

**FREDERICK COUNTY
INTERAGENCY INTERNAL AUDIT AUTHORITY**

**FREDERICK COUNTY
HOTEL RENTAL TAX AUDIT
FOR THE PERIOD
JULY 1, 2009 THROUGH JUNE 30, 2012**

**Report #13-04
November 21, 2012**





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**Frederick County Hotel Rental Tax Audit for the Period
July 1, 2009 through June 30, 2012**

Frederick County
Internal Audit Division

Executive Summary

We found that the Frederick County Tourism Council complied with County Ordinances; Memorandums of Understanding (MOU) with Frederick County, Maryland; and their internal policies related to Hotel Rental Tax revenues and expenses for FYs 2010 through 2012. The Tourism Council properly recorded Hotel Rental Tax revenues and set aside revenues for the Visitors' Center in accordance with County Ordinance 04-11-355. Our sample of Tourism Reinvestment in Promotion and Product Development (TRIPP) grant and Visitors' Center expenses yielded no exceptions. We found that all expenses sampled were approved, appropriate and allowable in accordance with applicable regulations, agreements, and Tourism Council policies.

During our audit, we reviewed Frederick County's financial records to determine the accuracy of the monthly Hotel Rental Tax revenues received from the hotels, and the resulting monthly payments to the Tourism Council. In doing so, we determined that the hotels are calculating and remitting the correct Hotel Rental Tax with one minor exception. We also determined that the County's Accounting Department is properly calculating the amounts due to/from the Tourism Council based upon the collections from the hotels except as related to debt service and administrative costs.

Although not addressed in the MOU, the County did not pay the Tourism Council interest that had accumulated on bonds from FYs 2007 through 2011, but had been recorded in the Hotel Tax Fund. They also did not pay the Tourism Council their share of FY 2011 equity in pooled cash. Additionally, they did not reduce amounts due from the Tourism Council by net premium amounts or refund the Tourism Council an unused escrow deposit for a bond refunding¹ in a timely manner as described in Section IV of the report. As a result, the County's Hotel Tax Fund had a balance due to the Tourism Council of \$144,245 as of June 30, 2012. The Accounting Department has already adjusted their FY 2012 financial records and issued a refund to the Tourism Council retaining \$40,276 of the premium to pay down FY 2013 debt. Accordingly, we are making no recommendations related to debt service.

The County did not charge the Tourism Council administrative costs in accordance with their internal procedure for FYs 2010 through 2012 and, as a result, undercharged them. We are recommending that the Accounting Department determine the feasibility and cost effectiveness of calculating and billing the Tourism Council for any underpayment of administrative costs for FYs 2010 through 2012, and adjust the FY 2013 rate accordingly. We are also recommending that the County's Accounting Department evaluate the procedure for charging administrative costs to the Tourism Council, and issue a revised procedure, if necessary.

The responses from the Tourism Council's Executive Director and the County's Acting Finance Director are summarized on page 7 and included as attachments.

¹ The act or practice in which a company repays a bond by making a new issue of another bond. A company refunds a bond when it borrows more money to repay the money it already owes to bondholders. This is similar to refinancing.



**Frederick County Hotel Rental Tax Audit for the Period
July 1, 2009 through June 30, 2012**

Frederick County
Internal Audit Division

I. Introduction

Internal Audit (IA) conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

This report is intended to provide information to management; however, it is also a matter of public record and with the exception of any applicable disclosure exemptions, distribution should not be limited. Information extracted from this report may also serve as a method to disseminate information to the public as a reporting tool to help citizens assess government operations. Management responsible for the functional area reviews the report, and their formal written responses are incorporated into the final report per Interagency Internal Audit Authority (IIAA) policy and generally accepted government auditing standards.

It is management's responsibility to design and implement an adequate system of internal control, and it is the Internal Audit Division's responsibility to determine if management's system of internal control is functioning properly. It is also management's responsibility to decide if action should be taken in response to any reported recommendations, taking into consideration related costs and benefits.

