

Audit Report

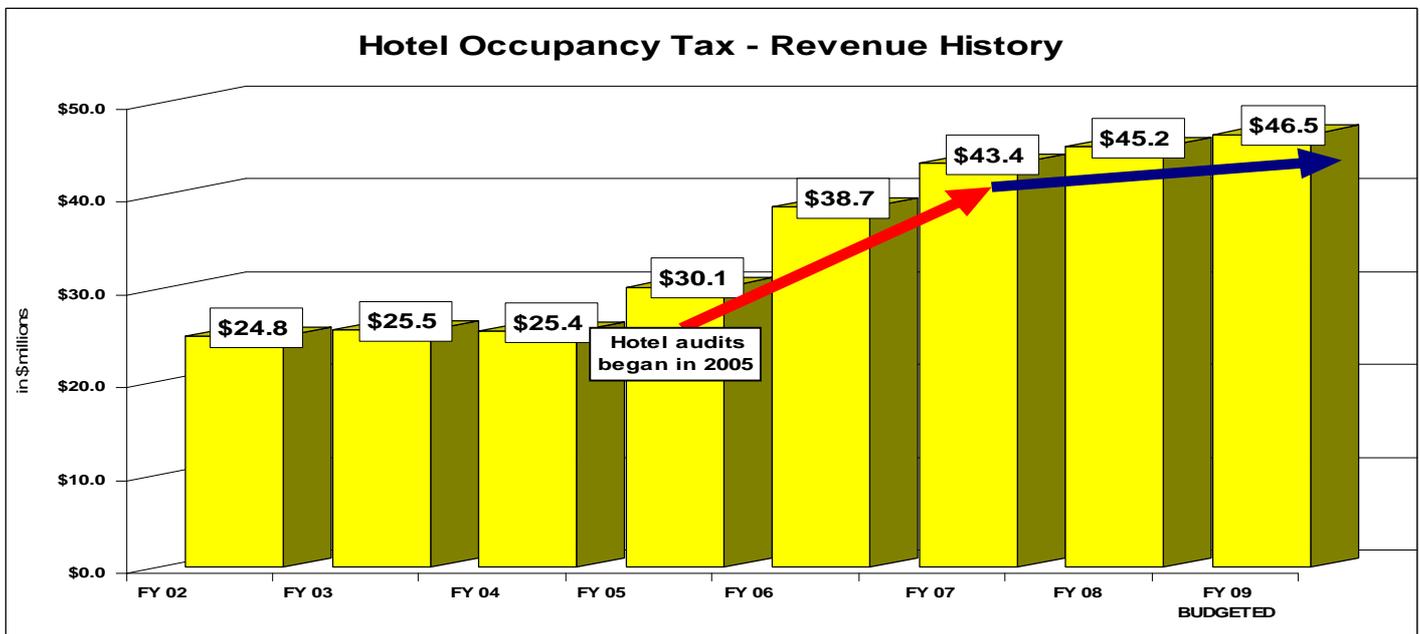
HOTEL OCCUPANCY TAX: COLLECTION AND REMITTANCE ASSISTANCE AUDIT PHASE V

January 27, 2009
Office of the City Auditor
Austin, Texas

BACKGROUND

The hotel occupancy tax (HOT) of nine percent is collected on overnight stays costing more than two dollars in hotels, motels, tourist homes, tourist courts, lodging houses, inns, rooming houses, and bed and breakfasts. Currently, there are 175 establishments collecting the tax within Austin's city limits. Hotel occupancy taxes have been steadily increasing over the past few years and now yield over \$45 million in annual revenue. The recipients of these revenues include the Convention Center Department, the Venue Project, the Austin Convention and Visitors Bureau, and the cultural arts program. We may see a leveling off of these revenues due to economic conditions.

EXHIBIT 1



The flow of HOT revenue is up by 78% since FY 2004. Growth trend started leveling off at the end of FY 2007.

