Audit Report

HOTEL OCCUPANCY TAX ADMINISTRATION

August 9, 2005

Office of the City Auditor
Austin, Texas

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City of Austin

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Date: August 9th, 2005

To: Mayor and Council

From: Stephen L. Morgan, City Auditor

Subject: Hotel Occupancy Tax Administration Report

I am pleased to present this audit report on the City's hotel occupancy tax. This audit project is being completed in two parts, the first focusing on the City's administration of the hotel occupancy tax, and the second focusing on hotels' reporting of hotel occupancy tax receipts. This report presents our work on the first part, reviewing the City's accounting, collection, and enforcement process for the hotel occupancy tax.

Results of this audit show that hotel occupancy tax payments remitted to the City are accurately accounted for following established policies and that the City has been collecting the majority of hotel occupancy tax revenues. However, the City has not sufficiently pursued delinquent hotels over the past several years. As a result, there were almost $700,000 in delinquencies as of June 2005. Not fully pursuing delinquent hotels contributes to a worsening trend of non-compliance, negatively impacts participating funds, and creates a greater risk of uncollectible accounts in the future. We also identified some establishments that may not be appearing on the tax roll at all.

We have issued nine recommendations intended to improve completeness of the tax roll, enhance the collections process, strengthen enforcement when taxes are not remitted, and improve public information about the hotel occupancy tax and related reporting requirements.

We appreciate the cooperation and assistance we received from staff in the Financial and Administrative Services Department and Law Department during this audit.

Stephen L. Morgan, CIA, CGAP, CFE, CGFM
City Auditor

COUNCIL SUMMARY

This report presents the results of the first part of our work related to the administration of the City's hotel occupancy tax, which focuses on the City's administration and collection of this tax. The hotel occupancy tax is a nine percent tax levied on qualified hotel room stays. The proceeds of this tax are earmarked for specific tourism-related uses. Proceeds from the hotel occupancy tax are a significant source of revenue for the City, yielding over $26 million in FY04.

We determined that accounting staff record remitted hotel occupancy tax revenues accurately and consistently following established policies. We also noted areas where system improvements could contribute to a more effective and efficient accounting process. For example, limitations of the current accounting systems require a cumbersome monthly reconciliation process for the Hotel Motel Occupancy Tax fund.

With regard to the City's collection of these revenues, the City has been collecting the majority of the hotel occupancy tax revenues, but has not sufficiently pursued delinquent hotels. As a result, there were approximately $697,000 in delinquencies as of June 2005, and several establishments that may not be appearing on the tax roll at all. Also, calculations of delinquencies prior to FY04 only included self-reported delinquencies, so total delinquencies may be understated.

The City has not made adequate collection and enforcement efforts in order to collect delinquent hotel occupancy taxes. The Controller's Office has been distributing delinquency letters to non-paying hotels, but has not been actively pursuing non-paying hotels. Collection calls have not been made to hotels to encourage payment of delinquent taxes since FY04, and no cases have been referred to the Law Department for litigation since FY96. Not fully pursuing delinquent hotels has contributed to a worsening trend of non-compliance, had negative impacts on participating funds, and creates a greater risk of uncollectible accounts in the future.

During the course of our work, we identified several enhancements that could be made to improve hotel occupancy tax administration and enforcement. For example, public information for the hotel industry can be improved and enforcement procedures can be strengthened by adopting practices in place in other Texas cities.

ACTION SUMMARY
HOTEL OCCUPANCY TAX ADMINISTRATION AUDIT

Recommendation Text	Management Concurrence	Proposed Implementation Date
01. In order to improve the efficiency and effectiveness of HOT administration, FASD staff should migrate to a unified system that supports the specialized accounting requirements for the HOT. Current AFS3 development provides an opportunity to address these needs.	Concur	October 2006
02. In order to effectively track performance, the Controller's Office should adopt as a new performance measure the estimated HOT collection rate.	Partially Concur	December 2005
03. To detect new hotels or new ownership, thus to ensure completeness of the hotel occupancy tax roll, Asset Accounting staff should include in their policies and procedures periodic • review of relevant data sources, such as Texas A&M Real Estate Center, Reference USA, and/or the Yellow Pages, and • review of City permitting data (coordinate with City programs).	Concur	October 2005
04. To further ensure the completeness of the tax roll, Controller's Office staff should research and assess the appropriateness of inclusion on the tax roll of 25 businesses identified by the auditors, and add these businesses to the roll as appropriate.	Concur	October 2005

ACTION SUMMARY
HOTEL OCCUPANCY TAX ADMINISTRATION AUDIT

Recommendation Text	Management Concurrence	Proposed Implementation Date
05. To ensure full compliance by hotels with the ordinance, FASD (including TARA and Controller's Office) and Law Department staff should review best practices and develop a continuum of enforcement. The agreed process should be documented and mapped, and include authority, criteria and/or referral and coordination mechanisms for: 1. Demand letters 2. Additional claims work (e.g., phone calls) 3. Payment plans 4. Litigation 5. Bankrupt hotel cases 6. Refund requests The ordinance should be revised, as needed, to reflect changes.	Concur	December 2005 (2006 if ordinance changes are needed)
06. To enhance public awareness and understanding of HOT requirements for hotels and motels, the Controller's Office staff should a. develop and implement a website that includes, at a minimum, • hotel occupancy tax reporting and payment requirements • exemption rules • reporting forms and guidelines • link to the ordinance and State law • information for prospective hotel buyers and new hotel owners on how to obtain reports from the City on tax delinquencies tied to their property b. organize periodic public outreach events with Austin's hotel/business owners association(s).	Partially Concur	December 2005

ACTION SUMMARY
HOTEL OCCUPANCY TAX ADMINISTRATION AUDIT

Recommendation Text	Management Concurrence	Proposed Implementation Date
07. To motivate hotels/motels to pay hotel occupancy tax to the City completely and timely, FASD staff should review and appraise best practices and actions allowable under State statute with regard to the following, and make changes to policies and procedures, and the ordinance, accordingly: 1. frequency of remittances (monthly vs. quarterly) 2. frequency, magnitude, and timing of penalties and interest 3. waivers vs. grace periods for late payments The ordinance should be revised, as needed, to reflect changes.	Concur	December 2005
08. To comply with the ordinance, Asset Accounting staff should ensure that delinquencies accrued by former hotel management are transferred to the new property owner's account, and that accounting systems reflect this requirement.	Concur	October 2005
09. Following OCA's completion of Phase II of the HOT audit, and in light of opportunities afforded by new State legislation for partial cost-recovery of future hotel audits, Controller's Office staff should evaluate the feasibility of conducting periodic hotel audits either by creating a new budgeted position or contracting with a financial auditor. Consultation with the Austin Convention Center Department may be appropriate.	Concur	To be determined.

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Exhibits

BACKGROUND

The City levies a hotel occupancy tax on hotel room night rents, and subsequently earmarks these revenues for tourism and Convention Center-related programs.

Municipal hotel occupancy tax collection and uses are authorized by State statute and City ordinance. Effective management of the tax program requires coordination across various City functions.

The City collects taxes on qualified hotel room stays. The hotel occupancy tax (HOT) is a 9 percent charge on the cost of hotel accommodation. This tax can only be imposed on hotel rooms located within the full purpose jurisdiction.

Under State and local regulations:

- Businesses required to pay the hotel tax include hotels, motels, tourist homes, tourist courts, lodging houses, inns, rooming houses, or bed and breakfasts.
- The tax is imposed on any “person”, which includes corporations and other legal entities, who pays for the use of a room in a lodging facility for the purpose of sleeping, where the charge is greater than $2 per day. The hotel’s taxable room price does not include the cost of meals served by the hotel or of other personal services.
- Persons contracting to use a hotel room for over 30 consecutive days are exempt from paying the hotel occupancy tax, as are federal employees. Employees of state agencies traveling on official business are entitled to refunds of the amount of tax paid. City employees are not exempt or entitled to a refund.

The hotel occupancy tax is originally paid by the hotel customer to the hotel, and is then rendered to the City on a quarterly basis. Hotels also collect and remit the State hotel occupancy tax. Significantly, the State allows a greater number of exemption-types. The State exempts non-profit and religious organizations from paying HOT tax, while the municipal hotel tax does not provide for such exemptions. The City does exempt revenues from conference halls or ball rooms, while the State taxes these.

All rules and regulations that govern the collection and allocation of Austin’s hotel occupancy tax are located in Chapter 351 of the Texas Tax Code, Chapter 334 of the Texas Local Government Code, and Chapter 11-2 of the Austin City Code of Ordinances.

Four participating funds benefit from collection of hotel occupancy taxes. Revenues are initially deposited in the City’s Hotel-Motel Occupancy Tax fund, and then transferred to four participating funds. City ordinance specifies the tax rate for each of these funds in terms of a percent of funds collected. The HOT is in fact a combination of an original 7 percent tax, plus a 2 percent venue project tax approved by voters in a 1998 bond election. Exhibit 1 describes the funds and required tax allocation.

