

FREDERICK COUNTY, MARYLAND
Hotel Rental Tax Audit
Frederick, Maryland

PERFORMANCE AUDIT REPORT
For the period July 1, 2016 through June 30, 2020
Report #21-09



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INDEPENDENT AUDITORS' REPORT AND EXECUTIVE SUMMARY

Interagency Internal Audit Authority
Frederick County, Maryland

CliftonLarsonAllen LLP (CLA) was engaged by Frederick County, Maryland (the County) to conduct a performance audit of the hotel rental tax as required by County Ordinance No. 04-11-355, adopted July 2004. The purpose of this report is to provide findings and recommendations regarding this audit. Our audit scope covered the period July 1, 2016 through June 30, 2020. Our audit was conducted in accordance with *Governmental Auditing Standards* issued by the Comptroller General of the United States.

We found that the Frederick County Tourism Council complied with the County Ordinances and Memorandums of Understanding (MOU) with the County. The Tourism Council properly recorded hotel rental tax revenues, administrative expenses and debt service on the outstanding bonds in their general ledger. During our review of the Tourism Reinvestment in Promotion and Product Development (TRIPP) Program, we noted the Tourism Council has policies and procedures in place to evaluate grant applications for the determination of grant awards. Our testing of a sample of TRIPP grants found that all grants were awarded in accordance with internal policies and procedures, expenses associated with those grants were properly approved in accordance with program guidelines, matching funds were properly received, where applicable and grant transactions were properly recorded in the general ledger. In conclusion, there were no exceptions related to the TRIPP program testing.

During our review of the County's financial records, we found that the monthly hotel rental tax revenues received from the hotels were properly recorded in the County's general ledger. We noted several exceptions related to the calculation of the monthly hotel rental tax by the hotels, which are noted below. Our review of the monthly calculations of amounts due to the Tourism Council by the County's Accounting Department appeared accurate based on the revenues received by the County, the administrative rate charged by the County and the debt service requirements of the bonds outstanding.

Out of the ten hotels selected during our audit, two of the hotels yielded no exceptions in the completion of the hotel rental tax report submitted to the County, and one hotel was non-responsive to the audit. We found exceptions at seven of the nine hotels tested, which included lack of documentation to support the hotel rental tax report, net room rental receipts not agreeing to supporting documentation provided and incorrect calculation of penalties and interest associated with late payments.

During our review of the Human Trafficking Training Program, we determined that seven out of the ten hotels selected for testing were required to provide annual employee training on human trafficking and certify to the County Human Relations Department annually that all their employees have completed the training. The remaining three hotels were located within the City of Frederick and therefore, do not fall under the County Ordinance. Of the seven hotels tested, all hotels provided annual certification in compliance with the guidelines prescribed the County Human Relations Department. During our testing to ensure employees at the seven required hotels completed the annual human trafficking program, two hotels yielded exceptions.

A summary of findings are as follows:

Finding #	Area	Finding
1	Lack of Documentation	The following hotels could not provide supporting documentation for testing – Hotel 1, Hotel 2, Hotel 3, and Hotel 4.
2	Net Room Rental Receipts	Net room rental receipts did not agree to supporting documentation for the following hotels – Hotel 5, Hotel 2, Hotel 6 and Hotel 7.
3	Inaccuracy of the Tax Calculation for Late Payments – Hotel 7	The penalty and interest associated with late payments were incorrectly calculated for five months.
4	Human Trafficking	Hotel 4 and Hotel 8 could not provide evidence that certain employees selected for testing participated in human trafficking training in 2019.

The responses from the County’s Finance Division and Human Relations Department are included after each finding in the findings, recommendations, and management’s responses section.