II. Background

The Tourism Council of Frederick County, Inc. (Tourism Council) is a non-profit organization created to encourage, foster and stimulate tourism in Frederick County Maryland. The Tourism Council obtains and distributes information about tourism attractions in Frederick County to promote cooperation and exchanges between businesses, organizations and tourist attractions both in and out of Frederick County. The Tourism Council's source of funding is a mix of the Hotel Rental Tax, private/government grants (National Scenic Byways, National Park Service, Chesapeake Bay Gateways, etc), membership dues, advertising cooperatives, sales and miscellaneous income. The Hotel Rental Tax accounts for approximately 50% of the Tourism Council's yearly revenues.

The Hotel Rental Tax was established as a result of the Frederick County Government's Ordinance No. 04-11-355, adopted July 2004, to provide a source of funding to the Tourism Council. Previously, the Council was funded directly from Frederick County's General Fund. The Ordinance requires Frederick County hotels² to submit the Hotel Rental Tax collected from patrons with stays of 30 days or less to the Frederick County Treasurer on a monthly basis.

The Ordinance states that the Hotel Rental Tax revenue will first be used to pay for administrative costs incurred by the County in collecting the tax. The balance is then to be paid to the Tourism Council, with a portion of the balance to be used for a visitors' center. Once the revenue is received, the County's Accounting Department records the revenue and deducts administrative fees which have remained at 2.61% for Fiscal Years (FYs) 2010 through 2012. The County also deducts debt service³ payments related to County bond issuances used to construct the Tourism Council's new Visitors' Center, which the Tourism Council moved into on April 1, 2011.

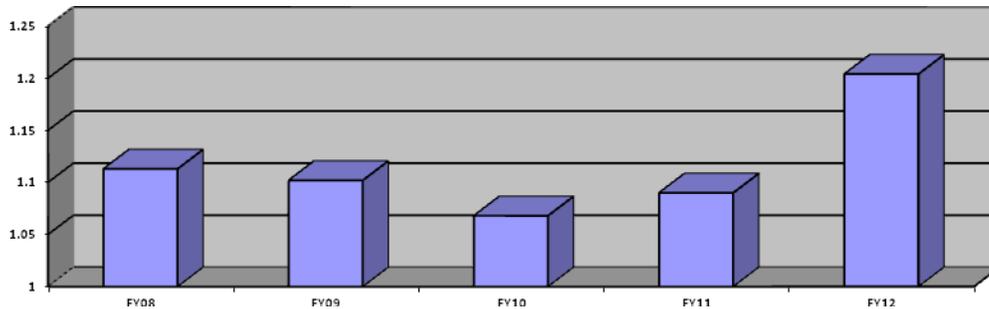
The Tourism Council uses Hotel Tax Revenues forwarded by the County for general operating expenses and the Visitors' Center. Hotel Tax Revenues are also used to fund the Tourism Reinvestment in Promotion and Product Development (TRIPP) program in which non-profit organizations within Frederick County may apply for funding from the Hotel Rental Tax in order to help promote tourism. These funds are available for advertising, trade show promotion, and/or development of local non-profit attractions, sites, events, and activities that attract tourists to Frederick County. The applicant must submit a complete application by the deadline, as well as a marketing plan for the project that they want to fund through the TRIPP program. The Tourism Council's selection committee chooses applicants that are most deserving and meet the overall guidelines of promoting tourism within Frederick County. Once funding is approved for an organization, the type of award stipulates how the funding is distributed. The organization must contribute a match of funds in order to receive an award from the Tourism Council, as stipulated by their award agreement.

Hotel Rental Tax revenues decreased from FYs 2008 through 2010 as hotel revenues declined due to the economic downturn with an increase in FYs 2011 and 2012 as the economy improved as shown on the following chart:

² A hotel also includes an apartment, cottage, hostelry, inn, motel, rooming house, or tourist home, but does not include a facility with 10 or fewer sleeping rooms in its main building and no more than 20 additional rooms in auxiliary structures on the facility's property.

