

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

Compliance Audit: Transient Occupancy Tax Operator Collections & Remittances

For the Calendar Year Ended
December 31, 2015

Engagement No: 3565
Report Date: May 31, 2017



Erick Roeser
Auditor-Controller-Treasurer-Tax Collector

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**Compliance Audit:
Transient Occupancy Tax
Operator Collections & Remittances
Audit No. 3565**

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Executive Summary

The Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (ACTTC) has completed a compliance audit of collections and remittances of certain operator entities subject to the Sonoma County (County) Transient Occupancy Tax (TOT) Ordinance.

Current Year Operator Audits

For the period January 1, 2015 to December 31, 2015, the eleven (11) operators audited reported a total of \$5.23 million in taxable receipts and paid \$466,059 in TOT. Eight (8) of these operators generally remitted TOT owed to the County in a timely manner and complied with the TOT ordinance, as summarized on Table 1 of Appendix A. Two (2) operators had minor underpayments (totaling \$74).

Table 2 of Appendix A summarizes the three (3) operators who did not provide sufficient records.

Introduction and Background

Introduction

The ACTTC has completed a compliance audit of the collections and remittances of certain operator entities,(operators), subject to the County TOT Ordinance. The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve audit objectives. We believe that the evidence obtained provides a reasonable basis for the results and recommendations contained in our audit report.

The purpose of this audit report is to furnish management independent and objective analyses, recommendations, and other information concerning the activities reviewed. The audit report is a tool to help management identify and implement improvements.

Occasionally, to fulfill its risk management responsibilities, management requests the ACTTC to perform studies, analysis or audits. In responding to these requests we ensure that we do not take on any responsibilities for designing, implementing or operating any part of internal control systems so that our independence in regards to those systems is not impaired.

At the request of TOT Administration, we have performed audits of entities subject to TOT and plan on providing such assistance in the future. We do not believe that performing these audits constitute assuming responsibility for the design, implementation, or operation of any part of TOT Administration's internal control system. The TOT Administration selects the entities and agrees to the audit scope proposed by ACTTC.

Background

Overview

The assessment and collection of TOT is authorized under California State Revenue and Taxation Code Section 7280, as an additional source of non-property tax revenue to local governments. TOT is assessed by operators on transients who occupy lodging facilities (e.g. hotels, motels, campgrounds, or vacation rental homes) in the unincorporated areas of the County for fewer than 30 consecutive calendar days. In Sonoma County, this tax is levied at a rate of 9%, effective October 1, 1993. The Board of Supervisors has established a policy to use 25% of funds raised from TOT for advertising and promotional activities aimed at benefiting County industries that rely upon tourism.

As of December 31, 2015, there were approximately 1,100 operators, registered with the TOT Administration, including hotels, motels, bed & breakfasts, inns, recreational parks, campgrounds, vacation rentals, and property management firms. The total collection of TOT for the calendar year 2015 was \$12.7 million, as compared to 2014 which had revenue of approximately \$12.3 million. The Investment and Debt Division of the Auditor-Controller-Treasurer-Tax Collector's Office is responsible for the administration and enforcement of TOT and works closely with the Permit and Resource Management Department to ensure that all vacation rentals registered by them obtain a TOT certificate.

Policies & Procedures

Introduction and Background

Each operator is required to report and remit TOT on a quarterly basis. TOT Administration sends the TOT return form to all active operators two weeks prior to the end of each calendar quarter, and it requests the gross rent receipts for the reporting period less qualified exemptions in order to calculate the 9% tax due. A qualified exemption is the rents received from a tenant who is a federal, state, or foreign government officer or employee on official business.

Penalties and interest are applied if the returns are not filed timely or the tax is unpaid. For late filings, a penalty of 10% of the base tax is calculated for failure to file on or before the last day of the month following the close of the calendar quarter, an additional 10% penalty is assessed for the second month of delinquency. For late payments, interest of 1.5% per month on the base tax is charged from the delinquent date to the date of payment. If payment is not received in full by the first working day of the second month of delinquency, the account is transferred to the Central Collections section of the Auditor-Controller-Treasurer-Tax Collector's Office. Central Collections assists the Investment and Debt Division with collection. A Certificate of Delinquent TOT Lien is filed with the Sonoma County Recorder's Office by the Investment and Debt Division when payments from an operator become two quarters late.

Objective, Scope and Procedures

Objective

The primary objectives of this audit were to determine:

1. Whether selected entities remitted TOT owed to the County in a timely manner and materially complied with the applicable ordinance.

Scope

Current Year Operator Audits

We audited one year of TOT returns for eleven (11) entities selected by the TOT Administration. TOT Administration agreed in advance to the scope of the audits. The audit covered the period January 1, 2015 to December 31, 2015. The scope of our work encompassed reviewing records of transactions subject to the TOT as well as interviewing the management and staff of operators responsible for the maintenance of financial and guest management systems (Operators).

Procedures

The overall objective of the audits was to determine if the Operators' financial records supported their filed quarterly TOT returns. To accomplish this, we performed a review of the Operators' internal controls over the collection and remittance of TOT, including the entering of guest information in reservation systems, processing and recording of financial transactions and summarizing of financial transactions for the purpose of preparing TOT returns.