CliftonLarsonAllen LLP

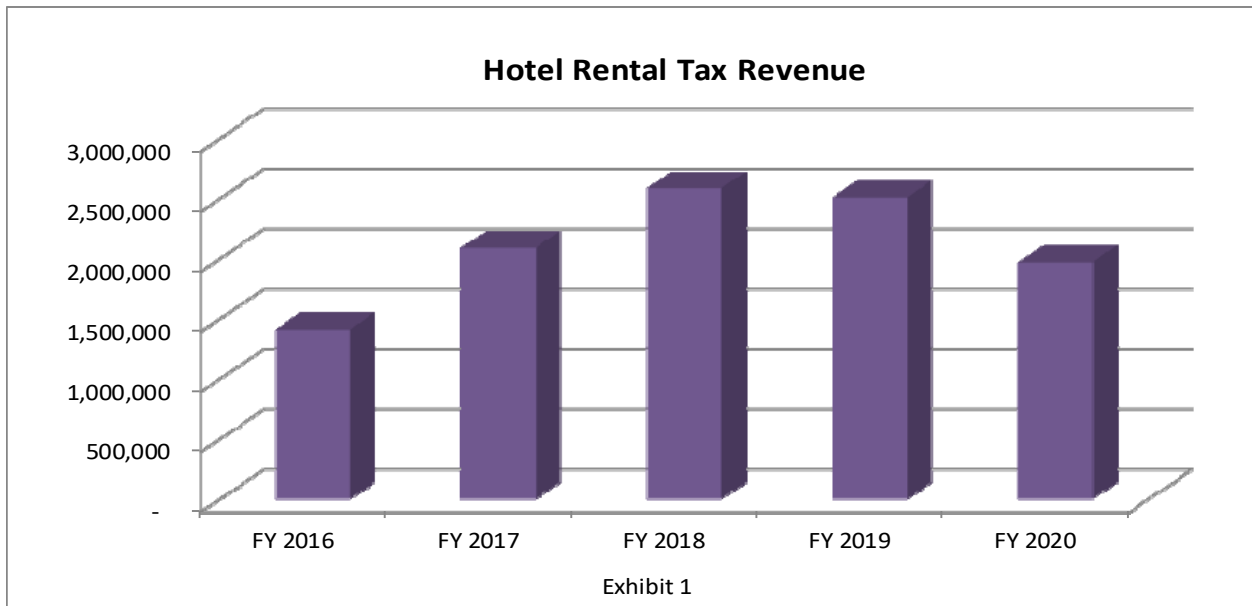
Baltimore, Maryland
 June 15, 2022

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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 County). The Tourism Council obtains and distributes information about tourism attractions in the County to promote cooperation and exchanges between business, organizations and tourist attractions both in and out of the County. The Tourism Council's source of funding is a mix of the Hotel Rental Tax, private/government grants, membership dues, advertising cooperatives, sales and miscellaneous income. The Hotel Rental Tax accounted for approximately 82.8%, 88.3%, 83.0% and 80.7% of the Tourism Council's revenue for FY 2017, 2018, 2019 and FY2020, respectively.

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 the County's General Fund. The County collects a 5% hotel rental tax on transient stays not exceeding 90 consecutive days from all hotels located in Frederick County. County hotels submit the hotel rental tax collected from guests to the County Treasurer on a monthly basis. Refer to Exhibit 1 for hotel rental tax collected by the County for fiscal years 2016 through 2020. Council Bill No. 16-13 amended the hotel rental tax, effective October 29, 2016 to increase the hotel rental tax from 3% to 5%.