³ If the debt service amount is less than the 10% that the Council is required to set aside for a Visitors' Center, the County forwards the additional funds to the Tourism Council who deposits the restricted funds in a separate cash account for the Visitors' Center.

**Gross Hotel Rental Tax Revenues
Fiscal Years 2008 – 2012 (\$ millions)**



III. Objective, Scope, and Methodology

The objective of this audit is to issue a conclusion on the Tourism Council’s compliance with all laws, regulations, agreements and procedures related to Hotel Rental Tax revenues and expenses. The scope of this audit covers Hotel Rental Tax revenues and expenses for the period July 1, 2009 through June 30, 2012.

To determine whether Hotel Rental Tax revenues were recorded properly, we:

- Verified that monthly Hotel Rental Tax collections reported by individual hotels agreed with amounts used by the County to calculate payments due to the Tourism Council.
- Verified the accuracy of the County’s calculation of administrative fees and debt service amounts.
- Verified that County payments to the Tourism Council were accurate and agreed with the amounts recorded in the Tourism Council’s financial ledgers and traced a sample of payments to the Tourism Council’s bank account.
- Verified that the Tourism Council properly recorded the debt payments and set aside the required minimum for the Visitors’ Center each fiscal year in their general ledgers.

We reviewed a sample of 43 of 571 expenses to determine if they were properly approved, appropriate, allowable in accordance with applicable laws and/or regulations, agreements, and Tourism Council procedures. We also verified that the appropriate match was received for TRIPP advertising grants, and that the total funding amount did not exceed the fiscal year’s maximum allowable amount for the individual grants. Details of our samples are shown on the following chart:

Sample Summary

Type of Expense	Sample Size	Sample Universe	Sample Value	% Total Dollars	Total Dollars
TRIPP Advertising	24	410	\$56,629	10.50%	\$540,118
TRIPP Product Development	9	59	48,405	22.30%	217,350
Construction/Building	10	102	61,618	3.60%	1,732,657
Total	43	571	\$166,652	6.70%	\$2,490,125

IV. Audit Results

DEBT SERVICE

A Memorandum of Understanding (MOU) between the Board of County Commissioners (BoCC) and the Tourism Council dated June 28, 2007, and the First Amendment to that MOU dated November 25, 2009, stipulated that the County would fund the construction of the Visitors’ Center through the issuance of General Obligation Bonds provided that the Tourism Council reimbursed the County for the cost. The Tourism Council agreed to assign to the County an amount equal to the debt service (principal and interest). One-twelfth of the annual debt service is to be deducted monthly from the receipts of the Frederick County Hotel Rental Tax prior to their being distributed by the County to the Tourism Council until the General Obligation Bonds are paid in full. The Tourism Council also agreed to reimburse the County for the cost of debt issuance and for interest and penalties related to arbitrage⁴ on the 2007 bonds caused by the lack of spending on such bonds due to the delay in commencement of the project.

The commencement of the project was delayed for over two years while the Tourism Council pursued State funding and, as a result, a significant amount of interest accumulated on the 2007 bonds. Although interest was not addressed in the MOU, the County recorded the accrued interest in the Hotel Tax Fund but did not disperse it to the Tourism Council. The interest continued to accumulate through FY 2011. They also did not distribute the Tourism Council’s share of equity in pooled cash for FY 2011. As a result, the Hotel Tax Fund had a fund balance payable to the Tourism Council as of June 30, 2011 of \$75,057.

In July 2011, Frederick County issued new bonds at a premium to fund the additional construction costs for the Visitors’ Center. However, they did not reduce the amount due from the Tourism Council by the net premium (premium less bond issue expenses) on this new bond

⁴The simultaneous purchase and sale of an asset in order to profit from a difference in the price.

issuance until the end of September 2012. They also held unused funds in escrow as a good faith deposit for fees related to the February 2012 refunding of a portion of the 2007 bonds. The unused funds were not refunded to the Tourism Council until October 2012. As a result, the fund balance increased by \$69,188 bringing the total due to the Tourism Council as of June 30, 2012, to \$144,245.

