

Audit Report

HOTEL OCCUPANCY TAX: COLLECTION AND REMITTANCE AUDIT PHASE IV

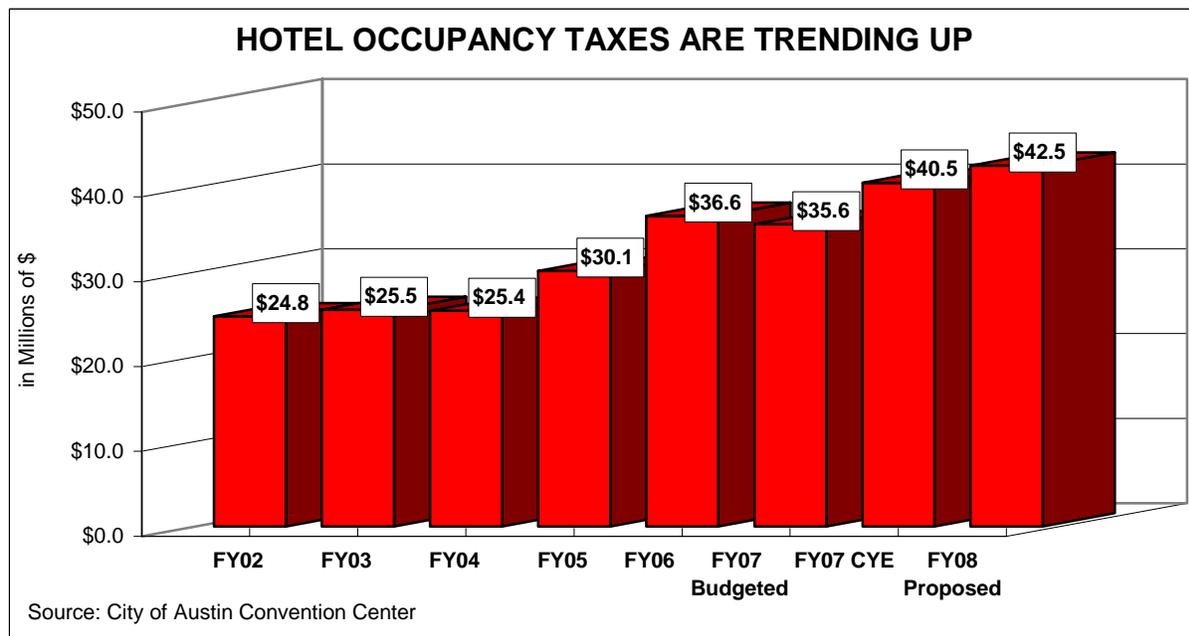
June 26, 2007

Office of the City Auditor
Austin, Texas

BACKGROUND

The hotel occupancy tax of 9% is collected on overnight stays costing more than \$2 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 \$40 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.

EXHIBIT 1



The flow of Hotel Occupancy Tax revenue is up by nearly 60% since FY 2004

This is the fourth 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 conducted over the last ten years and no major lawsuits filed. We recommended changes to the 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 Phase II we examined 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. We coordinated with Law and the City Controller's Office during the audit. We made two recommendations: improve the City Ordinance and add a full time revenue auditor position. As of June 2007, the Ordinance has not been revised but funding was provided to the OCA for a revenue auditor position to conduct hotel occupancy tax audits and other revenue audits.

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. We did not issue any recommendations other than to note that only tentative work by the Controller's Office and the Law Department has been done to revise the City Ordinance.

OBJECTIVES, SCOPE, AND METHODOLOGY

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

Objectives:

1. Determine whether selected hotels properly collect and remit the municipal hotel occupancy tax.
2. Educate the hotel owners/operators on applicable State and City laws and City polices/requirements for documentation.

Scope:

1. The time period under review is 1st Quarter of 2003 through 4Q of 2006 (48 months).
2. The sample of audited hotels is 15 selected out of 175 total.
3. Geographical scope is the full-purpose jurisdiction.