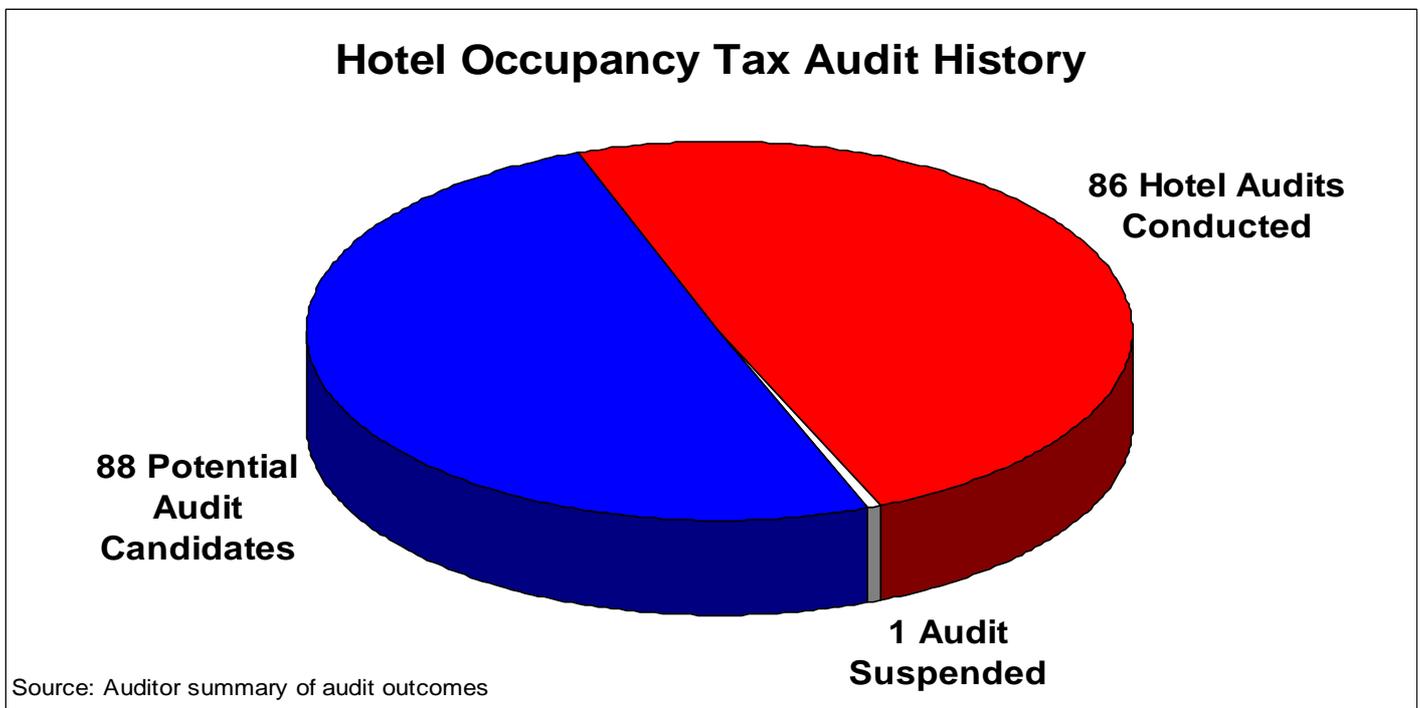
This is the fifth audit conducted in this series of hotel occupancy tax audits. In Phase I we evaluated the City's administration of the Hotel Occupancy Tax program. We found that the administration of the program was strong, although some control weaknesses were identified; for example, no hotel audits had been conducted in the previous ten years and no major collection lawsuits were filed. We recommended changes to the Hotel Occupancy Tax (HOT) ordinance, and some process improvements, including the staffing of a hotel audit position. The major reported effect of program administration and ordinance conditions was approximately \$700,000 in known or estimated delinquencies.

In the Phase II audit we selected and audited 28 hotels to determine whether they were properly collecting and remitting City hotel occupancy taxes. Nine of the establishments reviewed were in full compliance while 13 had compliance issues and/or additional tax liability totaling over \$500,000. Five hotel occupancy tax audits were not completed at the time of our report and the audit for one establishment was deferred.

In the Phase III audit we selected and audited 33 establishments and completed the 5 audits that were outstanding at the end of Phase II. The focus of Phase III was similar to but more limited than Phase II. The primary emphasis was to identify non-compliance and continue the program of educating hotel owners/operators regarding applicable City laws and policies. We worked with the Austin Hotel and Lodging Association and the State Comptroller's Office to present a well attended Hotel Occupancy Tax seminar in April 2006 for local hotel owners/operators. We also identified \$186,000 in total deficiencies and an additional \$77,000 from the audit work on the 5 establishments carried over from Phase II.