EXHIBIT 1
Participating Funds of the Hotel-Motel Occupancy Tax Fund

Participating Fund	Description	Percent of HOT collections	Proportion of HOT collections
Convention Center	Benefits the Convention Center	50.0 percent	4.50 cents
Venue Project	Funds the Hotel Tax Revenue Bond Redemption Fund, which is used to pay for the Convention Center expansion and Waller Creek project	22.2 percent	2.00 cents
Tourism and Promotion	Funds tourism and promotion activities performed by the Austin Convention and Visitors Bureau (ACVB) through a contract with the City	16.1 percent	1.45 cents
Cultural Arts	Funds the Cultural Arts Program, whose objective is to nurture, preserve, and promote Austin's arts and creative industries	11.7 percent	1.05 cents
		100.0 percent	**9.00 cents**

SOURCE: Auditor analysis of Chapter 11-2 of the Austin City Code.

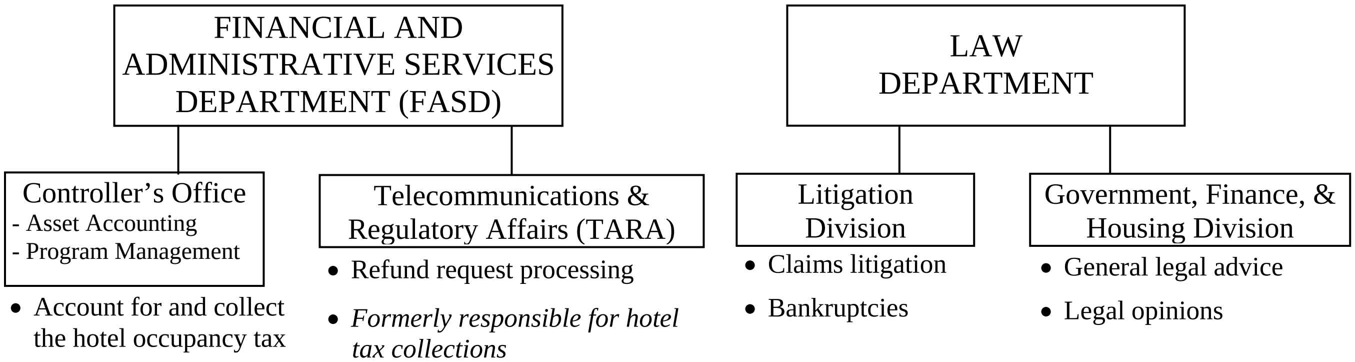
The City Controller's Office, a division of the Financial and Administrative Services Department, currently administers the tax. Exhibit 2 indicates those City departments, divisions and programs involved in hotel tax administration. Changes in organizational roles taking place over the last few years are discussed in greater length in the body of the report.

Hotels remit taxes directly to the Controller's Office, where three staff in the Asset Accounting program spend a portion of their time managing most aspects of HOT administration. This includes day-to-day accounting responsibilities, as well as collection activities needed to address delinquent accounts. Staff in Program Management have a minor role in printing out requests for remittance (blank tax reports).

Staff in Telecommunications and Regulatory Affairs (TARA), another division of the Financial and Administrative Services Department (FASD), currently play a minor role in the HOT process by processing State agency applications for small tax refunds. Prior to FY04, however, TARA handled the City's claims against hotels for unpaid taxes, and conducted periodic audits.

The Law Department currently has roles in advice and opinions and managing City claims against bankrupt hotels.

EXHIBIT 2
General Roles in Hotel Occupancy Tax Administration and Compliance Enforcement



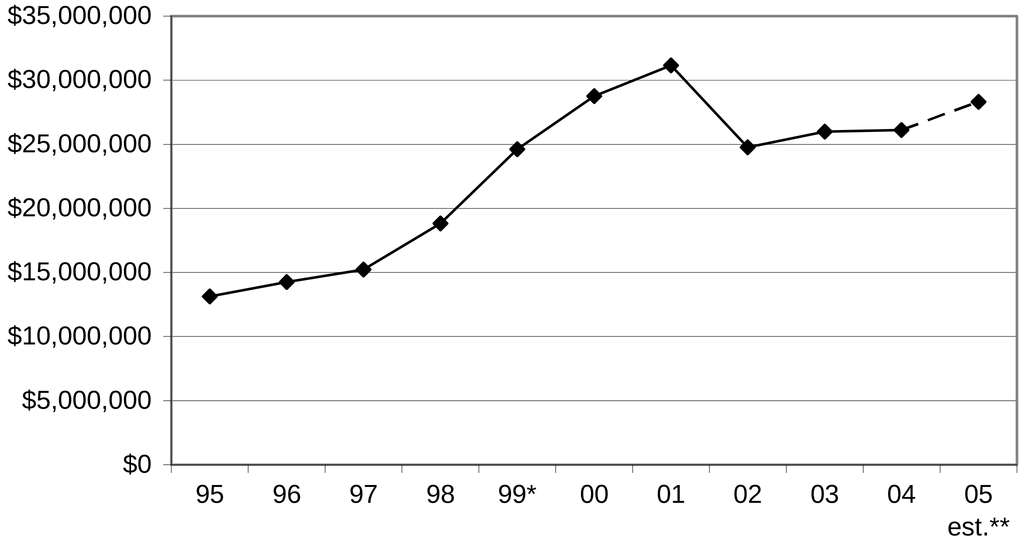
SOURCE: Auditor analysis of hotel occupancy tax administration responsibilities.

Hotel occupancy taxes are a significant revenue source that is sensitive to trends in the hotel industry.

The level of HOT revenue collected is sensitive to trends in the hotel industry. The events of September 11, 2001 had a marked impact on hotel stays. Market factors, such as declining average rental rates, have an impact on the City's hotel tax revenues.

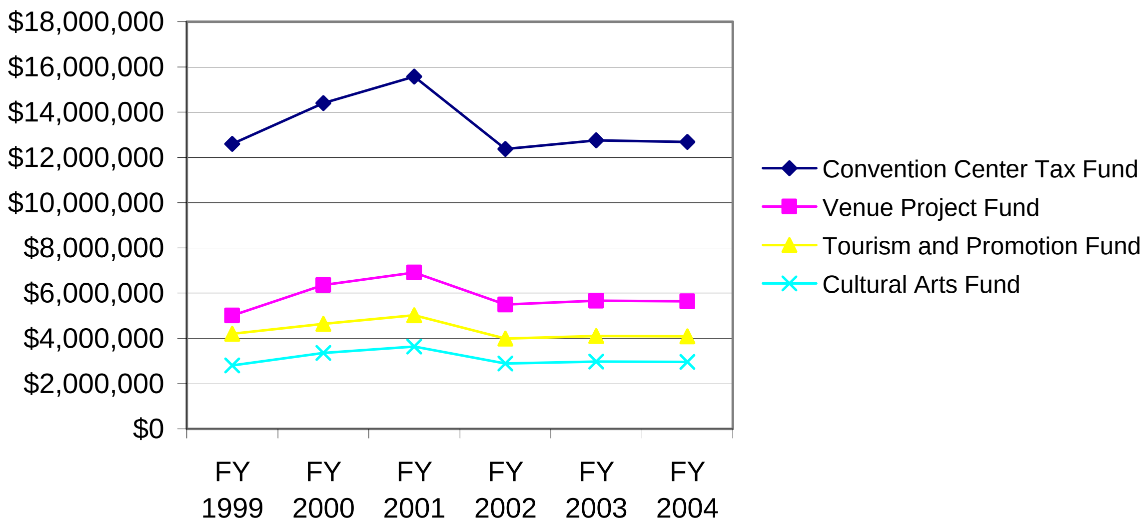
The hotel occupancy tax is a significant source of revenue for the City. As shown in Exhibit 3, the last four years have yielded just over $100 million for the City. The trend for FY05 indicates significant positive growth in revenues: first quarter revenues exceeded those of the first quarter of FY 04 by 11.7 percent and second quarter revenues exceeded those of the same quarter of FY 04 by 18.3 percent. The Austin Convention Center Department estimates the hotel occupancy tax for FY 05 at $28.3 million. Exhibit 4 presents revenues as distributed to participating funds. The relative values of these revenues are of course dictated by the City Hotel Occupancy Tax ordinance.

EXHIBIT 3
Total Hotel Occupancy Tax Fund Revenues, FYs 95-04



* Tax rate increased from 7 to 9 percent
** FY 05 estimate based on 2Q05 revenues, as of 6/1/05.
SOURCE: Budget documents, and AFS2. Data is audited, with exception of the FY05 estimate, originating with the Austin Convention Center Department finance division. Figures include penalties and interest collected.

EXHIBIT 4
Participating Fund Revenues, FYs 99-04



SOURCE: AFS2. Data is audited.

Hotels' taxable room night revenues are affected by the number of room nights sold, and the prices of those rooms. The most relevant hotel industry data, when it comes to the HOT, is the level of hotels' taxable room night revenue. As is evident in Exhibit 5, in 2004 taxable room revenue had yet to return to the peak 2000 level, though on a encouraging note it saw its first positive growth in four years.