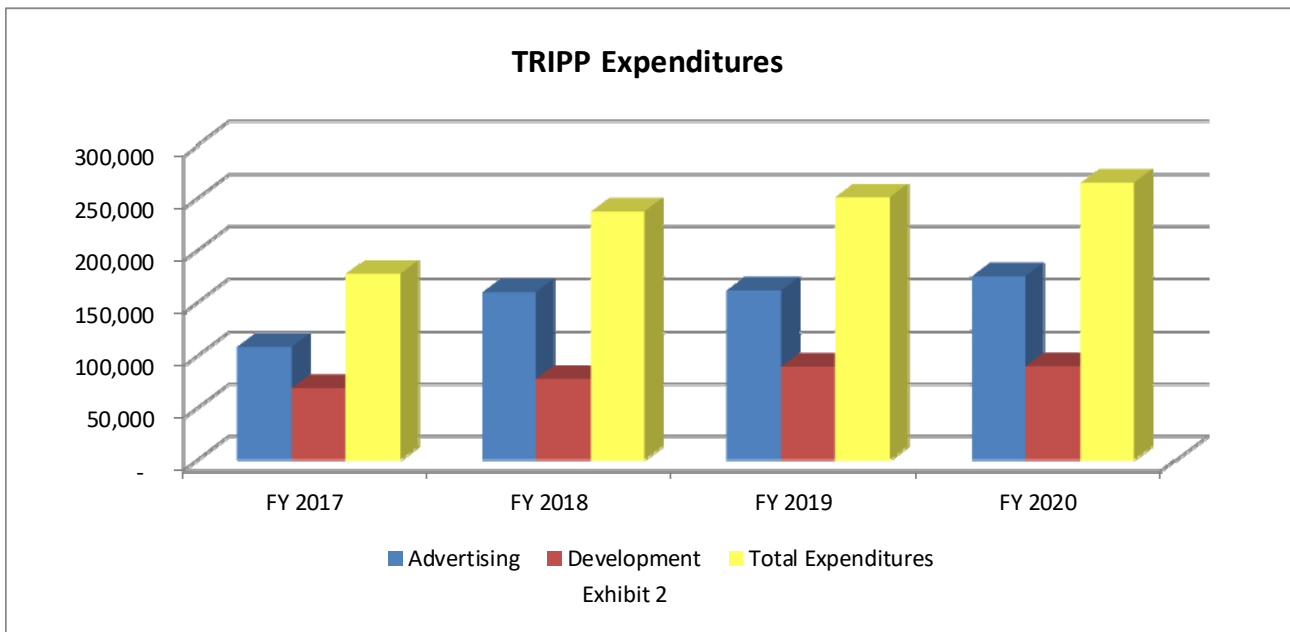
The Ordinance states that the Hotel Rental Tax revenue will first be used to pay for administrative costs incurred by the County in collecting the tax, which was \$1,300 for fiscal year 2017, increasing 1% annually for each year thereafter. The County also deducts debt service payments related to County bond issuances used to construct the Tourism Council's Visitors' Center. There are currently four bond issuances outstanding that are associated with the Tourism Council totaling approximately \$1,347,320 as of June 30, 2020. The balance of the Hotel Rental Tax revenue after administrative and debt service costs are deducted is then paid to the Tourism Council.

As a result of the COVID-19 pandemic, the County and Tourism Council signed a MOU in June 2020 for the following, effective April 2020:

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- Suspension and deferment of the County’s administrative fee, and the debt service (principal and interest) on the General Obligation Bonds used to pay for the Tourism Council’s Visitors’ Center until:
 - July 1, 2021 or
 - When the hotel rental tax collections reach or exceed 90% of the hotel rental tax collections of the corresponding quarter of fiscal year 2019;
- At the end of the suspension period, the County will resume collection of the administrative fee at 125% of the effective agreed upon administrative cost with 25% being applied to reimburse the County for the suspended and deferred administrative fee until fully reimbursed;
- At the end of the suspension period, the County will resume collection of the debt service at 125% of the actual debt service amount with 25% being applied to reimburse the County for the suspended and deferred debt service until fully reimbursed.

The Tourism Council uses Hotel Tax Revenues forwarded by the County for general operating expenses and the Visitor’s 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 the County may apply for funding to help promote tourism. These funds are available for advertising, trade show promotion, and development of local non-profit sites, attractions, events, and activities that attract tourists to the County. Refer to Exhibit 2 for TRIPP expenditures for fiscal years 2017 through 2020.