In the Phase IV audit we selected and audited 15 establishments and identified \$103,876 in tax liability. As with previous field audits, our primary focus was to identify non-compliance and to continue the program of educating hotel owners/operators regarding applicable City laws and policies.

EXHIBIT 2



Risk assessments identified the highest risk hotels for audit work. There is potential remaining revenue.

From the initial list of 175 local hotels within the City's full-purpose jurisdiction area, 86 audits have now been conducted, 1 audit suspended, and 88 potential audit candidates remain. The first four phases of this audit series resulted in approximately \$1.57 million in hotel occupancy tax revenue and a program of educating hotel operators on the requirements of the applicable City ordinance and State statutes was initiated.

OBJECTIVES, SCOPE, AND METHODOLOGY

The process of verifying that local hotels understand and comply with City ordinance and State statute continues with this fifth in a series of hotel occupancy tax audits.

Objectives:

1. Assist the City of Austin Controller's Office in identifying HOT tax deficiencies in non-compliant hotels.
2. Determine whether selected hotels properly collect and remit the municipal hotel occupancy tax.
3. Educate the hotel owners/operators on applicable State and City laws and City polices/requirements for documentation.

Scope:

- The time period under review is third quarter of 2004 through the fourth quarter of 2008 (48 months).
- The sample of audited hotels is 11 selected out of 175 total hotels in Austin.
- Geographical scope is the full-purpose jurisdiction.

In the field, testing was limited to testing exclusions, exemptions, and revenues reported.

Methodology:

Judgmental selection criteria:

- Based on industry knowledge; Revenue and earnings per room at variance with industry norms; unusual patterns in reported revenue and tax exemptions / exclusions claimed; and ownership patterns and corporate turnover.

Sources for data for conducting the audit included:

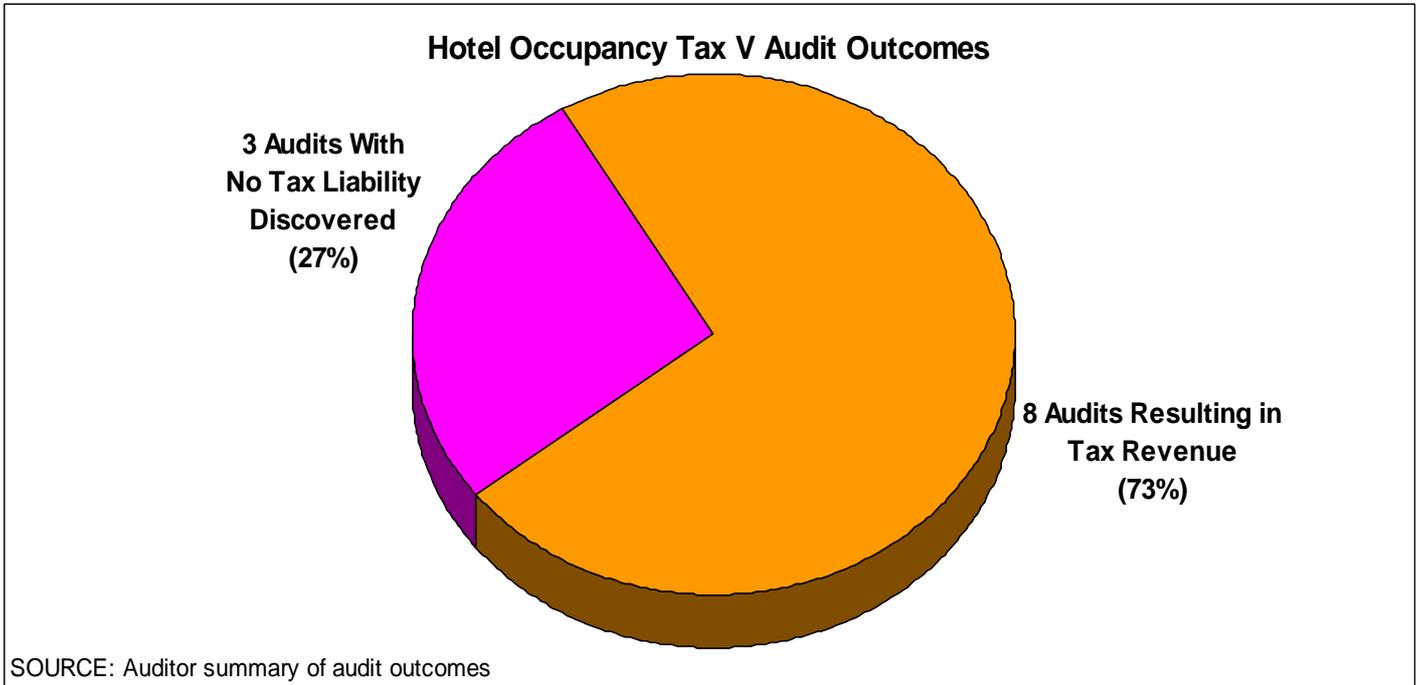
- Selected hotels using data obtained from the City Controller’s Office, including State Comptroller’s data on State hotel occupancy tax revenues; hotel web-sites; City Ordinance; and Texas State Statutes.

