

**Montgomery County, Maryland  
Office of the County Executive  
Office of Internal Audit**



**Montgomery County Carryout Bag Tax**

**May 6, 2014**

# Highlights

## Why MCIA Did this Audit

In January 2012, the Montgomery County Carryout Bag Tax went into effect under Bill 8-11. This tax was put into place in response to the increasing amount of litter in the streams and rivers of Montgomery County, specifically plastic bag litter. As a result, retailers charge customers \$0.05 on each plastic bag they provide and remit \$.04 to the County and retain a penny. The Department of Finance collects the remitted tax from retailers. For calendar year 2012 retailers remitted \$2.2 million in taxes. Funds remitted under the tax are deposited into the Water Quality Protection Charge (WQPC) fund. The WQPC funds projects for storm water management, litter control, and water quality improvement. The Department of Environmental Protection (DEP) manages the WQPC fund and monitors established metrics that measure the amount of plastic bags found in County trash and water ways. This audit reviews the internal controls over the tax remittance collection and the monitoring of the tax impact on resident use of plastic bags.

## What MCIA Recommends

MCIA is making four (4) recommendations to the Department of Finance to improve performance and enhance the existing internal controls related to the bag tax collection and monitoring. Finance and DEP generally concurred with the recommendations.

## May 2014

### Montgomery County Carryout Bag Tax

## What MCIA Found

The Department of Finance has designed and implemented procedures and internal controls for accepting and monitoring tax collection. However, we did note internal control weaknesses regarding 1) the lack of establishing population of retailers that should be remitting taxes; 2) ensuring the integrity of contact and remittance data submitted by retailers; and 3) enforcement of interest and penalties under the law. Lastly, we tested 40 retailers and found 7 with errors in retailer tax remittances that ranged from \$3.76 to \$1,128.56.

DEP has imbedded established metrics into its operations to monitor the amount of plastic bags found in County trash and waterways. Since the law went into effect, the department has worked to define a baseline for its metrics to which it can measure future results. DEP collects information and measurements on the amount of plastic bags found in County waterways and trash from three major sources: 1) Community watershed and environmental groups the volunteer to clean the County water streams; 2) Anacostia Trash Total Maximum Daily Loads (TMDL) monitoring; and 3) County Trash Transfer Station. The mix of data sources and method of data collection appear to be adequate and reasonable for the purpose of monitoring and assessing the impact of the carryout bag tax. The results received to date indicate some reduction in the amount of plastic bags found as trash or waste in some areas of the County.

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## **Objectives**

This report summarizes the work performed by Cherry Bekaert LLP on behalf of Montgomery County Office of Internal Audit (MCIA) in an internal audit of the Montgomery County Carryout Bag Tax<sup>1</sup> (“Bag Tax”). The scope of this engagement included reviewing the policies and procedures of the Department of Environmental Protection (DEP) and the Department of Finance (Treasury). The objective of the audit was to:

- Review and assess current policies and procedures associated with administering the collection of the Bag Tax which became law in Montgomery County on January 1, 2012;
- Perform testing on-site<sup>2</sup> at a limited selection of retailers to determine whether bag tax amounts are being appropriately collected on behalf of, and remitted to, Montgomery County.

This internal audit report was performed with consulting standards established by the American Institute of Certified Public Accountants and generally accepted government auditing standards established by the Government Accountability Office as appropriate. Our proposed procedures developed to meet the objectives stated above, were reviewed and approved in advance by MCIA. Interviews, documentation review, and field work were conducted from April 2013 to December 2013.

## **Background**

### Introduction

The Montgomery County Bag Tax was enacted to encourage using of reusable carryout bags and enhancing the environment. A large portion of floating litter in the County was traced to plastic bags, food packaging, styrofoam, and plastic bottles; the greatest of this litter was plastic bags, as determined by DEP. The Bag Tax was implemented on January 1, 2012 by way of Bill 8-11 to try to mitigate the litter due to plastic bags. The money the County receives from this tax is deposited into the Water Quality Protection Charge fund, which is used to fund projects for storm water management, litter control, and water quality improvement.

### Purpose

The tax is charged to encourage individuals to bring their own bags or opt out of taking a bag altogether. Retailers charge \$.05 per bag to a consumer, which is detailed on the receipt as a separate line item. Retailers are allowed to retain \$.01 per bag to cover administrative costs with the tax and are instructed to remit the remaining \$.04 per bag to the County every month.

### Remittance

The Bag Tax is a self-reporting tax; retailers are responsible for keeping records and remitting the tax due each month using the Bag Tax Registration and Payment System maintained by Treasury Services in the Department of Finance. Retailers are assigned a

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<sup>1</sup> Montgomery County Code Chapter 52, Article 14 “Carryout Bag Tax”

<sup>2</sup> In Phase I onsite testing was performed In Phase II testing was performed remotely. See further discussion in the “Scope and Methodology” section.

unique vendor ID number to report bags collected. They input their vendor ID, name, banking information, the time period they are reporting on, and the number of bags collected. The program automatically calculates the amount to be remitted based on the number of bags input into the system. Retailers are required to retain documentation supporting these remittances for at least three years.