County Code 1-6-68 requires lodging establishments provide certain employee training on how to identify human trafficking activities and human trafficking victims beginning on May 1, 2019. Additionally, beginning on November 1, 2019, lodging establishments are required to annually certify to the County Human Relations Department that all of their employees have completed the required training. County Code requires the Interagency Internal Audit Authority (IIAA) to include this training requirement as part of its audit of the hotels and lodging establishments registered with the County.

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OBJECTIVES, SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) established by the U.S. Government Accountability Office (GAO). 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusion based on the audit objectives. Because of the inherent limitations, a performance audit made for the limited purposes of our review would not necessarily disclose all weaknesses related to the County's compliance.

The County is required to have an independent audit of the Hotel Rental Tax revenues at least every four years under Frederick County Government's Ordinance No. 04-11-355, updated by Bill No. 19-11. The objective of this audit is to ensure that the Tourism Council is in compliance with all laws, regulations, and agreements related to the Hotel Rental Tax revenues and expenditures as well as testing the collection of and appropriate calculation of the hotel rental tax by the County. The scope of the audit covers the period July 1, 2016 through June 30, 2020.

As part of the hotel rental tax audit, we:

- Selected ten out of the twenty-nine hotels that remitted hotel rental tax revenues during the audit period. For each hotel that was tested, we:
 - Selected twenty-four out of the forty-eight months of the audit period and reviewed the supporting documentation used by the hotel to complete the hotel room rental tax report to ensure completeness and accuracy of the report. We also recalculated the hotel rental tax due to the County for accuracy.
 - Selected two guests per month for the twelve months tested and reviewed their hotel bill to ensure the tax was properly calculated and collected from the guest.
- Verified that the monthly tax collections reported by the individual hotels agreed with the amounts utilized by the County to calculate payments due to the Tourism Council.
- Obtained the County's calculation of payments due to the Tourism Council for twenty-four out of the forty-eight months of the audit period and:
 - Verified the administrative fees charged by the County were in accordance with the Memorandum of Understanding (MOU) between the County and Tourism Council;
 - Recalculated the administrative fees charged by the County for accuracy; and
 - Verified the debt service amounts charged by the County agreed to the amortization schedules of the bonds issued by the County for the Tourism Council's Visitor's Center.
- Verified that the payments made by the County to the Tourism Council were accurate and agreed with the amounts recorded in the Tourism Council's financial ledgers. We traced payments received by the Tourism Council for twenty-four out of the forty-eight months 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 Visitor's Center each fiscal year in their general ledger.

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- Gained an understanding of the Tourism Council's Tourism Reinvestment in Promotion and Product Development (TRIPP) Program and selected 36 out of 108 grants awarded during the audit period for testing to ensure program participants were eligible for the grant and funds were dispersed appropriately to those participants.
- Gained an understanding of the human trafficking training program at the County and hotels selected for hotel rental tax testing. For each hotel tested, we:
 - Obtained the employee listing as of December 31, 2019 and selected a sample of 25% of the employees to trace their compliance with the required training to supporting documentation maintained at the hotel;
 - Obtained the annual certification for 2019 from the County Human Relations department and verified the certification was in compliance with the guidelines prescribed by the Human Relations Department.

Our audit noted the following scope limitations related to the testing of the ten hotels as follows:

- Hotel 1 failed to respond to CLA and the Director of Internal Audit requests for information for this audit. At the direction of the IIAA, Hotel 1 was not included in this audit.
- Hotel 6 was purchased on December 28, 2019; therefore, only three out of six months under current management were tested for this audit. The prior owners/management company did not respond to our notification for testing the period July 1, 2017 through December 27, 2019.
- Hotel 9 was sold on December 19, 2019; therefore, only four out of seven months under current management were tested for this audit. The prior owners/management company did not respond to our notification for testing the period July 1, 2017 through December 19, 2019.
- Hotel 8 was sold and re-purchased in December 2018; therefore, nine out of eighteen months under current management were tested for this audit. The prior owners/management company did not respond to our notification for testing the period July 1, 2017 through December 2018.

