony Association	415,061
Portland Center Stage	216,620
Portland Opera	208,799
Oregon Ballet Theatre	128,745
Miracle Theatre Group	46,592
Young Audiences of Oregon	42,331
Hollywood Theater	35,041
Literary Arts	27,569
Northwest Dance Project	27,539
Bodyvox	19,451
White Bird	18,936
Portland Baroque orchestra	17,504
The Portland Ballet	17,191
Portland Youth Philharmonic	10,263
Friends of Chamber Music	9,478
PDX Jazz	8,322
Metropolitan Youth Symphony	7,677
Tears of Joy Theatre	7,052
Portland Gay Men's Chorus	6,022
Artists Rep	5,700
Oregon Children's Theatre	5,518
Chamber Music Northwest	5,305
Cappella Romana	5,242
PHAME	4,209
Portland Taiko	3,227
Blue Sky Gallery	3,164
Northwest Children's Theatre	2,486
Playwrite, Inc	2,386
Oregon Reperatory Singers	2,240
Imago Theatre	2,235
Do Jump!	2,185
Portland Institute for Contemporary Art	2,113
Third Angle New Music Ensemble	1,882
Profile Theatre Project	1,787
Pendulum Aerial Arts	1,468
Ethos Music Center	1,449
Write Around Portland	1,304
Children's Healing Art Project	1,008
Live Wire!	1,008
Portland Columbia Symphony Orchestra	1,008
Portland Piano International	1,008
Third Rail Repertory Theatre	1,008
Wordstock, Inc.	1,008
Independent Publishing Resource Center	882
NW Documentary Arts and Media	882
Total:	\$ 1,822,581

Access Grants	Total Amount
Native American Youth and Family Center	\$ 5,900
BCC BrownHall	5,000
Rogue Pack_Young Portland Speaks	5,000
Living Stages	4,350
Zenger Farm/Lents International Farmers Market	3,800
Asian Pacific American Network of Oregon	3,750
Know Your City	3,500
Wisdom of the Elders	3,300
Black United Fund - Vox Siren	3,000
Cascade AIDS Project	3,000
Center for Intercultural Organizing	3,000
The Skanner Foundation	3,000
Colored Pencils	2,750
Latino Network	2,750
Folktime, Inc.	2,500
Mochitsuki	2,500
Oregon Historical Society	2,500
The Portland Commission on Disability	2,500
ROSE Community Development	2,350
Spect-Actors Collective	2,100
Dance-Parkinson	2,000
Parkrose Heights Association of Neighbors	2,000
PassinArt: A Theatre Company/Juneteenth Portland	2,000
Oregon Nikkei	1,750
Hacienda CDC	1,518
Live On State	1,500
Fusionarte	1,495
Visegrad Group PDX	1,000
Total:	\$ 79,813

Source: Regional Arts and Culture Council

* Including both Arts Tax funds and one-time Special Appropriations

RESPONSE TO THE AUDIT




CITY OF PORTLAND
OFFICE OF MANAGEMENT AND FINANCE
BUREAU OF REVENUE AND FINANCIAL SERVICES

Charlie Hales, Mayor
Kenneth L. Rust, Chief Financial Officer
Thomas W. Lannom, Revenue Division Director

Revenue Division
111 SW Columbia Street, Suite 600
Portland, Oregon 97201-5840
(503) 823-5157
FAX (503) 823-5192
TTY (503) 823-6868

M E M O R A N D U M

TO: Mary Hull Caballero, City Auditor
FROM: Thomas W. Lannom, Revenue Division Director 
SUBJECT: Arts Tax Audit
DATE: July 21, 2015
CC: Drummond Kahn, Director of Audit Services
Fred Miller, Chief Administrative Officer
Ken Rust, Chief Financial Officer

Thank you for providing the Revenue Division the opportunity to respond to the Arts Tax audit.

