

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

Compliance Audit: Transient Occupancy Tax Operator Collections & Remittances

For the Calendar Year Ended
December 31, 2021

Engagement No: 3565
Report Date: December 15, 2023



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Transient Occupancy Tax
Operator Collections & Remittances
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For the Period: January 1, 2021 to December 31, 2021**

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Executive Summary

The Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (Internal Audit) has completed a compliance audit of collections and remittances of certain operator entities subject to the Sonoma County (County) Transient Occupancy Tax (TOT) Ordinance.

Current Year Highlights

For the period January 1, 2021 to December 31, 2021, Internal Audit reviewed and analyzed collections from the TOT collection system. From our analysis, we identified forty-eight (48) out of over two thousand eight hundred (2,800) entities and performed desk audits for forty-one (41) entities; seven (7) entities failed to provide records as required by the TOT ordinance (Appendix A). Out of the forty-one (41) entities that provided records, we selected ten (10) establishments for a detailed review, three (3) of the ten (10) failed to provide required records to complete the audit. We performed a detailed review on seven (7) to determine if the Operators' financial records supported their filed quarterly TOT returns (Appendix B). We expanded our testing by an additional ten (10) properties managed by KVR Management Inc. (KVR) in light of the underpaid TOT we found during the detailed review (Appendix C). During our audit, other matters came to our attention, specifically Airbnb reported \$41 million more in gross receipts than operators reported in Airbnb gross rent exemptions. The current year highlights are provided below:

- The seven (7) operators audited reported a total of \$6.9 million in taxable receipts and paid \$0.8 million in TOT.
- One (1) out of the seven (7) audited operators provided records that supported their filed TOT returns and generally complied with the TOT ordinance. The other six (6) operators failed to provide records that supported amounts reported in their TOT and Business Improvement Assessment (BIA) returns; and underpaid TOT and BIA by a total of \$36,004 and \$17,446, respectively.
- The ten (10) additional properties managed by KVR underpaid TOT and BIA by \$19,964 and \$3,328, respectively.
- The unpaid TOT from the six (6) entities plus KVR was due to a combination of factors such as reporting errors, underreporting of gross rent, and collection but non-remittance of TOT on fees such as cleaning and services fees.
- One (1) of the entities was inconsistently reporting its exemptions to the County.
- Overall, we identified a total of \$55,968 in unpaid TOT and \$20,774 in unpaid BIA.

Summary of Recommendations:

TOT Administration should:

- Investigate the difference in Airbnb exemptions reported by establishments versus the gross rent receipts reported by Airbnb.
- Review the exemption treatment for Hilton Garden Inn in accordance with the TOT Ordinance and provide guidance to ensure compliance by the establishment.
- Review the 'Frequently Asked Questions' on the County website to help operators better interpret the TOT Ordinance.
- Take steps outlined in the Ordinance to compel operators to comply with TOT audit documentation requirements, including revoking their TOT certificate.

Introduction & Background

Introduction

Internal Audit has completed a compliance audit of the collections and remittances of certain operator entities, (operators), subject to the County TOT Ordinance. The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve audit objectives. We believe that the evidence obtained provides a reasonable basis for the results and recommendations contained in our audit report.

The purpose of this audit report is to furnish management independent and objective analyses, recommendations, and other information concerning the activities reviewed. The audit report is a tool to help management identify and implement improvements.

Occasionally, to fulfill its risk management responsibilities, management requests Internal Audit to perform studies, analysis, or audits. In responding to these requests, we ensure that we do not take on any responsibilities for designing, implementing, or operating any part of internal control systems so that our independence regarding those systems is not impaired.

At the request of the County Administrator's Office, we have performed audits of entities subject to TOT and plan on providing such assistance in the future. For purposes of this report, TOT Administration is handled by the Auditor-Controller-Treasurer-Tax Collector's Revenue Accounting Division. We do not believe that performing these audits constitutes assuming responsibility for the design, implementation, or operation of any part of TOT Administration's internal control system. Internal Audit analyzes TOT data collection and proposes an audit scope which is agreed to by TOT Administration.

Background

The assessment and collection of TOT is authorized under California State Revenue and Taxation Code Section 7280, as an additional source of non-property tax revenue to local governments. TOT is assessed by operators on transients who occupy lodging facilities (e.g. hotels, motels, campgrounds, or vacation rental homes) in the unincorporated areas of the County for fewer than 30 consecutive calendar days. In Sonoma County, this tax was levied at a rate of 12%, for this audit period. TOT funds are discretionary, in that the Board of Supervisors may direct use of these funds for any legitimate county expense. The tax code does not require any specific use of TOT funds.