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FINDINGS, RECOMMENDATIONS AND MANAGEMENT'S RESPONSES

We identified several areas where exceptions to current policies and procedures were noted, or procedures or controls could be improved. These items are discussed below and include our findings and recommendations, together with the County responses to our findings.

1. Lack of Documentation

Finding:

A listing of documentation needed to complete the audit was provided to the ten hotels selected for testing. The following hotels did not provide documentation requested as follows:

- Hotel 1 – There were numerous attempts to reach Hotel 1 to complete the audit. These attempts were through email and phone call by CLA and the Director of Internal Audit. Since there was no response to the audit request, we were unable to determine the accuracy of the hotel rental tax remitted to the County or the tax charged to guests of the hotel.
- Hotel 2 – The hotel did not maintain copies of the hotel rental tax reports submitted to the County monthly for the period under audit. For one out of twenty-four months submitted, the County did not have a copy of the hotel rental tax report submitted by the hotel; therefore, we were unable to verify the accuracy of the report for September 2019.
- Hotel 3 –
 - We requested a list of guests of the hotel for twenty-four months during the audit period to select a sample of guest folios for recalculation of the hotel rental tax. The hotel was unable to provide a full guest listing for the months of September 2017 and November 2017 due to lost records at Choice Hotel International.
 - We were unable to test one out of forty-four guest folios for accuracy in the calculation of the hotel rental tax due to the hotel being unable to provide the guest folio.
- Hotel 4 – The hotel was unresponsive to our request for copies of the Hotel Rental Tax Reports and supporting documentation used to complete those reports for the twenty-four months selected for testing. Therefore, we could not test the accuracy of those reports. The hotel provided all required information needed to test the hotel rental tax rate charged to guests. That testing yielded no exceptions.

Recommendation:

We recommend the County or Tourism conduct training and/or communication to all hotels on the hotel rental tax laws and regulations, including the requirement of the County to have an independent audit of the hotel rental tax program. Additional training and/or communication should include best practices for the maintenance and retention of supporting documentation that corroborates the hotel rental tax reports submitted to the County.

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Management Response:

The Tourism Council and Finance will work together to communicate to the hotels the hotel rental tax laws, regulations, record retention of supporting documentation for their hotel tax report, and the County's independent audit requirement. The County will update the Frederick County Hotel Rental Tax Information document on the Treasury website to include best practices for maintenance and retention of supporting documentation. The estimated timeframe for completion is one year.

2. Net Room Rental Receipts

Finding:

The hotel rental tax is calculated on the net room rental receipts, which is gross room rental receipts less rental receipts from non-transients (those whose stay is over 90 consecutive days). The net room rental receipts in the hotel rental tax report did not agree to supporting documentation provided by the following hotels:

- Hotel 5 – The gross room rental receipts reported on the hotel rental tax report for nine out of twenty-four months tested did not agree to supporting documentation provided by the hotel. The net effect of these discrepancies was an \$64.14 overpayment of hotel rental tax to the County.
- Hotel 2 – The gross room rental receipts for twenty-three out of the twenty-three months tested did not agree to the supporting documentation from the hotel. Per the hotel, the former general manager provided the amounts used in the report and the current general manager could not reproduce those amounts. Based on documentation the hotel provided, we estimate the net effect of these discrepancies to be an underpayment of \$3,322.75 of the hotel rental tax to the County.
- Hotel 6 – The hotel could not provide supporting documentation for the deduction of non-transients on the hotel rental tax report. Therefore, we could not determine the accuracy of the net room rental receipts and hotel rental tax remitted by the hotel to the County for the months of February 2020 and June 2020. The hotel was closed the month of April 2020 due to the COVID – 19 pandemic and therefore, did not submit a hotel rental tax report.
- Hotel 7 –
 - The amounts reported for gross rental receipts and/or rental receipts from non-transients for eleven out of twenty-four months tested did not agree to supporting documentation. The net effect of these discrepancies was \$8,638.62 in underpayment of hotel rental tax to the County.
 - The hotel rental tax rate increased from 3% to 5% effective on October 29, 2016. The hotel continued to use the previous rate of 3% to calculate the hotel rental tax due to the County for the months of December 2016, February 2017, April 2017 and June 2017. The net effect of this discrepancy was an \$6,063.79 underpayment of hotel rental tax to the County. We noted that for the months noted above, the guests were charged the correct hotel rental tax rate of 5%.