If remittances are submitted late or if a retailer fails to remit altogether, the Director of the Department of Finance may impose interest and penalties as a percentage of the remittance amount as follows:

- Interest is calculated at the rate of 1% per month for each full or partial month after the remittance is due;
- A penalty is calculated at 5% per month for each full or partial month after the remittance is due, up to 25% of the remittance amount<sup>3</sup>.

#### Exclusions

The following bags are excluded from the tax<sup>4</sup>:

- Pharmacy bags for carrying prescription drugs;
- Newspaper bags, as these can be intended for use as garbage/pet waste/yard waste bag (functionally necessary);
- Bags from a temporary/seasonal stand;
- A paper bag used as a take-away bag from a restaurant/deli/fast-food establishment

Retailers are only required to remit the taxes to the County when the cumulative tax collected since the previous remittance exceeds \$100. For example, a retailer may only have to remit every other month if it did not reach \$100 for an individual month.

#### Trends

Table 1 below shows the comparison of total bag tax revenue and retailers between 2012 and 2013. While the total remittance has increased, the average remittance per retailer per year has decreased due to additional retailers who registered in calendar year 2013.

**Table 1: Bag Tax Revenue<sup>5</sup>**

Calendar Year	Total Registered Retailers	Total Remittance	Average Remittance per Retailer
2012	853	\$2.26M	\$2,649
2013	1,136	\$2.35M	\$2,069

<sup>3</sup> Montgomery County Code Chapter 52, Article 14 "Carryout Bag Tax, Section 52-104

<sup>4</sup> Data pulled from informational material provided to Montgomery County Residents.

<sup>5</sup> Data pulled from County batch logs from Treasury at the close of each calendar year.

## Scope and Methodology

We performed our review of the Bag Tax in two phases. Phase 1 consisted of interviewing responsible individuals from Treasury to gain an understanding of the policies and procedures followed in monitoring retailer performance under the Bag Tax. In addition, Phase 1 included detailed testing of tax collection and remittance procedures of three retailers for remittances during calendar year 2012. See Appendix A for details of the retailers tested as part of Phase 1. Results of the procedures performed in Phase 1 were used as a basis for developing the approach to Phase 2 testing. Phase 2 involved detailed testing of the tax collection and remittance procedures for 37 retailers during calendar year 2012. In Phase 1 and Phase 2, we reviewed retailer remittances totaling approximately \$1.6M or 70% of the \$2.26M in total remittances collected during calendar year 2012. The average 2012 remittance per retailer included in the audit was approximately \$37,207. Our scope was limited to calendar year 2012 as that was most recently completed tax year at the time of our audit work.

### **Retailer Testing**

#### **Phase 1 Sample Selection**

For calendar year 2012 we obtained monthly remittances from Treasury for all retailers that remitted taxes during the year<sup>6</sup>. Using the unique account number for the retailers we combined<sup>7</sup> the individual monthly reports into single listing by retailer with total taxes remitted for 2012. We did amend the data provided by Treasury for data integrity issues. In some instances the retailer name and number were inverted in the data fields in the reports.

Using a data tool called Active Data<sup>8</sup>, we stratified the population to identify parameters to classify retailers as Large, Medium, and Small based upon total tax remittances for 2012 for purpose of sample selection. The tax remittances seemed to decrease evenly until it reached \$10,000 for annual remittance; this seemed to be a natural break in the population for Large and Medium size retailers. Below \$10,000, the amounts seemed to decrease evenly until it reached \$1,000. Once the amount reached \$1,000, remittances decrease even more closely, making this the Small retailer grouping. We eliminated retailers with remittance amounts less than \$100 from sample population, since the law only requires remittance once a retailer collects \$100 a month or more in taxes. See Table 2 below for details:

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<sup>6</sup> Collected taxes are remitted one month after collection the reports received were dated February 2012-January 2013.

<sup>7</sup> We used the data analytic tool Active Data to combine the monthly reports and summarize remittance amounts.

<sup>8</sup> Active Data is an advanced data analysis tool that is an add-on to Microsoft Excel.

**Table 2: Retailer Population<sup>9</sup>**

Size	Count of Retailers <sup>10</sup>	Types	Annual Remittance Range	2012 Remittance Amount
Large	33	Grocery Stores, Clothing Retailers	\$517K-\$10K	\$1,698,393.84
Medium	137	Clothing Retailers, Food Service	\$9K-\$1K	\$392,338.52
Small	630	Restaurants, Specialized/Miscellaneous Retail	<\$1K	\$160,342.12

Using the Active Data random number generator, we selected one retailer from each category for Phase 1 testing as noted in Table 3 below:

**Table 3: Phase I Sample**

	Retailer Type	Size	Total 2012 Remittance
1	Grocery	Large	\$12,368.08
2	Restaurant	Medium	5,687.36
3	Restaurant	Small	362.68
<b>Total</b>			<b>\$18,418.12</b>

### Phase I Procedures

Procedures performed in Phase I consisted of interviewing members of Treasury to gain an understanding of the remittance process and what the County expects of the retailers. A member of Treasury walked us through the input form a retailer would fill out when remitting the tax, as well as the process the County goes through when downloading the monthly summary reports.

