

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, 2016

Engagement No: 3565
Report Date: January 15, 2019



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Executive Summary

The Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (Internal Audit) 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, 2016 to December 31, 2016, nine (9) of the eleven (11) operators selected for audit reported a total of \$13.79 million in taxable receipts and paid \$1,241,900 in TOT. All nine (9) 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.

Table 2 of Appendix A summarizes the two (2) operators who did not provide sufficient records. For the period January 1, 2016 to December 31, 2016, the Investment and Debt Division of the Auditor-Controller-Treasurer-Tax Collector's Office (TOT Administration) estimated their total taxable receipts and taxes due to be \$528,528 and \$63,342, respectively. These estimates were calculated in accordance with Sonoma County Ordinance 5823 and the California State Controller County Tax Collectors' Reference Manual.

Introduction and Background

Introduction

Internal Audit 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 Internal Audit 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 Internal Audit.

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 was levied at a rate of 9%, for this audit period. TOT funds are discretionary, in that the Board of Supervisors may direct use of these funds for any legitimate county expense. The tax code does not require any specific use of TOT funds.

As of December 31, 2016, there were approximately 2,071 operators, registered with the County, including hotels, motels, bed & breakfasts, inns, recreational parks, campgrounds, vacation rentals, and property management firms. The total collection of TOT for the calendar year 2016 was \$16.56 million, as compared to 2015 which had revenue of approximately \$13.9 million. The TOT Administration 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.

Introduction and Background

Policies & Procedures

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 they request 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 TOT Administration 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, 2016 to December 31, 2016. 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 are required 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, 2016 to December 31, 2016, nine (9) of the eleven (11) operators audited reported a total of \$ 13.79 million in taxable receipts and paid \$1,241,900 in TOT. All nine (9) 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 did not maintain records as required by the Ordinance and, as a result, we are unable to determine the degree to which these two operators complied with the Ordinance. TOT Administration estimated the amounts due from these two operators and we reviewed their calculation for compliance with Sonoma County TOT Ordinance 5823 Section 12-17 and the California State Controller's County Tax Collectors' Reference Manual.

Operators Not in Compliance with the Ordinance

Camp Outback submitted TOT returns with zero revenue reported. Through online research, it appears they were in operation during the audit period and should have reported TOT revenue and paid taxes. We made several attempts to contact the owners via phone and email with no response from them. Records obtained from Sonoma County PRMD show that in June of 2016, Camp Outback had a special event where campers were present. In accordance with Sonoma County TOT Ordinance 5823 Section 12-17 and the California State Controller's County Tax Collectors' Reference Manual, the TOT Administration estimated the taxable receipts for these two operators and the taxes due.

Home was not able to provide any documentation for the \$900 of gross receipts reported for 2016. In accordance with Sonoma County TOT Ordinance 5823 Section 12-17 and the California State Controller's County Tax Collectors' Reference Manual, the TOT Administration estimated its taxable receipts for the full calendar year (Appendix A, Table 2).

Based on our review, we conclude that the TOT Administration calculated the estimated receipts and tax liability of the above entities in accordance with Sonoma County TOT Ordinance 5823 Section 12-17 and the California State Controller's County Tax Collectors' Reference Manual.

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:

Management agrees and will follow standard policies and procedures to refund/collect amounts as identified.

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:

Management agrees and will follow standard policies and procedures to determine, assess and collect any liabilities due.

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, 2016 to December 31, 2016					
<u>Entity</u>	Taxable Receipts Reported	Taxable Receipts Per Review	Tax Paid	Tax Per Review	Over (Under) Paid
Plum Ranch Escape	\$ 272,820	\$ 273,418	\$ 24,553	\$ 24,608	\$ (55)
Four Sisters (Gauge House)	2,160,123	2,160,123	194,411	194,411	-
Ross Stromberg	62,466	80,943	5,622	7,285	(1,663)
Vie du Reve Guest House	40,425	40,425	3,638	3,638	-
Chanslor Ranch	144,445	144,445	13,000	13,000	-
Nunes Canyon Vineyard	14,334	14,334	1,291	1,291	-
Cloverdale KOA Camping Resort	655,622	655,622	59,006	59,006	-
Bodega Bay Lodge & Spa	6,365,947	6,365,947	572,935	572,935	-
The Farmhouse Inn & Restaurant	4,082,710	4,082,710	367,444	367,444	-
Total	\$ <u>13,798,892</u>	\$ <u>13,817,967</u>	\$ <u>1,241,900</u>	\$ <u>1,243,618</u>	\$ <u>(1,718)</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, 2016 to December 31, 2016					
<u>Entity</u>	<u>Taxable Receipts Reported</u>	<u>Taxable Receipts Estimated</u>	<u>Tax Owed Estimated</u>	<u>Tax Paid</u>	<u>Estimated tax over/under</u>
Camp Outback	\$ -	331,240	39,749	\$ -	(39,749)
Home	900	197,288	23,675	81	(23,594)
Total	\$ <u>900</u>	\$ <u>528,528</u>	\$ <u>63,423</u>	\$ <u>81</u>	\$ <u>(63,342)</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