The volume of room nights sold in 2004 was the highest in the last five years, surpassing the previously highest year, 2000. At the same time, however, the average rental rate in the Austin-Round Rock area was the lowest in the last five years. In fact, it has continued to fall annually since 1999, although the rate of decline is slowing. Exhibit 6 presents data on the relative annual growth for the factors in Exhibit 5.

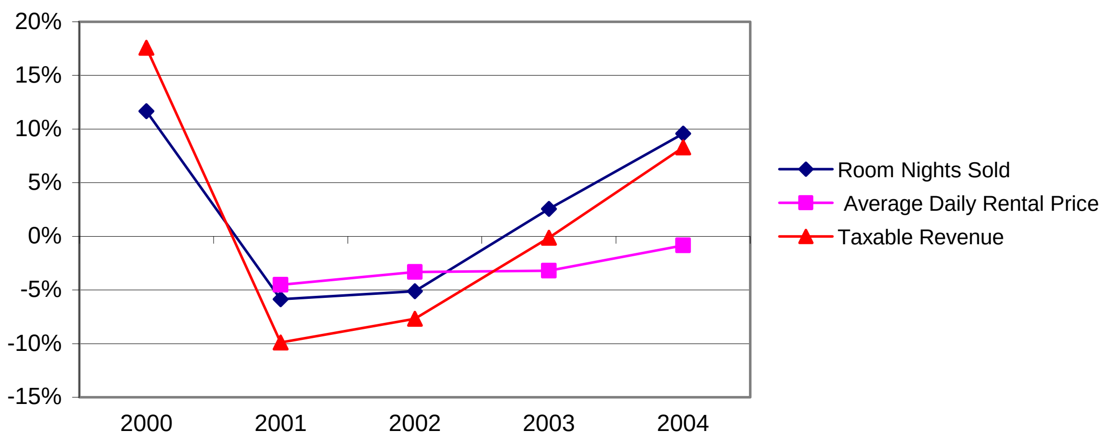
EXHIBIT 5
Austin Room Nights Sold, Rental Prices, and Taxable Revenues, CYs 99-04

Calendar Year	Room Nights Sold (000)	Average Daily Rental Rate*	Taxable Room Revenue ($000)
1999	3,708	na	$ 335,940
2000	4,140	$ 91.41	$ 395,029
2001	3,898	$ 87.29	$ 355,972
2002	3,698	$ 84.40	$ 328,588
2003	3,793	$ 81.70	$ 328,205
2004	4,156	$ 81.01	$ 355,422

SOURCE: Office of the Governor Economic Development and Tourism; for average daily rental rate, Texas A&M University (RECA). Data is not audited.

* This data is for the Austin-Round Rock MSA

EXHIBIT 6
Annual Growth Rates in Room Nights Sold, Rental Prices, and Taxable Revenues, CYs 00-04



SOURCE: Auditor analysis of data in Exhibit 5.

Austin experienced 28 percent growth in room night availability from 1999 to 2004, due to new hotel construction. In this five-year period, the volume of rooms available exhibits consistent positive annual growth. Concurrently, the occupancy rate– the ratio of room nights sold to room nights available– has fallen in recent years. Exhibit 7 presents the relevant data.

EXHIBIT 7
Hotel Occupancy Rates, CY99-04

Room Nights Sold / Room Nights Available

Calendar Year	# of Hotels	Room Nights Available (000)	Room Nights Sold (000)	Occupancy Rate
1999	128	5,793	3,708	64.0
2000	137	6,076	4,140	68.1
2001	144	6,505	3,898	59.9
2002	154	6,857	3,698	53.9
2003	158	7,038	3,793	53.9
2004	161	7,406	4,156	56.1

SOURCE: Office of the Governor Economic Development and Tourism. Only properties exceeding $18,000 are included; those units below $18,000 only result in 1.5% of the total state revenues, and are thus excluded. COA tax roll comprises 175 hotels.

OBJECTIVE, SCOPE, AND METHODOLOGY

OBJECTIVE

The objective of this audit was to evaluate the performance of the City's hotel occupancy tax administration, remittance and collection program. The audit was divided into two parts. The first part conducted was the Hotel Occupancy Tax Administration Audit where City controls and activities were evaluated. This report presents the first part of the audit. The second part will be the Hotel Occupancy Tax Collection and Remittance Audit where selected hotels/motels will be audited to determine if they properly collect and remit the applicable occupancy tax. This audit was proposed in our 2005 Annual Service Plan and approved by the City Council Audit and Finance Committee.

SCOPE

The scope of this audit was limited to testing internal controls, examining the completeness of the tax roll, assessing enforcement efforts and effectiveness, and collecting background information. The activities of the Financial and Administrative Services Department and the Law Department related to the administration of the hotel occupancy tax program were reviewed. Information and data from a variety of sources ranging from FY 1987 to FY 2005 was collected and analyzed. Special focus was placed upon data from FY 1999 to FY 2004, though limitations and incomplete data was encountered. Our scope excluded a review of compliance with GASB Statement No. 33, the City's standard for accounting and financial reporting for derived tax revenues such as is the hotel occupancy tax. The scope of this audit also excluded the uses of hotel occupancy tax revenues.

METHODOLOGY

Our methodology included interviews with relevant management and staff in the Financial and Administrative Services Department and the Law Department, review and analysis of documents and processes, limited testing of controls, interviews with staff in other cities, and collection of data and information from State agencies and other cities.

In order to conduct this audit, data and information was collected using a variety of methods as follows:

- To show hotel industry trends, we collected data from the Office of the Governor, Economic Development and Tourism Division and the Texas A & M University Real Estate Center.
- To analyze revenue trends, we collected data from City budget documents and the financial system, AFS2.
- To evaluate the adequacy of the accounting processes and controls; we interviewed Financial and Administrative Services Department staff and analyzed examples of documents, forms and financial reports.

- To validate the authority to collect the hotel occupancy tax and to check that all means of collection and enforcement available, we reviewed State statutes and City ordinances.
- To test the completeness of the tax roll, we queried an independent business database, Reference USA, reviewed the Yellow Pages on-line, and State Comptroller's Office field audits.
- To review best practices, other cities were surveyed. Information, reports, and audits were collected.

The audit was conducted in compliance with Generally Accepted Government Auditing Standards.

AUDIT FINDINGS

Accounting staff record hotel occupancy tax revenues accurately and consistently, but some system improvements may be helpful.

Controls are in place to accurately and consistently process hotel occupancy tax payments and to assess penalties and interest on hotel accounts. Additionally, refunds of overpayments and exemption requests are handled consistently. However, we also noted that limitations of the current accounting systems contribute to a cumbersome monthly reconciliation process related to hotel occupancy tax receipts. In addition, penalty waivers currently granted may be not be an effective policy for handling late payments and may not be authorized by the governing ordinance.

Policies and procedures are in place to guide verification, application, and distribution of hotel occupancy tax payments. We obtained copies of the Controller's Office's comprehensive procedures and walked through each step of the accounting process. For example, we obtained examples of process inputs and outputs, such as tax reports, aging reports, and account histories. We found that accounting processes and procedures for the administration of the hotel occupancy tax are thoroughly documented, sufficiently detailing appropriate controls.

Hotels collect the hotel occupancy tax from their customers and remit the collected taxes to the City of Austin on a quarterly basis. Once received, accounting staff verify that tax payments received from hotels are for the proper tax amount. Following this, staff confirm and reconcile the deposit of these payments to the relevant bank account. Staff next use an Excel spreadsheet to calculate the distribution of the bank deposit among four sub-funds. To complete payment processing, staff distribute payments in the AFS2 system, the City's financial system of record, to the participating funds.

We observed that this process includes separation of duties and management review. For instance, one person enters the data into AFS2, another person generates the receipt, and a manager reviews the distribution to the sub-funds.

Penalties and interest appear to be appropriately assessed prior to final payment on delinquent accounts. According to the City ordinance addressing the hotel occupancy tax, a hotel's failure to pay the tax results in the automatic assessment of a five percent penalty and, after 30 days, an additional five percent penalty. Delinquent taxes are also assessed interest at the rate of ten percent annually beginning 60 days from the tax due date.

Based on limited observations, we concluded that staff consistently follow documented procedures for applying penalties and interest to delinquent accounts once the delinquent hotel declares readiness to resolve the delinquency. In addition, for accounts on which a hotel has reported taxes due but not remitted those taxes, staff calculate and apply penalties or interest on a quarterly basis. Statements including updated penalties and interest are also sent out to delinquent hotels quarterly.

Although we walked through procedures with Controller's Office staff, we did not comprehensively test procedures or compare the process to accounting standards. Due to the complexity of the process for accruing penalties on account balances, and to the limited availability of audit resources, we limited our work to a review of controls over the application of penalties and interest to delinquent hotel accounts.

Complexity of the process may present future control risk regarding the appropriate assessment of penalties and interest. During our work we noted that the accounting system (MAS 90) is not designed to automatically apply penalty and interest to delinquent accounts. Instead, these are manually calculated offline then applied to accounts on the system. In addition, these manual updates are often not identified (labeled) in account history reports. To summarize, the combination of the manual processes and unfriendly system interface creates a steep learning curve that could be a significant problem if the activity loses the current staff familiar with the process.