Based on our understanding of the Bag Tax law<sup>11</sup> and its requirement for submission and document retention, we developed a questionnaire and a document request list to use during site-visits with retailers. We visited three retailers on site as part of Phase I to complete the questionnaire, observe procedures for charging the bag tax to customers, and detail test 2012 remittance records.

Questions presented to retailers during observations and through questionnaires can be found in Table 3 and 4 below. Responses and observations to both questionnaires are noted in Tables A-1 and A-2 in Appendix A.

<sup>9</sup> Population generated from County report of all remittances in 2012.

<sup>10</sup> Of the 853 retailer who remitted taxes for 2012 53 retailers had total annual remittances of less than \$100; these retailers were excluded from the sample population. This left a remaining population of 800, as shown in Table 2.

<sup>11</sup> We reviewed Bill 8-11 for Carryout Bag Tax to gain an understanding of regulations and procedures.

**Table 4: Phase I Retailer Observation<sup>12</sup>**

Questions	
1.	Are bags handed to the customer or can a customer directly obtain a bag?
2.	If the customer can directly obtain the bags, how does the vendor insure that they accurately capture the bag sales?
3.	Can the vendor pull archives of previously submitted remittances?

**Table 5: Phase I Retailer Inquiry<sup>13</sup>**

Questions	
1.	Did the vendor have to change procedures for bagging in order to ensure compliance with the law?
2.	Has the vendor had any confusion/trouble with submitting tax remittances or with the County's Bag Tax website?
3.	What resources provided by the County have been most helpful in learning about the tax?
4.	How are the bag sales transactions recorded?
5.	Where are the bag sales transactions recorded?
6.	What documentation is retained to support bag sales and tax collection?
7.	How long does documentation supporting the tax collected and remitted have to be retained?
8.	How is the number of bags sold determined?
9.	How is the amount of tax to be remitted determined?
10.	How do you ensure the amount of tax collected is what is remitted to the County?
11.	Who is in charge of making the remittance every month?
12.	Have you had any instances of duplicate or incorrect payments?
13.	How were any duplicate or incorrect payments resolved with the County?
14.	Have you submitted any payments late? If so, did the County assess you any interest or penalties for the late payment?
15.	Have you noticed any change in customer behavior as a result of the bag tax?

**Phase II Sample Selection**

We selected the Phase II sample based on the same stratification used in Phase I as described above. We determined our sample per stratification based upon the percentage of total remittance per strata as noted in Table 2. Using Active Data, we initially randomly selected 37 retailers, distributed among 28 large retailers, 6 medium retailers, and 3 small retailers. We randomly selected an additional three retailers<sup>14</sup> 2 medium and 1 small due to the unresponsiveness of 2 retailers and 1 retailer having gone out of business. We were able to test a total of 37 retailers for Phase 2.

The break-down of retailers by type can be found in Table 6 below:

<sup>12</sup> Responses are documented in Table A-1.

<sup>13</sup> Responses are included in Table A-2.

<sup>14</sup> See "Other Matters."

**Table 6: Phase II Sample**

	Type	Size	2012 Remittance
<b>4<sup>15</sup></b>	Grocery	Large	\$30,227.72
<b>5</b>	Clothing	Large	11,571.56
<b>6</b>	Misc. Retail	Large	34,770.92
<b>7</b>	Grocery	Large	13,355.56
<b>8</b>	Misc. Retail	Large	85,122.28
<b>9</b>	Misc. Retail	Large	10,455.32
<b>10</b>	Grocery	Large	18,403.40
<b>11</b>	Grocery	Large	21,057.08
<b>12</b>	Pharmacy	Large	10,031.72
<b>13</b>	Grocery	Large	46,161.28
<b>14</b>	Grocery	Large	102,281.92
<b>15</b>	Grocery	Large	14,053.44
<b>16</b>	Grocery	Large	52,405.72
<b>17</b>	Grocery	Large	13,983.16
<b>18</b>	Grocery	Large	13,182.84
<b>19</b>	Clothing	Large	\$10,282.60
<b>20</b>	Misc. Retail	Large	21,882.62
<b>21</b>	Grocery	Large	17,959.16
<b>22</b>	Grocery	Large	286,053.24
<b>23</b>	Restaurant	Large	15,700.20
<b>24</b>	Pharmacy	Large	85,010.84
<b>25</b>	Grocery	Large	17,857.24
<b>26</b>	Clothing	Large	26,083.28
<b>27</b>	Grocery	Large	22,794.64
<b>28</b>	Grocery	Large	517,128.80
<b>29</b>	Misc. Retail	Large	19,456.44
<b>30</b>	Clothing	Large	11,888.12
<b>31</b>	Clothing	Large	14,603.32
<b>32</b>	Restaurant	Medium	1,125.08
<b>33</b>	Restaurant	Medium	1,600.36
<b>34</b>	Misc. Retail	Medium	2,563.44
<b>35</b>	Clothing	Medium	2,860.80
<b>36</b>	Clothing	Medium	1,515.76
<b>37</b>	Clothing	Medium	1,078.48
<b>38</b>	Misc. Retail	Small	292.36
<b>39</b>	Grocery	Small	408.00
<b>40</b>	Restaurant	Small	175.20
<b>41</b>	Grocery	Large	16,976.00
<b>42</b>	Grocery	Medium	1,398.36
<b>43</b>	Grocery	Medium	7,745.16
<b>Total</b>			<b>\$1,551,275.70</b>