According to the County’s Acting Finance Division Director, the delay in calculating the premium amount due to the Tourism Council occurred because the Accounting Department went through several staff changes and because there were several complicated County-wide bond issuances and refundings during the year. Frederick County has already adjusted the balance due from the Tourism Council in their FY 2012 financial records, assigned as experienced accountant to the Hotel Tax Fund, and refunded the Tourism Council \$144,245⁵ as detailed on the following chart.

Accordingly, we are making no recommendations.

**Summary of Amount Due to Tourism Council
and the Repayment Process**

Interest Earnings 2007 through 2011 and FY 2011 Equity in Pooled Cash	\$ 75,057	Refunded to Tourism Council–9/19/12
Portion of premium not applied to Tourism Council's FY 2012 payments	\$ 22,772	Refunded to Tourism Council–9/19/12
Remaining premium from 2011A GO Bonds	<u>\$ 40,276</u>	Withheld – to be applied to Tourism Council’s FY 2013 debt payments
Net Premium on 2011A GO Bonds (issued July 2011)	63,048	
Funds Held in Escrow & Not Liquidated	<u>6,140</u>	Refunded to Tourism Council–10/12/12
Total	<u>\$ 144,245</u>	

ADMINISTRATIVE RATE CALCULATIONS

County Ordinance 04-11-355 Section 1-8-166A – Distribution of Revenue states that “Hotel Rental Tax revenue shall be used first to pay for hotel rental tax administrative costs of the County.” The Accounting Department developed a written internal procedure to comply with the Ordinance. *Finance Division Procedure – Hotel Rental Tax – Administrative Costs, Original Date: 7/5/2007, Updated: 3/23/2010* states that at the end of each fiscal year the administrative rate will be revised based upon employees’ reported hours working on the Hotel Rental Tax fund and actual salaries and fringe benefits. Any under or overpayment will be adjusted for in the subsequent fiscal year and the revised rate will then be used as an estimate to charge costs during

⁵The \$6,140 was refunded in FY 2013.

that year. Frederick County did not revise the FY 2010 estimated administrative rate used to charge the Tourism Council at the end of the year or recalculate revised rates for FYs 2011 and 2012. Instead, they used the 2.61% rate estimated at the beginning of FY 2010 to charge the Tourism Council administrative costs for all three fiscal years.

Using revised estimated hours and actual year end salary information, according to procedure, the FY 2010 administrative rate should have been 2.79 percent; therefore, the County undercharged the Tourism Council approximately \$2,260 for FY 2010. They should have charged that rate and recovered the underpayment during FY 2011. Using the revised rate of 2.79% for both FYs 2011 and 2012, Frederick County would have recovered a total of \$64,069 instead of the \$59,862 they actually recovered using the lower rate of 2.61 percent. Based on this estimate, the total amount undercharged for the three year period is approximately \$6,500. This figure is just an estimate because, based on the procedures, the Accounting Department would have had to adjust to actual salary costs at the end of each year to determine the actual rate. However, because the County did not adjust to actual costs, they undercharged the Tourism Council for the costs that it incurred to administer the Hotel Rental Tax fund over the three fiscal years. When discussing this matter with the Accounting Director, she indicated that the calculation is very subjective and that they may change to a flat rate in the future.

The County should recover all administrative costs; therefore,

Recommendation 1: We recommend that the Accounting Department:

- a. Determine the feasibility and cost effectiveness of calculating and billing the Tourism Council for any underpayment of administrative costs for FYs 2010 through 2012, and adjust the FY 2013 rate accordingly.
- b. Evaluate the procedure for charging administrative costs to the Tourism Council, and issue a revised procedure, if necessary.