AUDIT RESULTS

Hotel Occupancy Tax liability and compliance issues exist throughout the hotel industry in Austin; we identified \$28,336 in HOT tax deficiency from 8 hotels.

Tax deficiencies identified for the 11 hotels audited total \$28,336, not including penalty and interest. We identified 3 hotels out of the 11 audited that were fully in compliance with City ordinance and had no tax deficiency. This compliance rate of 27% is higher than identified in earlier phases of this series of audits which may reflect the small size of the sample or increased awareness in the hotel industry that the City is exercising oversight of the collection and remittance of the hotel occupancy tax.

EXHIBIT 3



An average of \$3,542 in tax deficiencies per non-compliant hotel was identified. Non-compliance rate was 73%.

Understanding and application of State law and City ordinance still presents a compliance barrier for many hotels. In addition, the trend of significant turnover in hotel ownership, observed in the previous audits conducted, continues. In past audits, owner-operators found themselves liable for tax liabilities incurred by prior owners under successor liability laws. We identified 8 hotels with compliance issues and worked with them to correct the deficiencies. The recurrent compliance issues identified in this audit contributing to the 73% deficiency rate include: poor record keeping; improper documentation;

missing records; accounting errors; and poor understanding and application of State law and City ordinance. In the non-compliant hotels audited, we continue to find multiple instances where tax exemptions were granted to guests not eligible for the exemption. Many hotels fail to collect written intent to stay from guests staying 30 days or longer. These are clear indicators that hotels do not understand the applicable regulatory codes.

EXHIBIT 4

HOTEL CODE LETTER	TAX DEFICIENCY	AUDIT OUTCOME
A	\$14,124	Non-compliant. Missing Documentation.
B	\$4,953	Non-compliant. Missing Documentation.
C	\$3,394	Non-compliant. Missing Documentation.
D	\$1,627	Non-compliant. Missing Documentation.
E	\$1,485	Non-compliant. Missing Documentation.
F	\$1,394	Non-compliant. Missing Documentation.
G	\$799	Non-compliant. Missing Documentation.
L	\$560	Non-compliant. Missing Documentation.
H	\$0	Compliant
I	\$0	Compliant
J	\$0	Compliant
	\$28,336	

Tax deficiencies range from \$560 to \$14,124 among the non-compliant hotels with an average liability of \$3,542.

The value of continuing these audits lies in the additional revenue collected combined with improved overall tax compliance rates for the hotel industry in Austin.

Recommended revisions to the City Hotel Occupancy Tax ordinance made in the previous Hotel Occupancy Tax audit reports are currently under way. These revisions could help the hotel industry in Austin do a better job of collecting and remitting the hotel occupancy tax faster and more efficiently.

Area for Future Study

Additionally, during the course of the audit, an area that has not been previously investigated, guest houses and vacation rentals, was identified as an area of focus for future audit work. Future compliance work may focus on properties being advertised as guest houses, bed and breakfasts, or short-term rentals on the Internet at multiple websites to bring them into compliance with City ordinance.



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