<sup>15</sup> Continuation of list from Table 3

## Phase II Procedures

### **Retailer Remittance Accuracy and Record Retention Testing**

Phase II Procedures involved detail testing of 37 retailers. All procedures were performed remotely for Phase II. Based on our understanding of the process that retailers follow, we decided it was not cost effective for us to perform site visits for the remainder of the testing. Rather, we sent selected retailers an electronic survey, similar to the questionnaire completed in person for Phase I. The survey was more extensive in Phase II, based on input from Treasury and DEP, as well as the information learned during Phase I. Once we received survey responses from retailers, we requested the retailers submit documentation supporting their tax amounts remitted during 2012. We reviewed the documentation submitted for accuracy and completeness.

Questions presented to retailers through questionnaires can be seen in Table 7 below. Summary of responses to these questions can be found in Table B-1 in Appendix B.

**Table 7: Phase II Retailer Inquiry<sup>16</sup>**

	<b>Survey Questions</b>
1.	At how many locations do you collect the carryout bag tax in Montgomery County?
2.	Do you remit taxes for each location individually or as a company?
3.	Did you change your bagging procedures to ensure compliance with the law?
4.	If bagging procedures were changed, please explain.
5.	How do you determine the number of bags sold?
6.	What internal controls, if any, do you have in place to ensure that customers pay for all bags used?
7.	How are bag sales and tax collection recorded in your system?
8.	If you use a POS system, which system do you use?
9.	What documentation or reports are retained to support bag sales and tax collection? Select all that apply.
10.	Do you know how long you are supposed to retain documentation supporting your Carryout Bag Tax remittances?
11.	Who determines the amount of tax to be remitted?
12.	Who is in charge of making the remittance?
13.	How often do you remit the bag tax to Montgomery County?
14.	On average, how much time do you spend during a remittance period recording, reconciling, and remitting the bag tax?
15.	Does the 1-cent bag administrative fee cover your costs for implementing the bag tax?
16.	Have you had any confusion or difficulty with remitting the bag tax on the Montgomery County Bag Tax website? If yes, please explain.
17.	Has your confusion and/or difficulty been resolved? If no, please explain.
18.	Have you had any instances of late or duplicate payments? If yes, please explain how these were resolved by the County.

<sup>16</sup> Responses included in Table B-1.

Survey Questions	
<b>19.</b>	Since the implementation of the Carryout Bag Tax, have you seen any of the following trends in your customer base? Select all that apply.
<b>20.</b>	Have you read any of the following resources made available by Montgomery County to help your understanding of the bag tax and remittance process? Select all that apply.
<b>21.</b>	Do you have any comments/suggestions/improvements to the Montgomery County bag tax collection and remittance process either from an administrative standpoint or a regulatory standpoint?

### **Determination of Retailer Population for Tax Remittance**

We performed inquiries with other County departments to gain an understanding of what measures have been taken to identify the retailer population subject to the tax. In addition we discussed procedures for monitoring tax remittances to determine if retailers were properly remitting, and identify and inform retailers found subject to the tax but not submitting tax remittances.

### **Measuring Effectiveness of CarryOut Bag Tax Law**

We inquired of DEP staff to assess the effectiveness of the tax in relation to the environmental goal of reducing litter due to plastic bags. We inquired of DEP to gain an understanding of current and proposed program metrics, metric data sources, collection method, compilation, review and approval for internal and public release.

## **Results**

### **Phase I and Phase 2 Retailer Remittance Accuracy and Record Retention Testing Results**

Our review found that the majority of retailers in our sample were retaining adequate records supporting their tax remittances submitting taxes in accordance to the law. We did find 9 errors in retailer records that impacted amounts remitted to the County. Those errors are discussed below.

1. In Phase 1 we found two of three retailers had under reported tax remittances in 2012. We also found one retailer had submitted a duplicate payment for one month. The under reported taxes were due to the retailers incorrectly entering the amount of bags sold into the tax remittance web site from their sales reports. The duplicate payment was caused by duplicate reporting by the retailer's accounting firm.

**Table 8: Phase I Retailer Remittance Results**

Retailer	Issue	Month	Amount
1	Underreported Taxes	January	\$1,082.44
1	Underreported Taxes	February	\$816.60
2	Underreported Taxes	September	\$227.40

Retailer	Issue	Month	Amount
1	Duplicate Tax Payment	June	\$1,128.56

Retailer #1, with two under reported payments, was aware of their under reporting prior to the audit, but was unsure how to submit the additional monies due to the County. The other errors were noted as a result of our review. We communicated the testing results for this Phase to Treasury on May 3, 2013.

2. In Phase 2, we found two retailers of the 37 tested, Retailers #7 and 8, who did not submit remittance for the first five and six months of 2012 after the tax went into effect. There was one retailer, Retailer #23, who, as the result of our information request, determined that they had skipped one monthly payment.