V. Summary of Responses

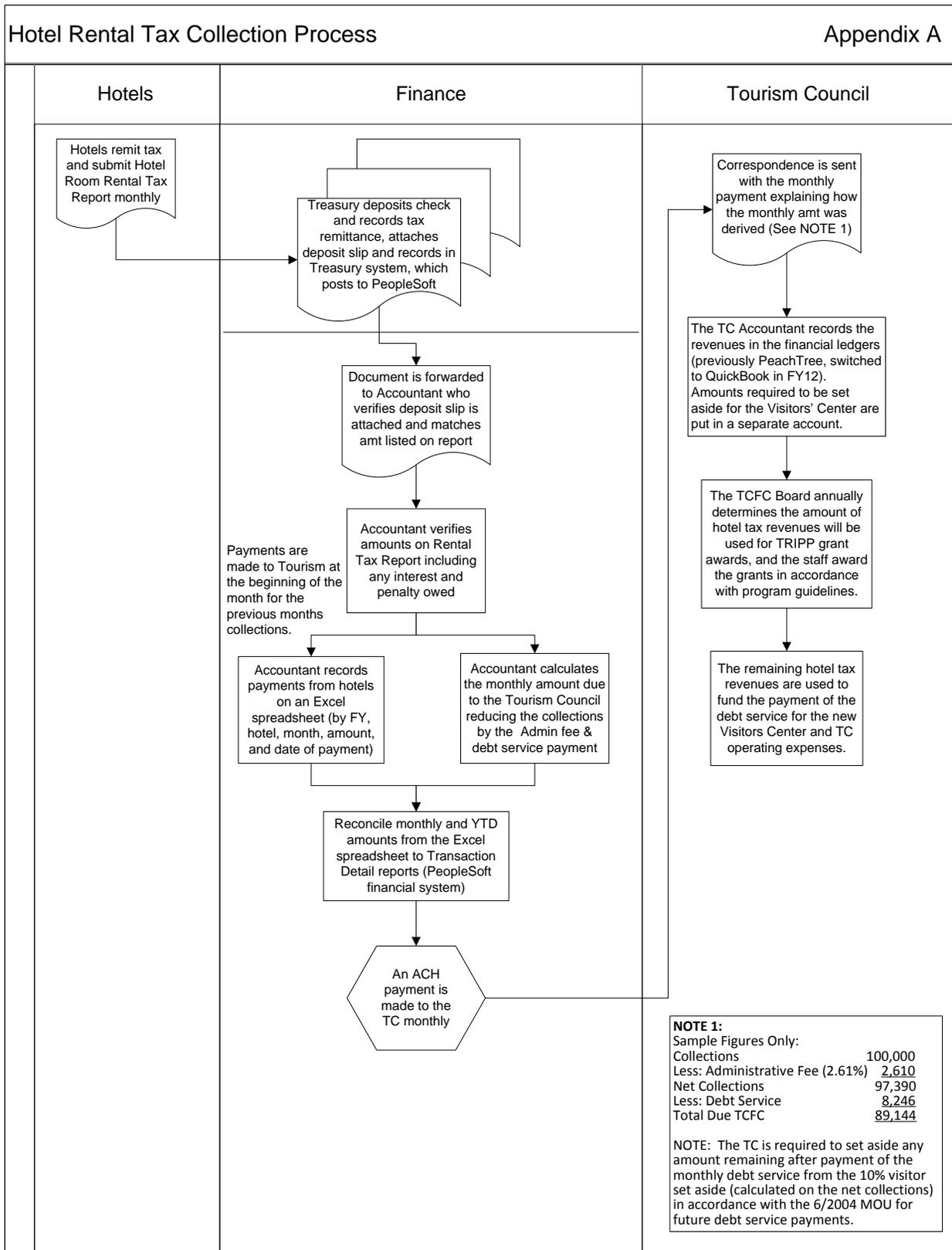
We received a response from the Executive Director for the Tourism Council of Frederick County. Although there were no findings related to his organization, he confirmed receipt of the report and stated that he greatly appreciated the thorough and professional approach that our Division took with this audit. We also received a response from the County's Acting Finance Division Director who stated that she does not believe it would be cost effective to calculate and bill the Tourism Council for any under or over payment of administrative costs for FYs 2010 through 2012. She believes the administrative rate charged was reasonable and that it is best in the interest of both organizations to keep the administrative FY 2013 rate at 2.61 percent. However, she agrees with our recommendation to evaluate the procedure for charging administrative costs in the future and has already determined that the most cost effective way is to establish a flat rate that both parties can agree upon. Finance staff will work with the Tourism Council to determine the rate and with the County Attorney's Office to develop a memorandum of understanding that is agreeable to both parties (see Attachments).