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

Methodology:

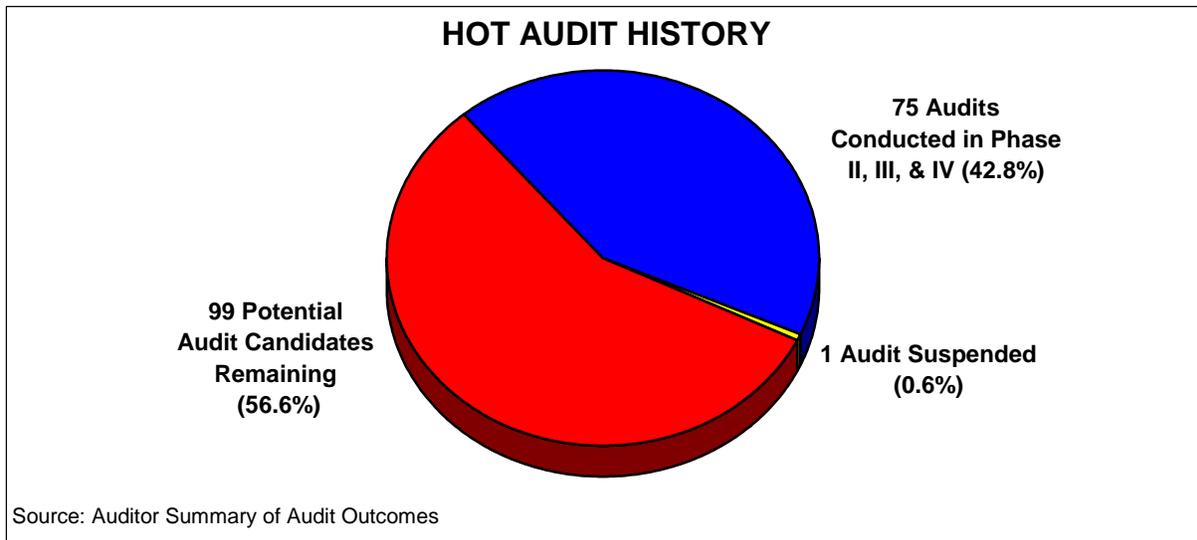
Judgmental selection criteria:

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

Sources for data for conducting the audit included:

- MBIA (information for lodging providers data)
- 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
- Texas State Statute

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, 75 audits have been conducted, 1 audit suspended, and 99 potential audit candidates remain. The first three phases of this audit series resulted in over \$1.5 million in hotel occupancy tax revenue and a program of educating hotel operators on the requirements of the applicable City ordinance and State statute was initiated.

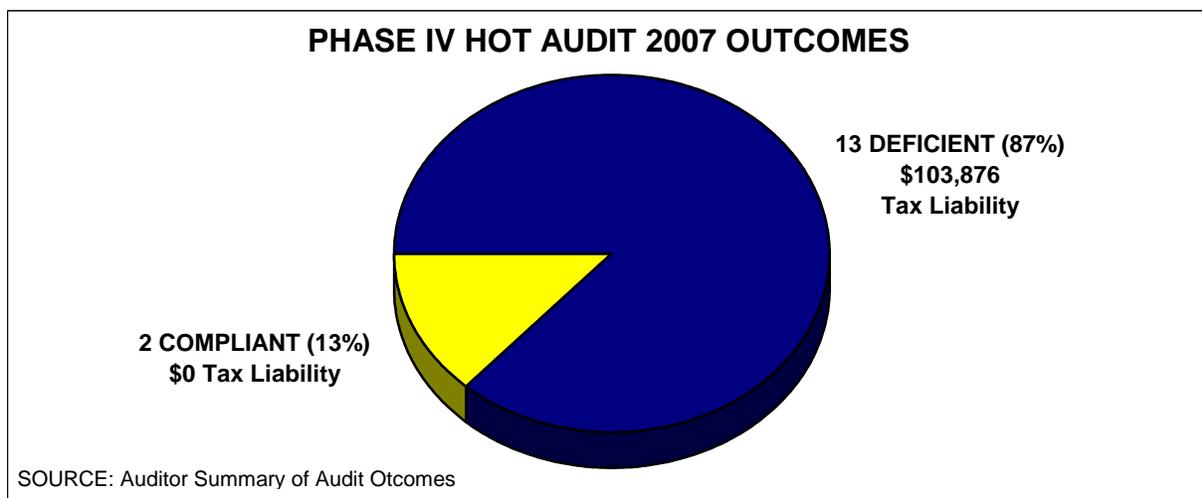
AUDIT RESULTS

Hotel Occupancy Tax liability and compliance issues exist throughout the hotel industry in Austin; we identified \$103,876 in deficiencies from 13 hotels.

