

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

**2<sup>nd</sup> Follow-Up:  
Transient Occupancy Tax –  
Administration Function Audit**

Original Report Dated  
September 30, 2014

Engagement No: 3565  
Report Date: March 15, 2023



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Auditor-Controller-Treasurer-Tax Collector

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**Transient Occupancy Tax – Administration Function**  
**For the Period July 1, 2010 – June 30, 2013**  
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## Executive Summary

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As part of the 2022/2023 annual Audit Plan, the Internal Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office conducted a follow-up audit of the Transient Occupancy Tax (TOT) - Administration Function Audit report dated September 2014.

The original report contained 14 recommendations which were accepted by management. The last follow-up audit was conducted in September 2016 where nine recommendations remained outstanding. Of the nine, management stated that they will not implement three. We have discussed these recommendations in the follow-up report including management's justifications and our positions including the impact, if any, on the program.

The objective of this follow-up is to determine the implementation status for these nine recommendations. In doing so, we noted that TOT Administration had implemented a new collection and reporting system in FY 2019/2020 which was a key tool needed for estimating potential under-reported TOT in the County.

We reviewed 9 recommendations during this follow-up. The results are as follows:

- **One recommendation has been implemented** (No. A-4.1)
- **Five recommendations are in process**(No. A-1; A-2; A-6; B-1; B-2)
- **Three recommendations will not be implemented** (No. A-3; B-3; D-1)

We will continue to follow up until all recommendations have either been implemented, management has accepted the risk of not implementing them or new evidence supports that the recommendations are no longer applicable.

Further discussions are provided in the Report.

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## Background, Objective, Scope, and Methodology

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### Background

The number of registered operators has increased significantly since the original audit of FY 2012/2013 by 2,201 (320%) from 686 to 2,887 in FY 2021/2022 while TOT collections grew by \$16.6m (171%) from \$9.7m to \$26.2m.

FY	No. of Operators	TOT Receipts
12/13	686	\$9,705,030
15/16	2,200	\$13,930,007
21/22	2,887	\$26,280,881

*Source: TOT activities for FY12/13 & 15/16 obtained from FAMIS and Tax Collection Database.  
TOT activities for FY 21/22 obtained from HdL Database.*

TOT Administration is responsible for the administration and enforcement of TOT and works closely with the Sonoma County Permit and Resource Management Department (Permit Sonoma) to ensure that all vacation rentals registered by them obtain a TOT certificate.

### Objective

The objective of this follow-up audit was to determine the status of implementation of the nine recommendations which remained outstanding in the last follow-up audit conducted in September 2016.

### Scope

Our procedures were limited to reviewing evidence supporting the actions taken by the TOT Administration towards implementation of the report recommendations. We reviewed TOT Administration's records, performed analysis of TOT payments, and conducted interviews with staff and management. Where available, we reviewed documentation supporting implementation of the recommendations.

### Methodology

We conducted the follow-up audit in accordance with the International Standards for the Professional Practice of Internal Auditing (Standards). These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve audit objectives. We believe that the evidence obtained provides a reasonable basis for the conclusion contained in our audit report. The Standards require that we establish a follow-up process to monitor and ensure that management has effectively implemented actions, or that senior management has accepted the risk of not taking action. We conducted this follow-up audit from March 2022 through October 2022.

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## Implementation Status of Recommendations

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The original report issued in September 2014, contained 14 recommendations which were accepted by management. The last follow-up audit was conducted in September 2016 where nine recommendations remained outstanding. The following is a discussion of the implementation status of the nine outstanding recommendations, management's justifications and our positions including the impact if any on the program. Of the nine recommendations, management stated that they will not implement three.

### **A) Non-filing tax gap (TOT not collected from operators of unregistered properties)**

#### **Recommendation No. A-1. Upgrade the current collection and reporting system**

We recommend that management develop a system requirements document to support the strategies discussed in the report dated September 2014 and either upgrade the current system or search for systems that would best meet their needs. It may be helpful to find out about systems other jurisdictions currently use.

#### **Status: In Process:**

Management implemented a new web-based TOT collection and reporting system, HdL Prime, in FY 2019/20. The new system replaces a large portion of paper applications enabling online payments, monitoring, and reporting capabilities. Staff are able to update accounts in real time and generate statistics needed for monitoring TOT collections. Although this facilitates recording of sleeping rooms and rates per night, data essential for operator profiling, TOT Administration is not entering this information consistently.

To complete the implementation of this recommendation, TOT Administration needs to verify the completeness and accuracy of data in the new system. This can be accomplished by reaching out to registered operators for a confirmation of their current record details with the County to ensure records are kept up to date.

#### **Recommendation No. A-2. Engage outside contractors to help update the inventory of properties**

We recommend that management investigate to determine if there are vendors who are able to offer a cost-effective solution as discussed in recommendation A-1.

#### **Status: In Process:**

In collaboration with TOT Administration, Permit Sonoma engaged a vendor for online vacation rental data scrape services in 2019. Using information obtained from the scrape project, TOT Administration reported that they were able to register 17 properties that had been operating without a TOT registration certificate and collected over \$400,000 in TOT from these previously unregistered properties as of June 30, 2022. 9 of the 17 properties are currently active registered properties. Data scraping is performed on a quarterly basis, however, it is currently on hold as Permit Sonoma is in the process of engaging a new vendor.

To complete the implementation of this recommendation, TOT Administration should continue to work with Permit Sonoma to ensure a smooth transition with the new vendor and continue efforts in vacation rental data scraping procedures to identify unregistered properties.

#### **Recommendation No. A-3. Amnesty**

A limited one-time amnesty program, forgiving penalties and interest for those registering during the program period, would be likely to increase property registrations. We recommend that management consult with other jurisdictions that have had success with amnesty programs and draft a plan for the County.