Penalty fee waivers may not be authorized by the ordinance, and furthermore may not be the most effective solution for providing leniency on late payments. As a part of our review of penalty and interest, we also looked at the controls over granting penalty fee waivers. Hotels can request a one-time penalty fee waiver. A common example of this is when a hotel sends a tax payment in a day or two late, is charged a penalty and then argues about the dates because they don't want to have to pay the penalty. A penalty fee waiver is granted if the delinquent taxpayer has never had a penalty fee waived before. The value of these waivers exceeded $18,000 over the past five fiscal years. Management review and documentation of the waiver are evident. However, although controls over the waiver process are evident, we could find no authorization in the City ordinance nor could we identify a Controller's Office written policy for granting a penalty fee waiver. Although there is nothing in the City Code or State statutes that specifically prohibits granting these waivers, an attorney in the City Law Department indicates that this practice may nto align with the general State statute that prohibits "forgiving debt" and advises against this practice in the future. Instead, the Controller's office can use the postmark date of the payment to determine whether or not the payment was made on time.

Refunds of overpayments and exemption requests are handled consistently but opportunity for increased efficiency exists. Financial and Administrative Services Department (FASD) staff handle hotel occupancy tax refunds. There are two types of refunds: overpayments by hotels and exemptions claimed by State agencies. Overpayments are tax miscalculations by the hotel and are refunded from hotel occupancy tax revenue. We found that hotels are required to submit proper accounting documentation and to file an amended return to qualify for a tax refund for overpayments. As for the exemptions, State employees on state business are exempt from the hotel occupancy tax and their agencies request refunds. Last year, there were approximately ten exemption requests with a typical value of no more than $50 each.

We also found that greater efficiency in the refund process could be achieved**.** Tax exemption requests are filed with Telecommunications and Regulatory Affairs (TARA), a division of FASD, for review then forwarded to the Controller's Office for further review and payment processing. Exemption refunds are then paid from the Hotel Occupancy Tax Reserve Fund. Channeling of exemption requests to TARA before the Controller's Office is an extra step and is not necessary to ensure proper separation of duties, thus greater efficiency could be achieved by requiring exemption requests to be filed directly with the Controller's Office.

Although accounting appears to be accurate and consistent, limitations of the current accounting systems contribute to a cumbersome monthly reconciliation process for the Hotel Motel Occupancy Tax fund. During our work, we noted that because of the limited capabilities of the City's AFS2 system, the Controller's Office uses a separate specialized system called MAS90 which has a module tailored to accounting needs associated with the hotel occupancy tax. As noted above, there are significant limitations of the system when it comes to managing delinquent accounts and the penalties accruing on those accounts. A monthly tax reconciliation process is conducted in order to confirm that AFS2 and MAS90 cash receipts match. The primary output of the monthly tax reconciliation process is the year-end schedule showing gross hotel receipts, net hotel receipts, taxes paid, and exemptions to be reviewed by the City's external auditor. Use of multiple databases, which include AFS2, MAS90, Access, and Excel, add to the accounting complexity.

Recommendation

01. In order to improve the efficiency and effectiveness of HOT administration, FASD staff should migrate to a unified system that supports the specialized accounting requirements for the HOT. Current AFS3 development provides an opportunity to address these needs.

MANAGEMENT RESPONSE: Agree. The current MAS90 system does not adequately meet all requirements for HOT reporting. FASD will assess the potential for migrating to AFS3 in the future.

The Financial and Administrative Services Department's estimate of the gap between the amount of hotel occupancy tax owed and the amount paid, while recently improved, may be understated.

The Financial and Administrative Services Department's estimate of the gap between the amount of outstanding hotel occupancy tax and the amount collected, while recently improved, may be understated for a couple of reasons: estimates of un-remitted taxes are not developed in all cases and the tax roll may be incomplete.

Hotel occupancy tax tracking is fragmented though generally functional. Currently, FASD uses a number of systems and reports to track activity on individual hotel accounts. The current practice is to

- record collections (taxes paid) on AFS2, and report those revenues in the financial statements (CAFR)
- record known hotel tax delinquencies in the FASD sub-ledger (MAS 90) and track these in an aging report
- record supplemental information on delinquencies in Excel spread sheets, and report total delinquencies in a comprehensive quarterly delinquency report.

The City Controller's Office had a strong revenue collection rate for 2004. The City is collecting the majority of hotel occupancy tax revenue from hotels on the tax roll. Using estimated delinquencies accruing in the four quarters of calendar year 2004 ($278,909) and actual HOT revenues for the same period ($27.1M), we estimated that the revenue collection rate for the period was 98.98%.

The June 2005 estimate of hotel delinquencies was $697,211. The Controller's Office has periodically produced delinquency reports since the fourth quarter of FY 02, and the most recent report estimates almost $700,000 in uncollected hotel occupancy taxes. This figure excludes delinquencies of prior quarters, penalty and interest on delinquent accounts, and delinquencies incurred by hotels that have since filed for bankruptcy. With penalty and interest this collectible figure totals $754,313.

Of the 37 hotels responsible for known delinquencies, three hotels are responsible for more than half of the delinquent taxes. Exhibit 8 below shows the number of currently delinquent accounts by delinquency amount.

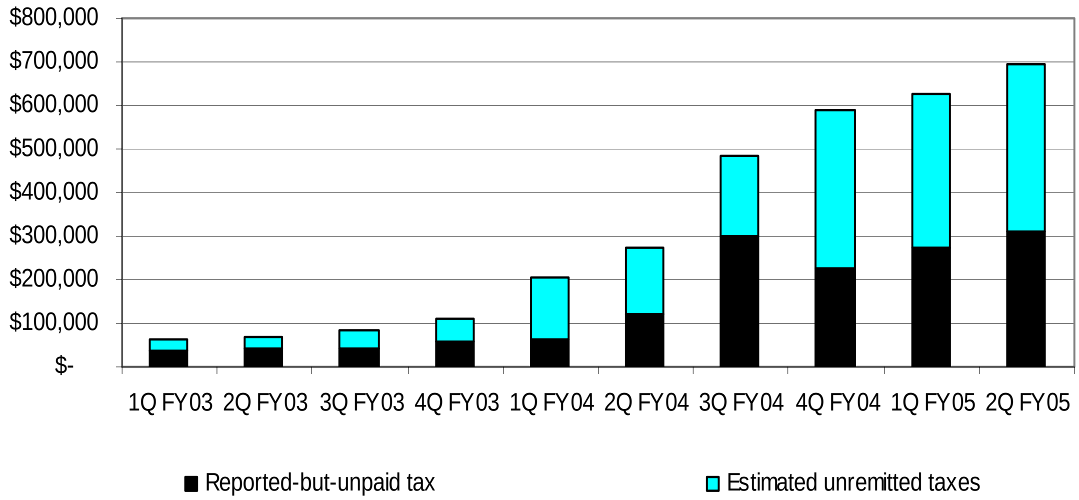
EXHIBIT 8
Delinquent Accounts by Delinquency Amount

Range of Delinquencies	Number of Accounts	Delinquent Amount
<$1K	8	$ 3,710
$1K to <$5K	10	$ 26,018
$5K to <$10K	6	$ 44,706
$10K to <$50K	8	$ 170,735
$50K to <$100K	4	$ 251,420
>$200K	1	$ 200,578
Total Accounts	**37**	**$ 697,167**

NOTE: This table presents accounts owing $50 or more as of 6/20/05
SOURCE: OCA analysis of City of Austin Controller's Office data.

Methods used to track Hotel-Motel Occupancy Tax Fund receivables are now sufficient to correctly identify and estimate uncollected revenues. Prior to FY04, the Controller's office relied solely on hotels' self-reported receipts in order to estimate receivables. That is, they limited their assessment of delinquencies to reported-but-unpaid taxes. Beginning in FY04, the Controller's Office began generating additional estimates based on hotels' State tax payments. During the course of this audit, Controller's Office staff constructed the historical data needed for a longer trend. Exhibit 9 presents the self-reported delinquencies and the estimated delinquencies from FY03 to present.

EXHIBIT 9
Hotel Occupancy Tax Delinquencies by Quarter, FYs 03-05



NOTE: Bankruptcies are excluded from this table, as the City has not recovered back taxes from any bankrupt hotel since 1987. Penalties and interest for these delinquencies are also excluded from this table.
SOURCE: City of Austin Controller's Office MAS 90 and internal delinquency report data.

- The black bars represent reported-but-unpaid taxes, for the first quarter of FY 03 to the second quarter of FY 05, as recorded in FASD's sub-ledger MAS 90. In these cases, hotels submitted information to the City on their taxable revenues, and the taxes due, but did not remit those taxes. For the two most recent quarters, an upswing in reported-but-unpaid taxes indicates a growing problem with reporting and not remitting. The black bars exclude penalties and interest accruing on these unpaid taxes.
- The grey bars show estimates calculated by staff accountants of unreported-and-unpaid taxes. These delinquencies have accrued in cases where a hotel neither reported nor remitted to the City taxes due. Staff derive these estimates when a hotel, though not paying the City for the quarter, has remitted to the State (the State makes this remittance data readily available on its website). Staff first applied this estimation methodology, for current and prior quarters, in May 2004. Staff do not calculate estimated penalties and interest accruing on these unpaid taxes.