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Recommendation:

We recommend the County perform a risk based, cost effective analysis of the hotels in the County, which takes into account the size, the experience and knowledge of management company/owner, the volume of reservations and the average amount of tax paid to the County annually. The County should utilize this analysis to determine if increased oversight by the County would be beneficial to ensure the correct amount of tax is remitted monthly.

Management Response:

The County's Accounting Department does not have adequate resources to perform a risk-based cost-effective analysis. The County will re-check that the tax submitted is accurate. A Frederick County Hotel Rental Tax Information document, with an example of calculating hotel room rental tax, discounts, interest, and penalties, is on the Treasury website with the Hotel Room Rental Tax report to assist hotels with the Hotel Room Rental Tax calculation. The estimated timeframe for completion is one year.

3. Inaccuracy of the Tax Calculation for Late Payments – Hotel 7

Finding:

The hotel rental tax is due on the 21st of the month for the previous month. When a tax payment is delinquent for one month or more, interest of 0.5% per month and penalty of 10% per month on the total tax due is charged to the hotel. We noted the following inaccuracies in the calculation of the interest and penalties for late payments for the Hotel 7 as follows:

- For the month of December 2019, the hotel did not remit the 10% penalty to the County, even though the payment was over two months late. For the month of December 2017, the hotel only remitted 1% instead of 10% penalty with their hotel rental tax payment. The combined effect of was an underpayment of hotel rental tax to the County totaling \$528.37.
- For the months of December 2019, February 2020 and April 2020, the hotel incorrectly calculated the 0.5% interest per month on late payments. The effect was an overpayment of hotel rental tax to the County totaling \$592.61.

Recommendation:

We recommend the County Accounting Department follow up with the Hotel 7 and provide training on the calculations for interest and penalties to ensure the hotel remits the correct amount of hotel rental tax in accordance with the County Ordinance.

Management Response:

The County will follow up with Hotel 7 and provide training on the calculations for interest and penalties to ensure the hotel submits the correct amount of hotel rental tax in accordance with the County Ordinance. An example of the calculation for rental tax, interest and penalties is in the Frederick County Hotel Rental Tax Information document located on the Treasury website with the Hotel Room Rental Tax report to assist hotels with the Hotel Room Rental Tax calculation. The estimated timeframe for completion is one year.

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4. Human Trafficking

Finding:

Frederick County Council Bill No.18-29, which is codified in Section 1-6-68 in the Frederick County Code, requires every employee of a lodging establishment to complete a human trafficking training program approved by a national hotel brand, a recognized national lodging association, or other training approved by the Frederick County Human Relations Department. Calendar year 2019 was the first year this training program was required. We selected a sample of employees from the hotels tested to ensure compliance with this ordinance and noted the following:

- Hotel 4 – The hotel was not able to provide supporting documentation (i.e., training certificate) for two out of three employees selected for testing.
- Hotel 8 – The hotel was not able to provide supporting documentation (i.e., training certificate) for seven out of seven employees selected for testing.

Recommendation:

We recommend the Frederick County Human Relations Department provide outreach services to the hotels that fall under section 1-6-68 to communicate the requirements of the human trafficking program and best practices for maintaining supporting documentation to ensure compliance.

Management Response:

The Frederick County Human Relations Department will provide outreach services to the hotels that fall under section 1-6-68 to communicate the requirements of the human trafficking program and best practices for maintaining supporting documentation to ensure compliance. The Human Relations department plans on performing outreach to each hotel by the end of calendar year 2023. Outreach activities will include a mixture of either in person, virtual and e-mail training materials.