Operators were expected to maintain records necessary to determine the amount of TOT owed to the County. At a minimum the records deemed necessary for this determination shall be a chronological cash journal showing tax and room rate separately, or other means acceptable to the TOT Administration of summarizing the Operator's monthly or quarterly revenue, supported by room registrations (including the name and address of the transient), a calendar of advance registrations, copies of forms used to claim exemption from the tax, and pre-numbered payment receipts showing payment for occupancy which state the room rate separate from the amount of tax paid and which may, with reasonable effort, be identified with the revenue summary. In instances where the Operator did not maintain records as stated above, all guest transactions within the period under audit were selected and tested. If the Operator maintained records as stated above, a sample of transactions within a specific time period was selected and tested.

Results

For the period January 1, 2015 to December 31, 2015, the eleven (11) Operators audited reported a total of \$5.23 million in taxable receipts and paid \$466,059 in TOT. Eight (8) of these operators generally remitted TOT owed to the County in a timely manner and complied with the TOT ordinance, as summarized on Table 1 of Appendix A (two had minor underpayments totaling \$74). All of the remaining three (3) operators did not maintain records as required by the Ordinance and as a result, we are unable to determine the degree to which these three operators complied with the Ordinance.

Operators Not in Compliance with the Ordinance

- West Sonoma Inn Failed to respond to our numerous requests and phone calls for TOT records. As a result, we were unable to complete the audit of their records and not able to provide any assurance over its TOT returns.
- The Blue House was unable to provide adequate records as back-up for their TOT returns. As a result, we were unable to complete the audit of their records and not able to provide any assurance over their TOT returns.
- M & G Properties was unable to provide adequate records as back-up for their TOT returns. As a result, we were unable to complete the audit of their records and not able to provide any assurance over their TOT returns.

The ACTTC Audit Division staff needed to spend a significant amount of time organizing the records provided by the Operators before they could be audited. We also found it necessary to assist the Operators in obtaining records that would substantiate the returns.

Recommendations & Staff Acknowledgment

Recommendation No. 1:

Over and under payments, as identified in Appendix A should be settled with respective Operators as appropriate.

Management Response: Agree

Recommendation No. 2:

TOT Administration should take steps as outlined in the TOT ordinance to determine and assess the tax, interest and penalties for all Operators that failed to cooperate with the audits.

Management Response: Agree

Staff Acknowledgement

We would like to thank management and staff for their time, information, and cooperation throughout the audit.

Appendix A: Schedule of Operators Reviewed

The following table details the Operators that provided sufficient records to complete their audit:

Table 1: Schedule of Audited Operators Providing Sufficient Records

County of Sonoma Transient Occupancy Tax For the period of January 1, 2015 to December 31, 2015						
<u>Entity</u>	Taxable Receipts Reported	Taxable Receipts Per Review	Tax Paid	Tax Per Review	Over (Under) Paid	
Johnsons Beach	\$ 190,792	\$ 190,792	\$ 15,475	\$ 15,475	\$	-
Woodfield Properties	473,282	473,282	35,235	35,235		-
Occidental Lodge	638,568	638,568	59,249	59,249		-
Mountain Home Ranch	304,734	304,734	29,086	29,086		-
Mojo's Lair	49,265	49,265	4,434	4,474		(40)
Beautiful Places	2,119,004	2,119,004	190,710	190,710		-
Fern Grove Cottages	650,289	650,673	58,526	58,560		(34)
The Little Yellow Cottage	30,316	30,316	2,728	2,728		-
Total Audited Operators	\$ <u>4,456,250</u>	\$ <u>4,456,634</u>	\$ <u>395,443</u>	\$ <u>395,517</u>	\$	<u>(74)</u>

Appendix A: Schedule of Operators Reviewed

The table below lists the Operators that did not provide sufficient records to complete their audit:

Table 2: Schedule of Operators with Insufficient Records

County of Sonoma			
Transient Occupancy Tax			
For the period of January 1, 2015 to December 31, 2015			
<u>Entity</u>		<u>Taxable Receipts Reported</u>	<u>Tax Paid</u>
West Sonoma Inn	\$	662,237	\$ 59,601
The Blue House		9,483	853
M & G Properties		108,845	10,159
Total Non-audited Operators	\$	<u>780,565</u>	<u>\$ 70,613</u>

Appendix B: Prior Year Results and Recommendations

Recommendation No. 1:

Over and under payments, as identified in Appendix A, should be settled with respective operators as appropriate.

Status: Implemented

Recommendation No. 2:

TOT Administration should take steps as outlined in the TOT ordinance to determine and assess the tax, interest and penalties for all operators that failed to cooperate with the audits.

Status: Implemented

Appendix C: Management Response

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TREASURER-TAX COLLECTOR

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To: Kanchan Charan, Audit Manager
From: Paul Cocking, Investment & Debt Manager (23 June 2017)
Cc: Jonathan Kadlec; Olivia Dondiego
Re: Response to Audit of Sonoma County Transient Occupancy Tax
Operator Collections and Remittances Audit

The Treasurer-Tax Collector has reviewed and evaluated the recommendations contained in the audit and we are pleased to provide you with our formal response.

Management Response to TOT Operator Collections and Remittances Audit

Recommendation No. 1:

Over and under payments, as identified in Appendix A and Appendix B, should be settled with respective operators as appropriate.

Management response No. 1:

Agree

Recommendation No. 2:

TOT Administration should take steps as outlined in the TOT ordinance to determine and assess the tax, interest and penalties for all operators that failed to cooperate with the audits.

Management response No. 2:

Agree