In Phase II of this audit, we will confirm actual delinquencies.

We estimate an additional $6,200 in uncollected taxes, which the Controller's Office does not account for in its current approach to tracking and pursuing delinquent accounts. While effectively tracking each occasion in which a reporting hotel skips a quarterly tax payment, staff do not estimate the value of these delinquencies in some cases. For example, we reviewed some account information on MAS 90 and noted that if a hotel does not remit taxes to the City for a quarter, the Controller's Office does not record an invoice on the system. At the same time, however, if the hotel has filed State reports for all three months of the delinquent quarter the Controller's Office does include an estimate of the un-remitted taxes on the delinquency report. The main problem in tracking arises when a hotel fails to make a quarterly payment to the City and the State both. Unlike other cities and the State Comptroller, the City's Controller's Office does not construct estimates based on prior remittances. Using the estimation method that is based on prior returns, we estimate another $6,245 uncollected on open delinquent accounts.

The tax roll may be incomplete, which suggests additional uncollected revenue. We queried Reference USA, a database of business listings, by industry code and found several businesses not on the hotel occupancy tax roll. Further research is needed to establish whether these businesses should in fact be collecting and remitting hotel occupancy taxes. In addition, a review of the Yellow Pages and an inventory of State Comptroller field audits yielded two other possible additions to the tax roll.

In summary we found,

- five hotel-type businesses in the full purpose jurisdiction that may need to be added to the tax roll.
- ten corporate housing businesses in the full purpose jurisdiction absent from the City roll. Some such types of accommodation are already on the roll.
- ten private dorms in the full purpose jurisdiction absent from the City roll. There are two such dorms on the roll. If 'hostelling' or short term accommodation is offered by these businesses, taxes should be collected.

Additionally, we identified and reviewed one other type of business that may qualify for inclusion on the roll under the State statute and City Code. We found that City of Dallas auditors have raised but not yet resolved the issue of hospital accommodations that are run for the convenience of relatives of hospital patients. A City Attorney opinion may be warranted to determine if this housing should be charging and remitting a tax. Hospitals themselves are exempt from charging the hotel occupancy tax.

We found that Controller's Office procedures are insufficient for ensuring HOT roll is complete. To detect if new hotels should be on the Austin HOT roll, City staff routinely compare State Comptroller tax reports to the City tax roll. The Controller's Office staff also relies on new hotels' knowing they are required to pay the local tax; this may be acceptable for large chains with industry experience, but for smaller businesses, this is risky. Staff rely on their general awareness of construction in Austin, and do not coordinate with other City staff maintaining permit data for new, expanding, or remodeling hotels. During the course of this audit, however, staff did request data from the Code Compliance staff of Solid Waste Services for this purpose.

Resources that could be periodically reviewed include Reference USA and the Yellow Pages. Also, the Texas A&M Real Estate Center publishes summaries of activity in the Austin hotel sector, including major renovations which may result in added rooms, new construction, and hotel sales.

Recommendations

02. In order to effectively track performance, the Controller's Office should adopt as a new performance measure the estimated HOT collection rate.

MANAGEMENT RESPONSE: Partial Concur. There are many factors that determine an effective performance measure. One of the most critical factors is the reliability of the underlying data. In order to develop a reliable measure, it is necessary to use actual data to evaluate performance over a period of time.

Due to the nature of the HOT, delinquent accounts are often estimated since actual data is not known until a hotel remits a quarterly tax report. The estimate consists of an averaging of past quarterly collection amounts.

In order to use actual data, FASD will develop a measure based on compliance with the referral process of delinquent accounts to the Law Dept. FASD and the Law Dept will jointly develop the referral process.

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03. To detect new hotels or new ownership, thus to ensure completeness of the hotel occupancy tax roll, Asset Accounting staff should include in their policies and procedures periodic review of relevant data sources, such as:
    - Texas A&M Real Estate Center, Reference USA, and/or the Yellow Pages, and
    - review of City permitting data (coordinate with City programs).

MANAGEMENT RESPONSE: Agree. The Controller's Office has historically performed reconciliations to entities that remit hotel taxes to the State. The Controller's Office will coordinate information sharing processes with SWS for the "Hotel Boarding and Rooming House" license issuance.

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04. To further ensure the completeness of the tax roll, Controller's Office staff should research and assess the appropriateness of inclusion on the tax roll of 25 businesses identified by the auditors, and add these businesses to the roll as appropriate.

MANAGEMENT RESPONSE: Agree. A preliminary review of the 25 businesses identified has revealed that only a few may be eligible for inclusion. These entities will have a <u>minimal</u> impact on the amount of HOT collected.

The City has not utilized all means of available enforcement power in order to collect hotel occupancy tax revenue.

In addition to the day-to-day administration of the fund, City staff have the authority to carry out steps to enforce the ordinance when hotels fail to remit hotel occupancy taxes due. Through FY04, routine collection efforts were in place and achieved some success. However, hotels with outstanding delinquencies not collected through routine efforts have not been referred to the Law Department for litigation since 1997. In addition, some routine collection efforts have not been pursued since FY04. We also noted some problems related to the handling of hotel bankruptcies.

The State statute and the City Code of Ordinances authorize procedures for collections and enforcement. Chapter 351 of the State of Texas Tax Code authorizes municipalities to impose the hotel tax. To ensure complete collection of the tax the Code further authorizes the City Attorney to:

> "bring suit against a person [owner, operator or manager who collects the tax payments levied by the City]…to collect the tax not paid, or … enjoin the person from operating a hotel in the municipality until the tax is paid or the report filed, as applicable, as provided by the court's order. In addition to the amount of any tax owed…the person is liable to the municipality for the municipality's reasonable attorney's fees and a penalty equal to 15 percent of the total amount of the tax owed."

Chapter 11-2 of the City Code addresses collection procedures and enforcement procedures when hotels are in violation of the ordinance. The Chapter authorizes a misdemeanor charge when a person "failed to file a required report, failed to collect the tax imposed, failed to pay the taxes over to the City when owed, or filed a false report". Class C misdemeanors of this type are punishable by fines up to $500, and each instance of a violation "is a separate offence and each day that a person remains in violation constitutes a separate offense."

Review of financial policies, administrative bulletins, and the City Code yielded no further definition of the City's commitment to HOT collection, such as language requiring "all reasonable effort" to collect this tax. In contrast, such language is in place for the property tax, which is collected by the County: the City's financial policies encourage the County to follow an aggressive policy of collecting, an average collection rate of at least 98 percent of current levy. No similar policy or performance measure exists for the HOT.

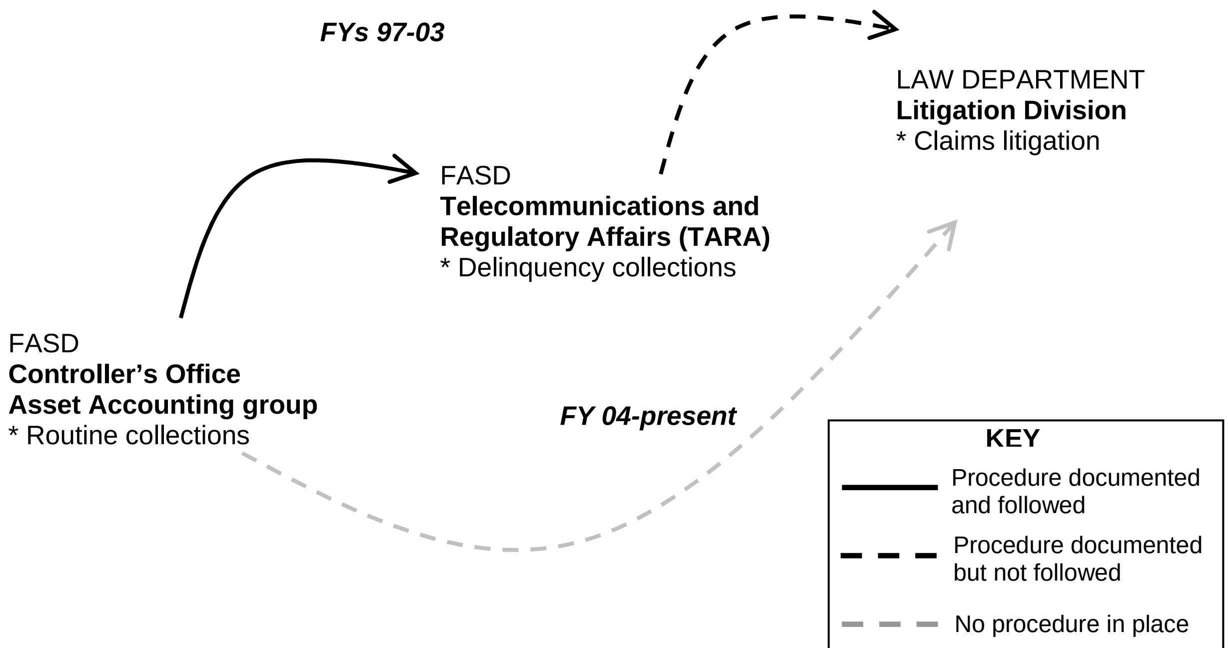
Internal procedures that were in place until FY04 have not been adopted to guide current collections efforts. Prior to FY04, Telecommunications and Regulatory Affairs (TARA) handled the City's hotel occupancy tax collections with some success. Since FY04, Controller's Office staff manage the City's hotel tax functions entirely, handling both accounting and collections enforcement. Procedures for collections and enforcement were in place when TARA handled collections but were not adopted by the Controller's Office when the office became responsible for collections.