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## Implementation Status of Recommendations

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### **Status: Will not be Implemented:**

TOT Administration made the decision not to pursue an amnesty program as efforts were focused on the scrape project and the Airbnb agreement instead.

### **Internal Audit Position:**

Amnesty programs have been applied successfully in tax collection operations in other jurisdictions, increasing one time collection and converting nonpayers to payers. We continue to recommend that TOT Administration consider using this strategy, especially if analysis support there is a high number of non-reporting operators. TOT Administration is working on other strategies to improve and will be in a better position to decide where it should spend its resources.

### **Recommendation No. A-4.1 Require property owners to post registration numbers on their online advertisements**

All operators should be required to post registration numbers on the websites (current County Ordinance Section 26-88-120 requires operators of only non-owner-occupied properties to post registration numbers on advertisements).

### **Status: A-4.1: Implemented:**

The TOT Ordinance amendment was adopted by the Board on October 04, 2022. A provision was added to Section 12-14 requiring the registration certificate number be included on all contracts, rental agreements, advertising materials and websites.

### **Recommendation No. A-6. Seek partnership with vacation rental websites**

The County may benefit with partnerships with companies such as VRBO and Airbnb such as an agreement by organizations to collect and remit the TOT. In return, the County could offer compensation. Other possible arrangements, such as a partnership to disseminate TOT information to property owners on an ongoing basis, should be explored as well.

### **Status: In Process:**

The County of Sonoma has a Voluntary Collection Agreement with Airbnb to collect and remit TOT effective January 1, 2017. A draft collection agreement with VRBO was developed in collaboration with other Counties to obtain favorable terms. Negotiations stalled due to COVID and the potential impacts of a senate bill introduced in 2021 (SB555). TOT Administration plans to restart discussion for a collection agreement with VRBO as soon as possible.

## **B) Under-reporting tax gap (TOT not collected from operators of properties who are registered but are underreporting gross receipts or overstating exempt revenue)**

### **Recommendation No. B-1. Develop property rent profiles**

After upgrading the system and collecting the additional data discussed above, property rent profiles could be created to accurately estimate gross rents and TOT due. This will allow the TOT Administration to better identify

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## Implementation Status of Recommendations

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and follow up on properties with potentially understated gross receipts, exemptions, or TOT liability.

### **Status: In Process:**

TOT Administration agrees with the recommendation and will work with Internal Audit to develop a methodology. TOT Administration will develop a process that can be implemented using the current resources of the team.

### **Internal Audit Position:**

Internal Audit is currently engaged in performing an audit of TOT operators. Since property profile information is not available, we are using alternative procedures to identify operators that are likely under reporting. We will share our results and methodology with TOT Administration for their consideration at the conclusion of the audit.

### **Recommendation No. B-2. Periodically calculate the total under-reporting tax gap**

The total underreporting tax gap would be the sum of negative variances of all properties calculated as described above. When monitored over time, this measure will indicate the effectiveness of strategies employed to discourage operators from underreporting.

### **Status: In Process:**

TOT Administration agrees with the recommendation and will work with Internal Audit to develop a methodology. TOT Administration will develop a process that can be implemented using the current resources of the team.

### **Internal Audit Position:**

As discussed above, Internal Audit will share the results and methodology at the conclusion of the current TOT audit with TOT Administration for their consideration.

### **Recommendation No. B-3. Collect occupancy data with the tax returns**

The property owners/managers are not required to provide occupancy data. Occupancy data is useful in performing analytical procedures to test the reasonability of reported rent.

Occupancy data should be collected and taken into consideration to accurately estimate the tax gap, perform variance analysis and direct audit resources. The occupancy data could also be used to explain material variances, thereby avoiding the cost of an audit.

### **Status: Will not be Implemented:**

TOT Administration held conversations with some stakeholders regarding the collection of occupancy data and reported there was severe resistance to providing occupancy data to the County. Management believes that historically, TOT audit results have demonstrated a very low level of under reported tax. Management believes that it is in the best interest of maintaining a collaborative working relationship with the tourism industry not to pursue this level of data collection at this time. Management understands that not implementing this

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## Implementation Status of Recommendations

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recommendation or another process to determine the reasonability of reported gross rents means risk remains that operators who significantly under-report gross receipts and TOT will go undetected.

### **Internal Audit Position:**

We continue to recommend that TOT Administration fully implement this recommendation to better determine if taxes have been under reported.

### **Recommendation No. D-1. Consider collaborating with the cities in the County who collect TOT**

The County should explore the feasibility of a joint TOT administration with local cities to reduce administration costs.

### **Status: Will not be Implemented:**

TOT Administration, consulted with local cities that collect TOT and found no support for a joint TOT Administration. Obstacles noted include differing TOT rules, varying tax rates, unwillingness by the cities to reimburse the County for cost of the program, and the lack of resources dedicated to the TOT programs at several cities.

### **Internal Audit Position:**

We recommend TOT Administration continue to explore the possibility of consolidating TOT collection function with other local jurisdictions to save costs.

Functional consolidations, which our recommendation addresses, is where one local government provides services to another or where two or more entities jointly perform a function. The purpose of these agreements would primarily be to save costs through economies of scale but could also result in operational improvement.

We believe the TOT collection functions of local jurisdiction, similar to property tax, have sufficient similarities to warrant investigating the potential benefits of consolidation. Obstacles mentioned above by management we believe can be overcome.

## **Staff Acknowledgement**

We would like to thank TOT Administration Management and Staff for their helpfulness and cooperation in conducting this follow-up audit. If you have any further questions regarding this report, please contact the auditor-in-charge, Venina Ranadi, at (707) 565-8323.