We are pleased the audit found the primary objectives of the tax are being achieved; art and music teachers and arts organizations are receiving funding as intended by voters. We also appreciate your recognition that our collection process and cost is reasonable. Voters wanted 95 cents of every tax dollar collected to flow to schools and arts organizations; according to your audit, we are one cent shy of attaining that goal.

A number of your recommendations state the Mayor and City Council should provide the Division direction around compliance and enforcement. City Council has already granted the Division authority to continue collections and improve compliance; we are executing that direction. As we discussed with your audit staff, a number of collection processes will begin in 2016 which will steadily improve compliance.

The audit also recommends closer tracking of full program costs. The Division has had a number of conversations with City Council and the citizen Arts Oversight Committee about program costs since 2012 and believes it is generally understood that full costs are not charged to the Arts Tax fund. The requirement that expenses not exceed five percent of collections, known as the "cost cap" was made part of the Council's resolution referring the Arts Tax to voters in 2012, which limited overhead and supervision costs. Given the Council's directive limiting overhead and support costs, the Division believes that providing a closer tracking of actual costs will have limited practical use.

Implementing a large scale income tax is rarely an easy proposition. This is especially true for a tax that is unique, resource constrained and has a high number of subject individuals each owing a relatively small amount of tax. As the Division has gained experience with the Arts Tax, procedures and processes have been and will continue to be streamlined and improved to effectively and efficiently collect and administer the tax. These improvements will result in increased compliance and revenues over time as the tax and processes mature.



Regional Arts & Culture Council

411 NW Park Avenue, Suite 101
Portland, OR 97209-3356
503.823.5111
racc.org

DATE: July 20, 2015
TO: Mary Hull Caballero, City Auditor
FROM: Eloise Damrosch, Executive Director, Regional Arts & Culture Council
SUBJECT: Arts Tax Audit

On behalf of the Regional Arts & Culture Council, thank you for the opportunity to be involved with the Arts Tax Audit and to respond to the final draft of the document. The process has been most efficient and, I am confident, productive.

As the Audit notes, we have not yet fully defined RACC's arts education coordination role, due to slow collections and new staffing needs, but I assure you that we are now proceeding fully staffed and with sufficient resources to undertake this important work. We look forward to reporting on our progress to City Council at the appropriate time and to discussing any changes they might suggest.

I am also pleased to report that Portland Public Schools has agreed to fund art and music teachers in the two charter schools currently not benefitting from the Arts Tax.

On the financial side, we will definitely break out the Arts Tax revenue and expenditures in our next annual audit presently underway. Given that collections have not yet reached the funding level promised to voters I look forward to working with the Mayor and City Council on a sustainable solution to the shortfall so that the level of services the voters approved will be achieved annually.

Thank you again for your work and we look forward to implementing the improvements suggested in the audit and ensuring that the results will be a stronger arts community, full and rewarding education for our students, and access to the arts for all Portlanders.

**Audit Services Division
Office of the City Auditor
1221 SW 4th Avenue, Room 310
Portland, Oregon 97204
503-823-4005
www.portlandoregon.gov/auditor/auditservices**

Arts Tax: Promises to voters only partly fulfilled

Report #472, July 2015

Audit Team Members: Kari Guy
Jennifer Scott

This report is intended to promote the best possible management of public resources. This and other audit reports produced by the Audit Services Division are available for viewing on the web at: www.portlandoregon.gov/auditor/auditservices. Printed copies can be obtained by contacting the Audit Services Division.

Mary Hull Caballero, City Auditor
Drummond Kahn, Director of Audit Services

Other recent audit reports:

Red Light Cameras: City can fine tune some program aspects and solidify plans for future (#466, July 2015)

Southwest Portland: Residents rate livability highly while some services are much worse than citywide (#467, July 2015)

Portland's Fiscal Sustainability and Financial Condition: Maintenance needs and pension costs challenge long-term position (#470, June 2015)