As of December 31, 2021, there were two thousand eight hundred eighty-seven (2,887) operators, registered with the County, including hotels, motels, bed & breakfasts, inns, recreational parks, campgrounds, vacation rentals, and property management firms. The total collection of TOT for the calendar year 2021 was \$31.8 million, as compared to 2020 which had revenue of approximately \$15.9 million. TOT for booking transactions completed by hosts and guests for the unincorporated areas of Sonoma County via the Airbnb internet-based platform is collected, reported, and remitted in aggregate by Airbnb to the County on the TOT return form.

The TOT Administration is responsible for the administration and enforcement of TOT and works closely with Permit Sonoma to ensure that all vacation rentals registered by them obtain a TOT certificate. Each operator is required to report and remit TOT on a quarterly basis, or a shorter basis as directed by the TOT Administration.

Objective, Scope and Methodology

Objective

The primary objective of this audit was to determine whether selected entities filed timely and accurate returns and paid the amounts due in compliance with the financial provisions of the TOT Ordinance.

Scope

We analyzed data from TOT returns for all registered establishments, forty-eight (48) entities were selected by Internal Audit for desk audits. From the forty-eight (48) entities, we selected ten (10) entities for a detailed review. The audit covered the period January 1, 2021 to December 31, 2021. The scope of our work encompassed reviewing records of transactions subject to the TOT, as well as interviewing the management and staff of operators responsible for the maintenance of financial and guest maintenance systems (Operators).

Methodology

The overall objective of the audit was to determine if the Operators' financial records supported their filed quarterly TOT returns. To accomplish this, we reviewed and analyzed the 2021 TOT collections by performing a trend analysis of all collections for all properties, against the seasonally adjusted TOT revenues to identify potential outliers.

From this trend analysis, we identified forty-eight (48) properties for desk audits; out of those forty-one (41) provided requested records and seven (7) did not. We performed desk audits for forty-one (41) entities, out of those, we selected ten (10) establishments for a detailed review; three (3) of the ten (10) operators failed to provide adequate records needed to complete the review. We performed a detailed review on the remaining seven (7) establishments by reviewing the Operators' internal controls over the collection and remittance of TOT, including the entering of guest information in reservation systems, processing and recording of financial transactions and summarizing of financial transactions for the purpose of preparing TOT returns. We performed ten (10) additional reviews on properties managed by KVR after identifying underpaid TOT during our initial testing.

Operators are required to maintain records necessary to determine the amount of TOT owed to the County. At a minimum, the records deemed necessary for this determination shall be a chronological cash journal showing tax and room rate separately, or other means acceptable to the TOT Administration of summarizing the Operator's monthly or quarterly revenue, supported by room registrations (including the name and address of the transient), a calendar of advance registrations, copies of forms used to claim exemption from the tax, and pre-numbered payment receipts showing payment for occupancy which state the room rate separate from the amount of tax paid and which may, with reasonable effort, be identified with the revenue summary.

In instances where the Operator did not maintain records as stated above, all guest transactions within the period under audit were selected and tested. If the Operator maintained records as stated above, a sample of transactions within a specific time period was selected and tested.

Results & Other Matters

For the period January 1, 2021 to December 31, 2021, we selected ten (10) establishments, three (3) of the establishments failed to provide adequate records needed to complete the audit. The seven (7) operators audited reported a total of \$6.9 million in taxable receipts and paid \$0.8 million in TOT. One (1) out of the seven (7) audited properties generally complied with the TOT ordinance. Six (6) of the properties underpaid TOT tax by a total amount of \$36,004 (Appendix B).

The initial testing included two (2) properties managed by KVR, which under remitted TOT and thus we expanded our testing to an additional ten (10) properties managed by KVR. KVR systematically collected TOT and BIA on certain rental charges but failed to remit that TOT and BIA to the County. This resulted in an underpaid TOT and BIA of \$19,964 and \$3,327, respectively (Appendix C).

Overall, we identified a total of \$55,968 in unpaid TOT and \$20,774 in unpaid BIA. For a detailed breakdown of these amounts and the related properties, see Appendix B and Appendix C.

Three (3) of the operators audited claimed Airbnb revenue exemptions totaling \$167,204 in 2021 (Appendix D). The collection, reporting, and remittance of gross revenues and TOT for the booking transactions completed on the Airbnb internet-based platform is reported and remitted in aggregate by Airbnb to the County. Thus, we are unable to verify that TOT applicable to the Airbnb revenue exemptions claimed was accurately assessed, collected and remitted to the County by Airbnb.