**Table 9: Phase II Remittance Results**

Retailer	Issue	Months	Amount not Remitted Timely	Potential Interest and Penalties <sup>17</sup>
8	Late remittance / no interest or penalties assessed	January May	\$36,649.00	\$5,557.82
7	Late remittance / no interest or penalties assessed	January June	\$5,827.96	\$1,806.67
23	Missed Remittance / no interest or penalties assessed	October	\$1,451.68	\$522.60

The accountant for Retailer #7 stated they were unaware of the tax until they made the first remittance in July. Retailer #23 indicated they would include the missed submission in their November 2013 remittance to the County.

Treasury staff told us that they have not assessed the applicable interest and penalties for the late payments as the department was focused on implementation of the tax and had not begun enforcement of late or missed payments. However, the County is foregoing potential revenue and there is an increased possibility that retailers may become lax in the accuracy and timing of remittances if the County continues to not charge interest or impose a penalty on remittance violations.

3. In Phase 2, we noted five retailers of the 37 tested who either over or under reported taxes. In all instances we noted discrepancies between the retailer's supporting sales reports that was provided to us for review and the amount of bags sold that the retailer subsequently entered on the tax remittance web site. We communicated the

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<sup>17</sup> Amount represents interest and penalties only.

testing results for this Phase to Treasury on January 27, 2014. See Table 10 below for details.

**Table 10: Phase II Retailer Remittance Results**

Retailer	Issue	Amount
6	Over-reported Taxes	\$9.04
32	Over-reported Taxes	\$49.32
36	Under-reported Taxes	\$3.76
37	Under-reported Taxes	\$14.56
29	Under-reported Taxes	\$970.04

#### **Determination of Retailer Population for Tax Remittance**

Treasury does not have a master list of the retailers who are required to remit bag tax and therefore is unable to determine if retailers are not reporting. We met with staff from the County's CountyStat office, to gain an understanding of the potential sources for retailer listings within the County that could be used to create a master list. The CountyStat staff told us that a listing that could be generated by the Department of Health and Human Services (HHS) detailing establishments that are required to have health inspections conducted at their locations for food preparation and packaged food sales. The listing would include any retailer that sells any type of food products from restaurants and grocery stores, even including clothing retailers that sell candy bars. We reviewed this listing and noted that substantially all retailers who would be required to remit the bag tax would be included in this population. While the list may not be perfect, it would provide Treasury with a good baseline list from which to start developing a comprehensive list of retailers who should remit the tax.

#### **Measuring Effectiveness of the Carryout Bag Tax Law**

Per discussion with DEP staff, method and metrics to measure the effectiveness of the tax are already inherently part of existing department environmental monitoring. DEP staff did state that since the law had only been in effect for two years there is low expectation that there will be a big decrease in plastic bags found in the trash. The identified sources for measuring the volume of plastic bags disposed as trash or waste in the County are: 1) Watershed and community environmental groups the volunteer to clean the County water streams; 2) Anacostia Trash TMDL monitoring; and 3) County Trash Transfer Station.

Community groups that volunteer to clean up the County streams self-report to DEP the results of their cleanup efforts, such as the type of trash items picked up. While DEP has not given the groups formal reporting guidelines or requirements, the department does accept the reports from the groups as useful information. DEP staff provided a

documented testimony from a June 18, 2013 public hearing on the Transportation, Infrastructure, Energy and Environment Committee bill to amend the bag tax law. Four environmental groups reported year over year changes in the amount of plastic bags observed by their respective groups. All groups noted year over year reductions in the amount of plastic bags collected by their groups.

The Anacostia Trash TMDL includes 15 stations in County waterways that are monitored by a third party<sup>18</sup> for the amount and type of waste caught at the stations. The station results are reported to DEP in the spring and fall of each year. Included in the report is a categorization of the type of trash observed at each station. Plastic bags are tracked in their own category. The report does include a four quarter trend analysis of plastic bags found at the stations. The DEP staff provided the *Montgomery County Trash TMDL Monitoring Update Summary Summer Sampling Period (September-October 2013)* which included a summary of plastic bags or pieces collected from Spring/Summer 2011 to Fall 2013. The count of bags or bag pieces collected in Spring/Summer 2011 was 514 while Fall 2013 was 379, or a decrease of 135 bags or 26%<sup>19</sup>.

At the County Trash Transfer station the trash received from County residents are sorted and categorized by trash type. The results of the sort are reported internally. DEP staff provided the Plastic Bag Sort Results that compared studies from Fall 2008 and Winter 2009 to Fall 2012 and Winter 2013. Overall, the report detailed a projected .08% increase in the Fraction of Film Plastic Shopping Bag found in County trash. Decreases were noted in single family sectors while multi-family and non-residential sectors were noted to have increases.

We found that the department is leveraging existing sources for data related to the amount of plastic bags being disposed as trash or waste in the County. The mix of data sources and method of data collection appear to be adequate and reasonable for the purpose of monitoring and assessing the impact of the carryout bag tax. The results received to date do indicate some reduction in the amount of plastic bags found as trash or waste in some areas of the County.