In this audit (Phase IV), we identified 15 hotels to audit. Tax deficiencies identified total \$103,876, not including penalty and interest. We identified 2 hotels out of the 15 audited that were fully in compliance with City ordinance and had no tax deficiency. This small compliance rate of 13% is similar to our experience in earlier phases of this series of audits.

Understanding and application of State law and City ordinance still presents a compliance barrier for many hotels. The trend of significant turnover in hotel ownership in recent years, observed in the previous audits conducted, was encountered. In past audits, owner-operators found themselves liable for tax liabilities incurred by prior owners under successor liability laws.

EXHIBIT 3



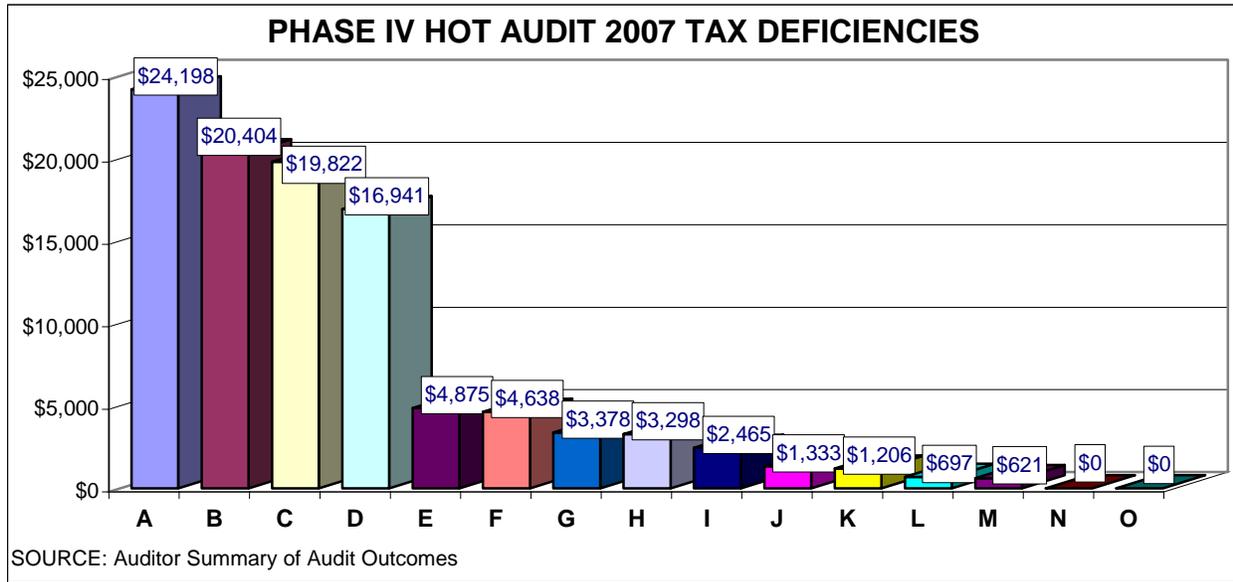
An average of \$8,000 in tax deficiencies per non-compliant hotel was identified

The recurrent compliance issues identified in this audit contributing to the 87% deficiency rate include:

- Poor record keeping
- Improper documentation
- Missing records
- 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. We identified 13 hotels with compliance issues and worked with them to correct the deficiencies.

EXHIBIT 4



Tax deficiencies ranged from a low of \$621 to a high of \$24,198 among the non-compliant hotels

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 previous audit reports are under consideration by the Controller’s Office. These revisions could help the hotel industry in Austin do a better job of collecting and remitting the hotel occupancy tax.

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