Unpaid TOT from the six (6) entities plus KVR was due to a combination of factors such as reporting errors, underreporting of gross rent, and collection but non-remittance of TOT on fees such as cleaning and services fees.

The details related to these nine (9) operators who had records that did not support the gross rent and TOT reported on the TOT Tax Return are listed here:

River Bend Resort, LLC & Hilton Campground

TOT was under paid by \$2,841 in 2021, based on our estimate of underreported gross rent receipts of \$23,672. Although Hilton Campground did not receive an official letter from TOT Administration on the assessment and collection of BIA, \$9,893 in BIA was collected but not reported or remitted to the County. We initially performed a detailed review on River Bend Resort but found that River Bend Resort and Hilton Campground use one reservation system which records and consolidates all campground reservations and payments received. To ensure we assessed the records necessary to determine the amount of TOT owed to the County, we considered gross rents and TOT paid from both operations to calculate the under paid TOT and BIA.

Winner's Circle

TOT was under paid by \$3,143, based on our estimate of \$26,196 in underreported services fees that were paid by the transient. Based on our assessment of the records provided, the service fees are system generated. The underreported services fees resulted in an underpaid BIA of \$524.

Kenwood Knoll

We were unable to complete the audit of Kenwood Knoll. The property manager, Beautiful Places, provided incomplete financial records. Despite multiple requests, we were unable to obtain records necessary to complete our audit. The owner/operator is out of compliance with section 12-18.1 of the TOT Ordinance.

Results & Other Matters

Hilton Garden Inn

TOT was underpaid by \$5,892 in total for 2021, based on our estimate of underreported gross rent receipts of \$49,193. The underreported gross rent also resulted in underpaid BIA of \$984. The establishment inconsistently applied tax exemptions for one of its corporate occupants in 2021. A total of \$143,353 was reported as tax exemptions in 2021. The establishment was exempting the transient occupancy taxes in some transactions whilst charging and collecting taxes for other transactions.

Carneros Vineyard View

TOT was under paid by \$8,025 in total for 2021, based on the operator failing to include direct bookings which resulted in underreported gross rent receipts of \$70,876.

Twilight Ridge

We were unable to complete the audit of Twilight Ridge. The property manager, Beautiful Places, provided incomplete financial records and, despite multiple requests, we were unable to obtain records necessary to complete our audit. The owner/operator is out of compliance with section 12-18.1 of the TOT Ordinance.

Villa Carneros & The Attune Estate

We were unable to complete the audit of Villa Carneros & the Attune Estate. The property manager, Beautiful Places, provided incomplete financial records, and, despite multiple requests, we were unable to obtain records necessary to complete our audit. The owner/operator is out of compliance with section 12-18.1 of the TOT Ordinance.

Casa Martin

TOT was under paid by \$4,804 in total for 2021, based on our estimate of underreported gross rent receipts of \$39,533 and ex emptions of \$500. BIA was underpaid by \$801. Casa Martin is managed by KVR who charged and collected TOT and BIA on cleaning, service & supply and processing fees; however, it was systematically excluded from amounts remitted to the County in 2021.

Villa Montebella

TOT was under paid by \$11,299 in total for 2021, based on our estimate of underreported gross rent receipts of \$94,155. BIA was underpaid by \$5,244. Villa Montebella is managed by KVR who charged and collected TOT and BIA on cleaning, service & supply and processing fees however, it was systematically excluded from amounts remitted to the County in 2021.

KVR Management Inc.

In addition to Casa Martin and Villa Montebella, ten (10) other properties managed by KVR underpaid TOT and BIA by \$19,964 and \$3,327 respectively in 2021 (Appendix C). TOT and BIA were charged and collected on cleaning, service & supply and processing fees; however, it was systematically excluded from amounts remitted to the County in 2021. During our review, we also found mismatches in the Airbnb amounts reported in the quarterly returns and some direct bookings from the folio reports were not reported in the quarterly returns submitted to the County.