November 21, 2012

Interagency Internal Audit Authority
Interagency Internal Audit Authority

Audit Team

Richard A. Kaplan, Director
Kelly Hammond, Senior Auditor II
Mark Matlock, Senior Auditor (Temporary)





Nov. 1, 2012

Richard Kaplan, Director
Internal Audit Division
Frederick County Government
12 E. Church St., 2nd Floor
Frederick, MD 21701

Dear Richard,

I am writing to confirm receipt of, and concurrence with the findings of the Draft for Response of the Frederick County Hotel Rental Tax Audit covering the period of July 1, 2009 through June 30, 2012. The Tourism Council greatly appreciates the thorough and professional approach that your Division took with this audit.

Sincerely,



John J. Fieseler
Executive Director

Cc: Mike Irons, TCFC Board Treasurer
Barbara Lindberg, TCFC Accountant



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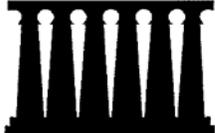
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Erin White, CPA
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To: Richard Kaplan, Internal Audit Division

From: Erin White, Acting Finance Director

Date: November 9, 2012

Re: Response to Draft Report on Frederick County Hotel Rental Tax Audit for the
Period July 1, 2009 through June 30, 2012.

I have reviewed the draft report and as per your request have the following responses
relating to the recommendations stated in the report.

Recommendation 1.a. - The Accounting Department should determine the feasibility
and cost effectiveness of calculating and billing the Tourism Council for any
underpayment of administrative costs for FYs 2010 through 2012, and adjust the FY
2013 rate accordingly.

Response – The Accounting Department does not consider it cost effective to calculate
the administrative costs or bill/refund the Tourism Council for any under or over payment
for FY 2010 through FY2012.

The audit report estimated the total amount the County undercharged the Tourism
Council, over the three year period, at \$6,500. This calculation is extremely subjective,
due to the fact the staff that administered this tax at the time, would be required to
estimate their annual hours from up to 3 years ago. Also, several of the key staff who
administered this hotel rental tax from FY 2010 through FY 2012, are no longer
employed by the County. We believe the amount of time and effort involved in
calculating this rate would likely cost more than the amount the County would recover
from Tourism.

After discussing this matter with the Tourism Council, we believe the administrative rate
charged from FY 2010 through FY 2012 was reasonable and that it is best in the interest
of both organizations to keep the administrative costs at the 2.61% rate charged.

Recommendation 1.b. – The Accounting Department should evaluate the procedure for
charging administrative costs to the Tourism Council, and issue a revised procedure, if
necessary.

Response – The Accounting Department concurs with this recommendation. We have
evaluated our current procedure for charging administrative costs to the Tourism Council
and have determined the most cost effective way to charge the Tourism Council would be
to determine a flat rate that both parties can agree to. The rate, as it has been calculated
in the past, is very subjective and as such, is only an estimate. Finance staff will work
with the Tourism Council to determine a flat rate. Finance staff will also work with the
County Attorney’s Office to develop a memorandum of understanding that is agreeable to
both parties.

Please let me know if you have any questions or concerns.