## Other Matters

### 1. Weakness in the Carryout Bag Tax Remittance Web Site.

The online submission site used by Treasury contains several weaknesses that impair the quality of tax remittance records being retained as follows:

- Lack of edits on web site data fields. Retailers entering information on the web site are entering data in the wrong fields. For example, we noted the following data errors:
  - A retailer name where the tax remittance date should be
  - Remittance dates with the wrong year

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<sup>18</sup> The Metropolitan Washington Council of Governments (COG) has responsibility for monitoring the 15 stations and report monitoring results to DEP.

<sup>19</sup> Source, Summary: Combined Total Number of Plastic Bags/Pieces and Total Number of Items, 2011-2013 (PBSA100 Omitted) *Montgomery County Trash TMDL Monitoring Update Summary Summer Sampling Period (September-October 2013)*.

- No opportunity for retailers to update contact information. Six of the 40 retailers in our sample notified us that the point of contact information (primary contact name, email or phone number) was incorrect.

The weaknesses noted impair the historical record of tax payments retained by the County and the ability to reach out to retailers when issues regarding tax remittance are noted.

According to the Department of Technology Services (DTS), several modifications have taken place to the system in July 2013. DTS added a drop down calendar icon to the field requiring a date to be entered to eliminate the typos in entering the year. In addition, a drop down was added to pre-populate a retailer's bank routing number to eliminate the number of returned payments due to typos in the number.

## *2. Responsiveness of Retailers Selected for Auditing.*

In performing Phase II procedures, eight of the initial 37 retailers selected for auditing did not respond to repeated request of the audit team to complete the survey and/or provide requested documentation. We contacted DEP and Treasury to determine what action could be taken to inform the retailers of the law's requirement for compliance with the audit request. For the eight retailers, the Director of Finance sent notices that failure to comply would result in a Class A civil violation. We received responses and documentation from six out of the eight retailers by the cutoff of November 15, 2013. To reach the sample size of 40, we selected three additional retailers to be included in the sample.

## **Recommendations**

We are making four recommendations to improve internal controls over the Montgomery County Bag Tax. MCIA recommends that the Director, Department of Finance:

1. Collaborate with individuals from CountyStat to research potentially creating a master listing of retailers who should be remitting the bag tax. Because this is a self-reporting tax, there is a risk that some retailers are not remitting. Creating a master list and periodically comparing submissions to the list would assist the County in being aware of those who may not be remitting timely, or at all, and allow the County be proactive and better assure retailer accountability.
2. Take appropriate action to ensure retailers with over and under payments as noted above in the report are contacted and the respective payment discrepancy is corrected.
3. Expand the existing online submission site to include data field checks to ensure that correct data is entered in the correct fields; for example, data fields that are for a date should have a check to ensure that only numerical figures are entered. A screen could be added that a retailer would see first when logging in to prompt them to review their contact information and either modify it or continue on to the next screen. If a master list is created, an alert should be sent to a member of Treasury if a retailer that is noted as potentially owing tax so that communication can occur between the retailer and County.
4. Develop and publicize a formal strategy to enforce current tax regulations that describe interest and penalties being imposed upon retailers who are not

remitting timely, or at all. The County, before implementation, decided to delay the enforcement of imposing penalties and interest to give retailers time to properly educate themselves of the new regulations. As with creating a master list, enforcing penalties will communicate to retailers that the County will not be allowing non-compliance with bag tax regulations.

## **Department Comments and MCIA Evaluation**

We provided the Department of Finance and Department of Environmental Protection with a draft of this report for formal review and comment on April 17, 2014 and they responded in a joint memo on May 2, 2014. Both departments stated that the four recommendations are reasonable and that they generally agreed with them. The departments also indicated that they have begun or will take actions to implement the recommendations. (See Appendix C for the response memo.)

## Appendix A:

**Table A-1: Phase I Retailer Observation**

	Questions	Retailer		
		3	1	2
1.	Are bags handed to the customer or can a customer directly obtain a bag?	Bags are handed to the customer by the cashier	Bags are handed to the customer by the cashier	Bags are handed to the customer by the cashier
2.	If the customer can directly obtain the bags, how does the vendor insure that they accurately capture the bag sales?	N/A	N/A	N/A
3.	Can the vendor pull archives of previously submitted remittances?	Yes	Yes	Yes

**Table A-2: Phase I Retailer Inquiry**

	Questions	Retailer		
		3	1	2
1.	Did the vendor have to change procedures for bagging in order to ensure compliance with the law?	No	No	No
2.	Has the vendor had any confusion/trouble with submitting tax remittances or with the County's Bag Tax website?	Yes, dates not changing on the website	No	Yes, dates not changing on the website
3.	What resources provided by the County have been most helpful in learning about the tax?	None provided beyond the letter providing notice of the need to collect the tax	None provided beyond the letter providing notice of the need to collect the tax	None provided beyond the letter providing notice of the need to collect the tax
4.	How are the bag sales transactions recorded?	Button on cash register linked to the POS system	Cashier scans bar code and indicated quantity in POS System	Button on cash register linked to the POS system
5.	Where are the bag sales transactions recorded?	POS system	POS system	POS system
6.	What documentation is retained to support bag sales and tax collection?	Daily Sales Report, Monthly Sales Report, and Montgomery County website confirmation page	Sales Movement History report and Montgomery County website confirmation page	Menu Item Mix Detail – Family Group report and Montgomery County website confirmation page
7.	How long does	Vender was not	Vender was not	Vender was