Comprehensive written procedures that were in place through FY04 specified the following timeline and actions:

- At the close of the quarter, staff should send blank reporting forms to all hotels.
- After 30 days, if a hotel has not returned the report along with a payment for taxes due, staff should prepare and send a demand letter to the hotel.
- For the next 45 days, staff should make collections calls and negotiate with the hotel to obtain payment (this includes establishing a payment plan if necessary).
- On the 75th day, if the taxes have not been paid and no payment plan has been arranged, staff should refer the delinquency to the Law Department.

Exhibit 10 shows current and past hotel occupancy tax collection roles.

EXHIBIT 10
Hotel Occupancy Tax Administration Roles



SOURCE: Auditor analysis.

In accordance with collection procedures, the Controller's Office has been distributing of delinquency letters to non-paying hotels. We noted that Controller's Office staff have been sending blank reporting forms to all hotels prior to the payment due date. After 30 days these same staff respond to phone calls from delinquent hotels and arrange for payment of back taxes. Although delinquency letters are being sent out consistently, we did note that even after FY04 budget cuts that eliminated TARA's role in the collections process the Controller's Office delinquency letters continued to warn that the hotel would be "referred to the Claims Division" in the event of non response.

While TARA was responsible for collections, the Controller's Office referred cases to TARA and TARA had some success in collecting on these cases. From FY97 until FY04, the Controller's Office referred delinquent accounts to TARA. We did not verify whether the Controller's Office consistently followed procedures to turn over to TARA *all* delinquencies over 30 days old, but we did confirm that TARA handled multiple delinquent accounts referred by the Controller's Office.

We limited our review of TARA's discontinued process to FYs 00-03, although we collected some evidence of collections work prior to FY00. According to data from TARA's case management system, claims staff collected 57.3 percent of value referred: the Controller's Office referred $82,273 of claims, of which TARA subsequently collected $47,122. (We did not audit this data.) On cases where hotels did not file tax reports, staff recorded the delinquency as one penny, as a placeholder in the case management system. This method naturally affects the totals noted.

Since FY04 changes that eliminated TARA's collection role, nobody at staff level is authorized to negotiate payment plans, compromising the City's proactive collections procedures. Payment plans are a method to encourage and enforce compliance without going to court. TARA staff were once authorized and exercised the right to formulate payment plans with the cooperation of the delinquent hotels in question. Controller's Office staff report that currently the authority to remedy delinquencies through payment plan arrangements resides with the Chief Financial Officer. In fact, the Chief Financial Officer authorized two payment plans in 2004 for hotels that had approached City Council for assistance once they had become delinquent following annexation. The ordinance itself does not address how payment plans should be formulated.

Accounting staff report that they cannot arrange payment plans. This results in delinquent hotels are effectively dictating payment terms to staff. One hotel expressed interest in paying off its outstanding taxes through a payment plan. Since a formal plan is not available through staff, they are simply making partial payments outside of any formal plan. The City will not be able to enforce this plan should the hotel default.

Although outstanding HOT cases should be referred to the Law Department for litigation once routine collection efforts have failed, evidence indicates that no such cases have been referred since 1997. For FYs 00-03, TARA staff did not follow collection procedures for referring accounts delinquent for more than 75 days to the Law Department. In this period, of the 15 cases referred to TARA by the Controller's Office, TARA successfully worked six cases to closure using demand letters and phone calls. In some of the 15 cases, staff used installment plans to avoid litigation and achieve compliance. However, nine cases were delinquent for sufficient time as to require, per procedures, a referral to the claims litigator. Referral did not occur in any of these nine cases. TARA staff indicated that they preferred to use in-house options for avoiding lawsuits even when these options had reasonably been exhausted.

With the loss of TARA claims work in FY04, FASD management did not ensure that documented enforcement procedures for referring claims to the Litigation Division of the Law Department, were reassigned. In the course of our work, we learned that in May 2004 Controller's Office management called a meeting with its Law Department liaison to share, among other agenda items, a concern and summary report regarding mounting delinquencies. However, neither Law nor FASD followed up on the issue: Controller's Office staff did not approach the claims attorney in Litigation nor did Law Department staff refer the delinquencies to the claims attorney. The lack of follow through is a concern because no referral process was in place at the time. At the time, nineteen hotels had delinquencies over $500, totaling an estimated $420,809, a figure which includes the penalties and interest due on a portion of the accounts. In particular, two hotels were presented as chronically non-compliant, one with $34,498 outstanding.

When we shared delinquency data with staff in the Litigation Division, they were not aware of the magnitude of the City's outstanding HOT claims. Claims staff in the Litigation Division welcomed the opportunity to work these claims in the future, as it would support improved performance as currently measured.

Breakdowns exist in communicating the outcomes of hotel bankruptcy cases to FASD. In the event that a hotel files for bankruptcy, the City must file a "proof of claim" with the bankruptcy court if the hotel does not list the City's tax debt in its bankruptcy filing or if the hotel lists the amount due incorrectly. We were able to verify that for the most significant hotel bankruptcy case, the City Controller's Office was appropriately identified on their bankruptcy forms. However, we noted that FASD has not been informed of the status of the seven hotel bankruptcy cases, dating from 1987 to 2003, on which hotel taxes were owed to the City. FASD carries these cases on their HOT delinquency report as "uncollectible" delinquencies valuing $270,677. However, when we asked claims staff in the Litigation Division to review the FASD list of bankrupt hotels carrying delinquencies, they recommended writing off all but the two most recent bankrupt accounts.

Recommendation

05. To ensure full compliance by hotels with the ordinance, FASD (including TARA and Controller's Office) and Law Department staff should review best practices and develop a continuum of enforcement. The agreed process should be documented and mapped, and include authority, criteria and/or referral and coordination mechanisms for:
    1. Demand letters
    2. Additional claims work (e.g., phone calls)
    3. Payment plans
    4. Litigation
    5. Bankrupt hotel cases
    6. Exemption requests

    The ordinance should be revised, as needed, to reflect changes.

MANAGEMENT RESPONSE:
FASD Response: Agree. Although FASD met with the Law Department to discuss the increasing amount of delinquent HOT accounts in 1994, the discussion did not produce agreed-upon procedures that could be employed to produce an effective collection process.

FASD will work with the Law Dept to document effective collection and enforcement processes in the future to reduce the likelihood of long-term delinquencies.

Law Department Response:
FASD and Law Department personnel have had an initial meeting to discuss implementing new procedures which will be in place September 1, 2005.

Low utilization of available enforcement powers has contributed to a worsening trend of non-compliance, negative impacts on participating funds, and greater risk of uncollectible accounts in the future.

Delinquencies affect four City funds that are reliant upon the HOT. The proportion of compliant hotels on the tax roll has declined, from 92 percent in the third quarter of 2002 to 79 percent in the last quarter of 2004. Also, the history of hotel bankruptcies shows that early enforcement action could limit City's losses.

Delinquencies affect the four City funds that rely upon hotel occupancy taxes. By multiplying the Controller's estimated delinquencies by the tax rate applying to each recipient fund, we can see impacts of enforcement weaknesses on City activities: less money for debt service, for marketing Austin, and for supporting the arts. As noted elsewhere, these delinquencies are growing quarterly.

EXHIBIT 11
Uncollected Revenues:
Impact on Participating Funds

	Portion of tax	Estimated Impact
Convention Center Tax Fund	0.50	$ 348,606
Venue Project Fund	0.22	$ 153,386
Tourism and Promotion Fund	0.16	$ 111,554
Cultural Arts Fund	0.12	$ 83,665
	1.00	**$ 697,211***

*June 2005 estimated accounts receivable excluding penalties and interest.
SOURCE: Auditor analysis of City Controller's Office reported delinquencies as of 6/20/05.

The proportion of compliant hotels on the tax roll has dropped, from 92 percent in the first quarter of FY03 to 79 percent in the first quarter of FY05. In the first quarter of FY03, 14 of the 176 open, collectible accounts had delinquencies. By the first quarter of FY05, 37 of the 175 open accounts on the tax roll were delinquent. The value of each quarter's delinquencies is presented in Exhibit 9. Stronger, more timely enforcement action may reduce the number of delinquent hotels and limit the amount of effort needed to collect delinquent accounts.