Results & Other Matters

Other Matters

We reviewed the TOT data provided by TOT Administration and found that gaps exist in the data. These are summarized below:

- The gross rent collected by operators via the Airbnb platform and reported as exemptions to the County should match the gross rent collected by Airbnb and reported to the County. Based on the TOT data for 2021, there is a material difference of \$41 million in Airbnb exemptions reported by establishments versus the gross rent receipts reported by Airbnb. Airbnb is reporting \$41 million more in gross rents than operators are reporting in exemptions. Ideally, total Airbnb exemptions reported by establishments should be equal to or close to the gross rent receipts reported by Airbnb. It is likely that operators registered under Airbnb are not submitting their Returns or are not registered with the County, or both. There could also be a possibility that operators are incorrectly reporting their Airbnb exemptions. It is also possible, Airbnb is reporting revenue and paying tax on collections belonging to other jurisdictions. This should be investigated by TOT Administration.

Recommendations & Staff Acknowledgement

Recommendation No. 1 (Risk Classification C: Control Weakness):

TOT Administration should investigate the difference in Airbnb exemptions reported by establishments and the gross rent receipts reported by Airbnb.

Management Response No. 1:

TOT administration investigated as requested. The gross rents calculation didn't account for over 500 registered operators deemed Airbnb exclusive and not required to provide Airbnb Exemptions reports in the 2021 calendar year. Beginning with the reporting period January 1, 2023, all Operators (including Airbnb exclusive) are required to submit documentation that supports the gross rent and TOT collected from guests.

Recommendation No. 2 (Risk Classification D: Opportunity for Improvement):

TOT Administration should review the exemption treatment for Hilton Garden Inn in accordance with the TOT Ordinance and provide guidance to ensure consistent application of the exemption rule. TOT Administration should prescribe appropriate documents to support exemptions reported by the establishment.

Management Response No. 2:

As staff availability permits, the TOT Administration will reach out to Hilton Garden Inn and provide an overview of the exemption rules as outlined in the TOT ordinance.

Recommendation No. 3 (Risk Classification D: Opportunity for Improvement):

TOT Administration should review the 'Frequently Asked Questions' on the County website to help operators better interpret the TOT Ordinance. We noted the operators lack of understanding of the TOT Ordinance that resulted in inaccurate calculation of the taxable gross rent and inappropriate exclusion of fees and charges.

Management Response No. 3:

The TOT Administration will review the 'Frequently Asked Questions' on the County website and will look for opportunities to provide additional instructions to operators.

Recommendation No. 4 (Risk Classification D: Opportunity for Improvement):

For those entities that failed to provide requested TOT records as required by the TOT Ordinance, TOT Administration should consider taking steps outlined in the ordinance to compel the operators to provide records, including revoking their TOT certificate.

Management Response No. 4:

In future audits, the TOT Admin will review the accounts for auditees who failed to respond to internal audit requests using data from our data scrape vendor and make a determination on next steps for additional information.

Recommendations & Staff Acknowledgement

Staff Acknowledgement

We would like to thank management and staff for their time, information, and cooperation throughout the audit.

Appendix A: Entities that Failed to Provide Records

Table 1: Entities that failed to provide gross receipt records and are out of compliance with Section 12-18.1 of the TOT Ordinance

**County of Sonoma
Transient Occupancy Tax
For the period of January 1, 2021 to December 31, 2021**

Entity

1. 17341 Highway 12
2. 339 Lake Street
3. Villa Gaia
4. Villa Vigneto
5. Miraval
6. 4193 Sonoma Mtn. Rd.
7. Vizslay Estate House
8. Kenwood Knoll
9. Twilight Ridge
10. Villa Carneros & The Attune Estate

Note:

*Entities 1 - 7 failed to provide records for the desk audits.

**Entities 8 - 10 failed to provide records needed to complete the detailed reviews.

Appendix B: Schedule of Operators Reviewed

Table 2: Schedule of Transient Occupancy Tax Over (Under) Paid

County of Sonoma Transient Occupancy Tax For the period of January 1, 2021 to December 31, 2021					
<u>Entity</u>	Taxable Receipts Reported	Taxable Receipts Per Review	Tax Paid	Tax Per Review	Over (Under) Paid
Winner's Circle	\$ 654,893	\$ 681,088	\$ 78,587	\$ 81,731	\$ (3,143)
Carneros Vineyard View	261,095	327,969	31,331	39,356	(8,025)
Casa Martin	71,977	112,010	8,637	13,441	(4,804)
Hilton Garden Inn	3,866,499	3,915,692	463,991	469,883	(5,892)
River Bend Resort, LLC & Hilton Campground	816,748	840,420	98,010	100,850	(2,841)
Sonoma Raceway	606,202	606,202	72,744	72,744	0
Villa Montebella	630,040	724,195	75,605	86,903	(11,299)
Total	\$ 6,907,454	\$ 7,207,576	\$ 828,905	\$ 864,909	\$ (36,004)