		Retailer		
	documentation supporting the tax collected and remitted have to be retained?	aware of retention requirement stated in the law	aware of retention requirement stated in the law	not aware of retention requirement stated in the law
<b>8.</b>	How is the number of bags sold determined?	Cashier recording sale in POS system	Cashier recording sale in POS system	Cashier recording sale in POS system
<b>9.</b>	How is the amount of tax to be remitted determined?	Monthly Sales Report from the POS system	Sales Movement History report from the POS system	Menu Item Mix Detail – Family Group report from the POS system
<b>10.</b>	How do you ensure the amount of tax collected is what is remitted to the County?	Reconciliation of Monthly Sales Report to QuickBooks	Rely on the POS system report	Rely on the POS system report
<b>11.</b>	Who is in charge of making the remittance every month?	Hannah Duke, Bookkeeper	Choi & Associates, CPAs	Juan Carlos Solano, Co-owner
<b>12.</b>	Have you had any instances of duplicate or incorrect payments?	No	Vendor stated two under-remittances, CB also noted one duplicate payment	Vendor stated No. CB noted one under-remittance
<b>13.</b>	How were any duplicate or incorrect payments resolved with the County?	N/A	Has yet to be resolved CB notified DTS of potential duplicate payment	Has yet to be resolved CB notified DTS of underpayment
<b>14.</b>	Have you submitted any payments late? If so, did the County assess you any interest or penalties for the late payment?	Yes, no interest or penalty assessed	No	Yes, no interest or penalty assessed
<b>15.</b>	Have you noticed any change in customer behavior as a result of the bag tax?	Yes, a decline in bag usage. Now only for salad purchases	Yes, an increase in customers who bring their own bags	No

## Appendix B:

**Table B-1: Phase II Survey Results<sup>20</sup>**

	<b>Questions</b>	<b>Retailer</b>
<b>1.</b>	At how many locations do you collect the carryout bag tax in Montgomery County?	Most are multiple that are combined into one company reporting.
<b>2.</b>	Do you remit taxes for each location individually or as a company?	Most retailers who remit for more than one location choose to remit as a company.
<b>3.</b>	Did you change your bagging procedures to ensure compliance with the law?	Yes
<b>4.</b>	If bagging procedures were changed, please explain.	Changes in procedures involved notifying customers of new policies, ensuring that orders were completely bagged before payment, and programming cash registers to accommodate the new item.
<b>5.</b>	How do you determine the number of bags sold?	Some determine this by keeping a count of bags sold while others add up the total tax collected and calculate the bag count by dividing the total by \$0.05.
<b>6.</b>	What internal controls, if any, do you have in place to ensure that customers pay for all bags used?	Retailers train cashiers about the tax and how to enter it in the system. Some retailers created a prompt in their POS systems to remind cashiers to take a count and ask customers if they want bags before the transaction is completed. In addition, many retailers post informational signage near the registers for customers to be reminded of the bag tax.
<b>7.</b>	How are bag sales and tax collection recorded in your system?	All retailers use a POS system.
<b>8.</b>	If you use a POS system, which system do you use?	Many different POS systems are used; a few retailers use systems developed in-house.
<b>9.</b>	What documentation or reports are retained to support bag sales and tax collection? Select all that apply.	All retailers retained POS system reports; some saved daily sales reports as well as monthly. Most did not retain receipts as they contain the same information as the reports.
<b>10.</b>	Do you know how long you are supposed to retain documentation supporting your Carryout Bag Tax remittances?	All retailers knew that they were supposed to retain for 3 years, except for one, who answered 2 years.
<b>11.</b>	Who determines the amount of tax to be remitted?	All answered either a tax accountant or someone in the accounting/management departments. Smaller retailers combined the two departments.
<b>12.</b>	13. Who is in charge of making the remittance?	Same answer as above; the person who determines the amount is the one remitting.
<b>13.</b>	How often do you remit the bag tax to Montgomery County?	Almost all were monthly; a few were remitting every other month, as their monthly collections were below \$100.

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<sup>20</sup> Table B-1 is a summary of survey results provided by sample retailers.

	<b>Questions</b>	<b>Retailer</b>
<b>14.</b>	On average, how much time do you spend during a remittance period recording, reconciling, and remitting the bag tax?	Smaller retailers noted that the time was less than 30 minutes; larger retailers noted that the time was usually less than 1-2 hours.
<b>15.</b>	Does the 1-cent bag administrative fee cover your costs for implementing the bag tax?	This answer was split almost half and half; some said yes and some said no.
<b>16.</b>	Have you had any confusion or difficulty with remitting the bag tax on the Montgomery County Bag Tax website? If yes, please explain.	All said no except for one retailer who noted that the website is occasionally unavailable.
<b>17.</b>	Has your confusion and/or difficulty been resolved? If no, please explain.	For the retailer who had difficulty with site access, they noted that the problem is resolved after they attempt to log in a few times. The issue has not been brought to the attention of anyone from the County.
<b>18.</b>	Have you had any instances of late or duplicate payments? If yes, please explain how these were resolved by the County.	There was one vendor that noted that they paid late. The County accepted the late payment; there was no late fee incurred by the retailer.
<b>19.</b>	Since the implementation of the Carryout Bag Tax, have you seen any of the following trends in your customer base?	Most noted that they saw an increase in use of reusable bags, decrease in use of plastic bags, and people declining plastic bags. A few noted that after the first 6 months of the bag tax, behaviors regressed back to how they were before the tax.
<b>20.</b>	Have you read any of the following resources made available by Montgomery County to help your understanding of the bag tax and remittance process?	The majority of retailers had reviewed the publication "Basics for Retailers;" only a few had read additional materials.
<b>21.</b>	Do you have any comments/suggestions/improvements to the Montgomery County bag tax collection and remittance process either from an administrative standpoint or a regulatory standpoint?	One retailer noted that business near the border line between Montgomery County and PG County experience a small decline in business due to the fact that PG County does not charge a bag tax. People are crossing the county lines to avoid the tax.