Reviewing past hotel bankruptcies indicates that early enforcement action could limit the City's losses. Hotel bankruptcy cases number seven over the last 18 years. The City has never collected on any of these cases, which is why allowing delinquencies to build is risky. For example, one area Holiday Inn filed for Chapter 11 bankruptcy in 2002 after accumulating $182,919 in back taxes, penalties, and interest. We were able to confirm that the hotel was allowed to be delinquent for at least four quarters before it filed for Chapter 11. This tax bill is five times the size of the next largest Chapter 11 bankruptcy. The fact that the normal enforcement process is weak encourages larger delinquencies advancing to uncollectible, bankrupt status.

The City could benefit from enhancements to hotel occupancy tax program procedures and from improvements to the related ordinance.

In the course of our work, we found areas of program management that, if improved, could stimulate greater compliance by area hotels and thus greater revenues and collection rates. These include both incentives to report and remit timely and completely, and corrective measures in cases of non-compliance. Many of these observations come from a benchmarking survey in which we asked other Texas cities to report their activities.

Public information for the hotel industry can be improved. The HOT program currently has no presence on the City's website. Placing public information about exemptions, due dates, and other requirements, as well as electronic forms can make customer relations more efficient and effective, and improve compliance. For example, the State Comptroller and the City of San Antonio use interactive report templates on their website. E-filing and e-payment could speed booking of revenue. The City of Austin's practice is to send new hotels a package of materials, including the ordinance to apprise them of their lawful obligations; it would save time and money if these were made continuously available on the City website.

Dallas has also developed presentations for hotels, to educate the industry on the requirements and uses of the tax. Austin staff do not currently interact with hotel management in this type of forum.

One of the effects of not communicating the scope of the hotel tax ordinance to businesses is the low frequency of requests by hotels for certificates of zero-taxes when purchasing a hotel. Staff report that hotels run the risk of shouldering the outstanding taxes of the prior owner, unless they request a certificate from the City and arrange payment accordingly. These are rarely requested.

Strong enforcement procedures are common practice in other Texas cities. We contacted a number of cities to benchmark Austin's practices. Other cities provide some helpful ideas for program improvement.

First, we found that the City is not imposing the maximum penalties allowable under the law. As noted elsewhere, the City imposes a penalty of 5 percent of the tax bill on both the 31st and 61st day of delinquency. However State law allows 15 percent penalty, on the 1st day of delinquency. The City of Arlington applies penalties in the same manner as Austin, but Dallas, Fort Worth and Houston charge 15 percent for the first penalty, and do not charge a second penalty. See Exhibit 12 for more information and Exhibit 13 for a full picture of these cities hotel tax enforcement practices.

EXHIBIT 12
Examples of Other Cities' Compliance Activities

Compliance Activity *reflects current and/or recent activities*	**Austin**	**Dallas**	**Houston**
First penalty applied	1st day past due. 5%	25th day past due. 15%. (10 day grace period.)	1st day past due. 15%
Second penalty applied	31st day past due. Additional 5%	-	-
Interest charges applied	61st day past due. 10% per annum	45th day past due. 10% per annum	1st day delinquent.10% per annum.
Includes in demand letters estimates of all taxes, penalty and interest due	Only demand reported taxes, do not use estimates	Yes, on first late notice, which is sent certified mail.	No.
Attorney referral criteria	None for hotel tax. For other claims, >$500.	> $1,000 and 90th day past due	>$500, 61st day past due

SOURCE: OCA benchmarking of other Texas cities.

Interest charges, as we have seen elsewhere in this report, require complex manual calculations, as the current accounting system is not designed to manage these accounts. Other cities take a range of different approaches. The City of Fort Worth does not apply interest at all. Austin charges ten percent interest per year beginning on the 61st day of delinquency, per City Ordinance, while other cities begin to charge on the 1st, 45th or 61st day.

Also, estimates for unreported tax bills are never used in demand letters sent out by the Controller's Office. These estimates could be included to encourage timely compliance. Currently, hotels receive a letter stating that they owe hotel taxes to the City, without any estimate of the amount owed. A hotel receiving a letter that notes an approximate amount owed may respond more readily to confirm the amount owed and clear the delinquent balance. Other cities, as well as the State Comptroller, do include estimates in their demand letters.

With regard to the use of courts, other cities report that they routinely use lawsuits as a way to collect taxes due. As discussed elsewhere, the Law Department has not worked on a claim since 1997. Criteria used to refer cases to the City Attorney vary across cities. For Arlington, an attorney demand letter is sent on the 61st day past due, though case referral is not made until the 91st day. The City of Fort Worth first performs an audit, and then the claims attorney formulates a contract in the form of a payment plan. Houston refers on the 61st day, Dallas on the 90th. Again, see Exhibit 13 for more details.

Austin also has the authority under the statute and ordinance to cite non-compliant hotels with a criminal misdemeanor charge. City Controller's Office staff report that they have never initiated such a citation. Of the cities contacted, only the City of Arlington reports that the law enforcement has issued citation booklets to a financial services supervisor, and that they have issued citations, with police escort when necessary.

The City could use regular audits of hotels to encourage compliance. The City has not conducted a hotel audit since 1996. In the early 1990s a series of audits with follow up resulted in collection of $713,256, or 98 percent of findings. The Law Department was involved in enforcing those claims identified through the audit process. With budget cuts at TARA, the audit function was formally terminated in 1996.

Staff in the Controller's Office indicate that audit positions may not be cost effective, with diminishing returns after initial audits. However, in the most recent legislative session, a bill was passed becoming effective September 2005, whereby hotels will be lawfully required to pay the costs of audits conducted when delinquencies have accumulated on two or more fiscal quarters. The prospect of cost recovery for most audits provides additional support for employing a hotel auditor. Audits could also reasonably be conducted on hotels where payments may be timely, though accuracy unknown.

Audit enforcement may also help identify accounting practices in violation of the ordinance. During our work, we learned that delinquent hotels may be using funds to offset operating costs. Controller's office staff reported to us that in some cases, hotel management actually explained their problem with remitting to be slow season, cash flow issues. This indicates that hotel management may have mingled funds which the ordinance explicitly prohibits. Staff in TARA who were previously responsible for delinquent collections have reported similar behavior. As the City does not audit these hotels, these contentions have not been confirmed. We will follow up on this issue in the next phase of this audit.

We found that in the City of Dallas the auditor is funded in part by the Convention Center, which is the major beneficiary of the HOT revenues as is the case in Austin. This may be more appropriate than FASD fully funding this position. Dallas, Houston, and the State Comptroller all report a budgeted HOT auditor position, with the Fort Worth auditing through its City Auditor's Office.

Recommendations

06. To enhance public awareness and understanding of HOT requirements for hotels and motels, the Controller's Office staff should
    1. develop and implement a website that includes, at a minimum,
        - hotel occupancy tax reporting and payment requirements
        - exemption rules
        - reporting forms and guidelines
        - link to the ordinance and State law
        - information for prospective hotel buyers and new hotel owners on how to obtain reports from the City on tax delinquencies tied to their property
    2. organize periodic public outreach events with Austin's hotel/business owners association(s).

MANAGEMENT RESPONSE: Partial concur. FASD will begin developing the necessary information to include on the City's website. In addition, a brochure of specific HOT processes and contacts will be developed to facilitate the educational processes for hotels within the Austin area.

In the past, it was necessary to conduct educational events due to the complexities of HOT reporting. However, most of the complexities related to exemptions and HOT reporting have been simplified over the last several years.

Members of Austin's hotel/business associations are typically aware of the reporting requirements necessary to comply with HOT. FASD will instead focus on a more direct educational process, including possible information dissemination with SWS.

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07. To motivate hotels/motels to pay hotel occupancy tax to the City completely and timely, FASD staff should review and appraise best practices and actions allowable under State statute with regard to the following, and make changes to policies and procedures, and the ordinance, accordingly:
    1. frequency of remittances (monthly vs quarterly)
    2. frequency, magnitude, and timing of penalties and interest
    3. waivers vs. grace periods for late payments

The ordinance should be revised, as needed, to reflect changes.

MANAGEMENT RESPONSE: Agree. FASD will review practices in the contexts of cost/benefit, State law, and overall collection objectives and will implement changes to practice and to the City's HOT ordinance as warranted.

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08. To comply with the ordinance, Asset Accounting staff should ensure that delinquencies accrued by former hotel management are transferred to the new property owner's account, and that accounting systems reflect this requirement.

MANAGEMENT RESPONSE: Agree. Although delinquencies from the hotel seller will be transferred to the buyer's account, the delinquency amount will be for tracking and collection purposes only. Revenue will not be reported for delinquent accounts.

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09. Following OCA's completion of Phase II of the HOT audit, and in light of opportunities afforded by new State legislation for partial cost-recovery of future hotel audits, Controller's Office staff should evaluate the feasibility of conducting periodic hotel audits either by creating a new budgeted position or contracting with a financial auditor. Consultation with the Austin Convention Center Department may be appropriate.

MANAGEMENT RESPONSE: Agree. FASD will analyze the hotel audits conducted by OCA and will consider this recommendation based on the findings of those audits.