Table 3: Schedule of Business Improvement Assessment Over (Under) Paid

County of Sonoma Business Improvement Assessment For the period of January 1, 2021 to December 31, 2021					
<u>Entity</u>	Taxable Receipts Reported	Taxable Receipts Per Review	BIA Paid	BIA Per Review	Over (Under) Paid
Winner's Circle	\$ 654,893	\$ 681,088	\$ 13,098	\$ 13,622	\$ (524)
Carneros Vineyard View	261,095	327,969	0	0	0
Casa Martin	71,977	112,010	1,440	2,240	(801)
Hilton Garden Inn	3,866,499	3,915,692	77,330	78,314	(984)
River Bend Resort, LLC & Hilton Campground	816,748	840,420	6,915	16,808	(9,893)
Sonoma Raceway	606,202	606,202	12,124	12,124	0
Villa Montebella	630,040	724,195	9,240	14,484	(5,244)
Total	\$ 6,907,454	\$ 7,207,576	\$ 120,146	\$ 137,592	\$ (17,446)

Appendix C: Schedule of Operators for Additional Review

Table 4: Schedule of Additional Audited Operators for KVR Management Inc.

County of Sonoma Transient Occupancy Tax & Business Improvement Assessment For the period of January 1, 2021 to December 31, 2021									
<u>Entity</u>	Taxable Receipts Reported	Taxable Receipts Per Review	TOT Paid	TOT Per Review	BIA Paid	BIA Per Review	Over (Under) Paid TOT	Over (Under) Paid BIA	TOTAL Over (Under) Paid
Dream House	\$ 49,247	\$ 63,786	\$ 5,910	\$ 7,654	\$ 985	\$ 1,276	\$ (1,745)	\$ (291)	\$ (2,035)
Barron Vineyards House	8,719	9,919	1,046	1,190	174	198	(144)	(24)	(168)
Dutton Winery House	65,944	108,126	7,913	12,975	1,319	2,163	(5,062)	(844)	(5,906)
Dutton Ranch Orchard Estate	136,637	163,299	16,396	19,596	2,733	3,266	(3,199)	(533)	(3,733)
Jam's Nest	72,441	88,632	8,693	10,636	1,449	1,773	(1,943)	(324)	(2,267)
Pleasant House	4,334	9,325	520	1,119	87	186	(599)	(100)	(699)
Point View	83,718	105,614	10,046	12,674	1,674	2,112	(2,628)	(438)	(3,066)
Dolphin Beach House	94,391	118,397	11,327	14,208	1,888	2,368	(2,881)	(480)	(3,361)
Tranquil Acres	53,236	67,939	6,388	8,153	1,065	1,359	(1,764)	(294)	(2,058)
The Vines	0	0	0	0	0	0	0	0	0
Total	\$ 568,667	\$ 735,037	\$ 68,239	\$ 88,205	\$ 11,374	\$ 14,701	\$ (19,965)	\$ (3,328)	\$ (23,293)

Appendix D: Schedule of Operators Reporting Airbnb Exemptions

Table 5: Operators Reviewed with Unverifiable Airbnb Exemptions

**County of Sonoma
Transient Occupancy Tax
For the period of January 1, 2021 to December 31, 2021**

<u>Entity</u>	Airbnb Exemptions
Casa Martin	\$69,644
River Bend Resort, LLC & Hilton Campground	\$68,555
Villa Montebella	\$29,005
Total	<u>\$167,204</u>

Appendix E: Report Item Risk Classification

For purposes of reporting audit findings and recommendations, audit report items are classified into three distinct categories to identify the perceived risk exposure:

➤ **Risk Classification A: Critical Control Weakness:**

Serious audit findings or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s), policies, and/or business goals of a department/agency or the County as a whole. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

➤ **Risk Classification B: Significant Control Weakness:**

Audit findings or a combination of Control Weaknesses that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.

➤ **Risk Classification C: Control Weakness:**

Audit findings concerning internal controls, or compliance issues that require management's corrective action to implement or enhance processes and internal controls. Control Weaknesses are expected to be addressed within our follow-up process.

➤ **Risk Classification D: Opportunity for Improvement:**

Audit findings concerning opportunities for improvement or efficiency/effectiveness issues that require management's consideration to implement or enhance processes. Opportunities for improvement are expected to be addressed within our follow-up process.

The current status of implementation of recommendations will be followed up no later than the end of the second fiscal year after the report has been issued. Critical control weaknesses will be followed up between six months and one year of the date of the report.