## Appendix C:



Isiah Leggett  
*County Executive*

### OFFICE OF THE COUNTY EXECUTIVE

#### M E M O R A N D U M

May 2, 2014

TO: Larry Dyckman, Manager  
Office of Internal Audit

Deidre Bland  
Cherry Bekaert

FROM: Joseph F. Beach, Director  
Department of Finance

Robert Hoyt, Director  
Department of Environmental Protection

SUBJECT: Formal Comment to Carryout Bag Tax Audit

The draft bag tax audit report is comprehensive and reasonable with a clear scope and methodology. The four recommendations are reasonable, given that the Carryout Bag Tax is a new program developed with a quick turn-around and implementation. We generally agree with the recommendations and suggested improvement, e.g. a master list of retailers to validate any omissions, tracking transactions with payments and accruals, data entry field validation, and P&I assessment and collection procedures. Our comments are in red below, and follow each of the four recommendations.

#### Response to Recommendations

1. Collaborate with individuals from CountyStat to research potentially creating a master listing of retailers who should be remitting the bag tax. Because this is a self-reporting tax, there is a risk that some retailers are not remitting. Creating a master list and periodically comparing submissions to the list would assist the County in being aware of those who may not be remitting timely, or at all, and allow the County to be proactive and better assure retailer accountability.

**The Departments of Finance and Environmental Protection agree with the recommendation. The Division of the Treasury has developed, and maintains, a list of all vendors that have paid, and follows up on reports about non-paying vendors**



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Cherry Bekaert  
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as they are brought to us. We can also collaborate with CountyStat to add potential vendors to the list who currently do not yet pay the Carryout Bag Tax.

2. Take appropriate action to ensure retailers with over and under payments as noted above in the report are contacted and the respective payment discrepancy is corrected.

The Departments of Finance and Environmental Protection agree with the recommendation. The over and under payment discrepancies the auditor noted were the result of the vendor typing incorrect information on the payment website. It is not possible that these errors would be identified except by auditing, as the payment website calculates the tax due based on the number of bags the vendor enters. The Amount Due field cannot be changed by the vendor, as it is calculated and locked, nor can the vendor change the amount paid by ACH, as it uses the data from the Amount Due field and is also locked. The duplicate payment errors are also vendor errors, and they are found by Treasury, but only after they are made. Normally the vendor identifies these errors quickly and the Treasury Division has the duplicate item corrected. Treasury does try to identify duplicates in a timely manner, but there may be a programming change that can be made to forestall duplicates from occurring. Treasury will work with Finance-IT to identify if there are any enhancements or modifications that can be made to the online vendor payment website to address the causes of these issues. Such modifications may be subject to the budget process and timeline if additional resources are required for implementation.

3. Expand the existing online submission site to include data field checks to ensure that correct data is entered in the correct fields; for example, data fields that are for a date should have a check to ensure that only numerical figures are entered. A screen could be added that a retailer would see first when logging in to prompt them to review their contact information and either modify it or continue on to the next screen. If a master list is created, an alert should be sent to a member of Treasury if a retailer that is noted as potentially owing tax so that communication can occur between the retailer and County.

The Departments of Finance and Environmental Protection agree with the recommendation. The Treasury Division will work with Finance-IT to implement the recommended system enhancements to the Carryout Bag Tax Program. Such modifications may be subject to the budget process and timeline if additional resources are required for implementation.

4. Develop and publicize a formal strategy to enforce current tax regulations that describe interest and penalties being imposed upon retailers who are not remitting timely, or at all. The County, before implementation, decided to delay the enforcement of imposing penalties and interest to give retailers time to properly educate themselves of

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the new regulations. As with creating a master list, enforcing penalties will communicate to retailers that the County will not be allowing non-compliance with bag tax regulations.

**The Departments of Finance and Environmental Protection agree with the recommendation. The Treasury Division has begun implementing the penalties manually because the Carryout Bag Tax Program does not currently allow penalty and interest calculations. Treasury will work with Finance-IT and on these types of enhancements to the Carryout Bag Tax Program. Such modifications may be subject to the budget process and timeline if additional resources are required for implementation.**

copies:  
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Michael Coveyou, Chief, Division of the Treasury, Department of Finance  
Jhason Abuan, Chief, Division of Information Technology, Department of Finance