EXHIBIT 13
BENCHMARKING STUDY: TEXAS CITIES AND HOTEL OCCUPANCY TAX ADMINISTRATION

Compliance Activity *reflects current and/or recent activities*	**Austin**	**Dallas**	**Arlington**	**Fort Worth**	**Houston**
Hotel remittance occurs quarterly or monthly	Remit quarterly	Monthly, retain 1% for on-time payment. On-time payments must be sent by the 15th.	Quarterly	Quarterly	Remit quarterly
First penalty applied	1st day past due. 5%	25th day past due. 15%. (10 day grace period.)	1st day past due. 5%	First month past due. 15%	1st day past due. 15%
Second penalty applied	31st day past due. Additional 5%	-	31st day past due. Additional 5%	-	-
Interest charges applied	61st day past due. 10% per annum (not 6%?)	45th day past due. 10% per annum	61st day past due. 6% per annum	None applied.	1st day delinquent.10% per annum.
Includes in demand letters estimates of all taxes, penalty and interest due	Only demand reported taxes, do not use estimates	Yes, on first late notice, which is sent certified mail.	Yes, on 90th day past due	Yes, on second late notice. Past receipts may be used.	No.
Attorney referral criteria	None for hotel tax. For other claims, >$500.	> $1,000 and 90th day past due	Attorney demand letter on 61st day past due, referred to legal 91st day	City first performs an audit. Hotel then offered payment arrangements.	>$500, 61st day past due
Preferred or actual maximum payment plan arrangement	One year to 10 years	Six months regardless of outstanding amounts. For cases more than four years out, four years.	Six months to three years	Arrangements made by contract through collection attorney, must also stay current. Less than 12 months.	Six months, 50% down
Has assessed criminal penalties - Class C misd. on past due accounts	No	No	Yes, on 75th day past due	No.	No.
Has filed law suits to force compliance, or bind payment plans	No	Yes, 10 days following Legal demand letter	Yes	Yes.	Yes.
Have a budgeted hotel auditor position, or on-site reviews	No	Yes	No	No. Audit department rotates responsibility.	Yes.

SOURCE: OCA benchmarking of other Texas Cities and the State Comptroller's Office

APPENDIX A
MANAGEMENT RESPONSE

MEMORANDUM

To: Stephen Morgan, City Auditor
Office of the City Auditor

From: Jeff Knodel, Controller
Financial and Administrative Services Department

Date: August 3, 2005

Subject: Hotel Occupancy Tax Audit – Phase 1

Thank you for the opportunity to respond to the Hotel Occupancy Tax Audit – Phase 1. We look forward to working with the Law Department to enhance the City's collection processes. In addition, a review of the ordinance related to the hotel occupancy tax may be appropriate.

Although we have reported certain delinquent amounts during the audit process, it must be reiterated that some of the amounts are estimated based on historical collections. The reporting of the actual tax due is dependent on reporting from the hotels based on actual taxable receipts.

The second phase of the Hotel Occupancy Tax Audit consists of field audits of Austin-area hotels. The audits should help the City assess potential compliance and reporting deficiencies that exist in the reporting process.

Jeff Knodel, Controller
Financial and Administrative Services Department

John Stephens, Chief Financial Officer
Financial and Administrative Services Department

FASD ACTION PLAN
HOTEL OCCUPANCY TAX AUDIT

Rec. #	Recommendation Text	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/Phone Number	Proposed Implementation Date
1	In order to improve the efficiency and effectiveness of HOT administration, FASD staff should migrate to a unified system that supports the specialized accounting requirements for the HOT. Current AFS3 development provides an opportunity to address these needs.	• Develop reporting and collection system requirements • Perform initial assessment of AFS3 capabilities • Assess other systems if necessary	Planned.	Jeff Knodel Controller 974-2589	October 2006
2	In order to effectively track performance, the Controller's Office should adopt as a new performance measure the estimated HOT collection rate.	Document collection process and how data will be collected for the measure. Communicate accountability.	Planned.	Jeff Knodel Controller 974-2589	December 2005
3	To detect new hotels or new ownership, thus to ensure completeness of the hotel occupancy tax roll, Asset Accounting staff should include in their policies and procedures periodic • review of relevant data sources, such as Texas A&M Real Estate Center, RefUSA, and/or the Yellow Pages, and • review of City permitting data (coordinate with City programs).	• Continue to use State Comptroller data for comparative purposes • Coordinate with SWS for permit issuance	Underway.	Jeff Knodel Controller 974-2589	October 2005

Rec. #	Recommendation Text	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/Phone Number	Proposed Implementation Date
4	To further ensure the completeness of the tax roll, Controller's Office staff should research and assess the appropriateness of inclusion on the tax roll of 25 businesses identified by the auditors, and add these businesses to the roll as appropriate.	Research entities and ascertain if they meet the criteria for inclusion on the tax roll. Begin HOT reporting process if eligible.	Underway.	Jeff Knodel Controller 974-2589	October 2005
5	To ensure full compliance by hotels with the ordinance, FASD (including TARA and Controller's Office) and Law Department staff should review best practices and develop a continuum of enforcement. The agreed process should be documented and mapped, and include authority, criteria and/or referral and coordination mechanisms for: 1. Demand letters 2. Additional claims work (e.g., phone calls) 3. Payment plans 4. Litigation 5. Bankrupt hotel cases 6. Exemption requests The ordinance should be revised, as needed, to reflect changes.	• FASD will meet with the Law Dept. to develop collection strategies. • Document collection procedures • Analyze HOT ordinance. Ascertain if revisions are needed. • Propose ordinance revisions if necessary	Agree. Underway.	Jeff Knodel Controller 974-2589	December 2005 – Procedures 2006-Ordinance revisions (if needed)

Rec. #	Recommendation Text	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/Phone Number	Proposed Implementation Date
6	To enhance public awareness and understanding of HOT requirements for hotels and motels, the Controller's Office staff should a. develop and implement a website that includes, at a minimum, • hotel occupancy tax reporting and payment requirements • exemption rules • reporting forms and guidelines • link to the ordinance and State law • information for prospective hotel buyers and new hotel owners on how to obtain reports from the City on tax delinquencies tied to their property b. organize periodic public outreach events with Austin's hotel/business owners association(s).	FASD will begin developing the necessary information to include on the City's website. In addition, a brochure of specific HOT processes and contacts will be developed to facilitate the educational processes for hotels within the Austin area.	Planned.	Jeff Knodel Controller 974-2589	December 2005

Rec. #	Recommendation Text	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/Phone Number	Proposed Implementation Date
7	To motivate hotels/motels to pay hotel occupancy tax to the City completely and timely, FASD staff should review and appraise best practices and actions allowable under State statute with regard to the following, and make changes to policies and procedures, and the ordinance, accordingly: 1. requency of remittances (monthly vs quarterly) 2. frequency, magnitude, and timing of penalties and interest *3.* waivers vs. grace periods for late payments The ordinance should be revised, as needed, to reflect changes.	Identify allowable actions under State statute. Analyze other Texas cities. Collect statistical data if available. Propose changes to ordinance if necessary.	Planned.	Jeff Knodel Controller 974-2589	December 2005
8	To comply with the ordinance, Asset Accounting staff should ensure that delinquencies accrued by former hotel management are transferred to the new property owner's account, and that accounting systems reflect this requirement.	Transfer delinquent amounts to new property owner's account	Underway	Jeff Knodel Controller 974-2589	October 2005

Rec. #	Recommendation Text	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/Phone Number	Proposed Implementation Date
9	Following OCA's completion of Phase II of the HOT audit, and in light of opportunities afforded by new State legislation for partial cost-recovery of future hotel audits, Controller's Office staff should evaluate the feasibility of conducting periodic hotel audits either by creating a new budgeted position or contracting with a financial auditor. Consultation with the Austin Convention Center Department may be appropriate.	FASD will analyze the hotel audits conducted by OCA.	Planned	Jeff Knodel Controller 974-2589	Unknown

LAW DEPARTMENT ACTION PLAN
HOTEL OCCUPANCY TAX AUDIT

Rec. #	Recommendation Text	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/Phone Number	Proposed Implementation Date
05	FASD and Law Department should review best practices and develop a continuum of enforcement. Specifics:	FASD and Law Department personnel have had an initial meeting to discuss implementing new procedures.	Underway	Jeff Knodel 974.2589 Anne Morgan 974.2507	New procedures will be in place September 1, 2005
	Demand letter	New letter drafted	Implemented	Don Ploeger 974.2920	Implemented
	Additional claims work	FASD will start collecting taxes on a monthly basis	Planned	FASD	New procedures will be in place September 1, 2005
	Payment plans	FASD will send a letter to hotels demanding payment within 10 business days; if no payment received FASD will refer file to Law Dept	Planned	FASD	New procedures will be in place September 1, 2005
	Litigation	When file comes to Law Dept, we will send Demand Letter stating payment must be made within 30 days, or suit will be filed.	Planned	Don Ploeger 974.2920	New procedures will be in place September 1, 2005
	Bankrupt hotel cases	All bankruptcy notices for hotels will be sent to the Law Department upon receipt. Law will monitor, and will either collect the taxes, if any recovery is possible, or will notify FASD when the debt has been discharged.	Planned	Don Ploeger 974.2920	New procedures will be in place September 1, 2005