



Agenda Date: 3/21/2006
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NAPA COUNTY BOARD OF SUPERVISORS Board Agenda Letter

TO: Board of Supervisors
FROM: Pamela Kindig - Auditor-Controller
Auditor - Controller
REPORT BY: Karen Querin, Audit Manager, 253-4588
SUBJECT: Audit Reports for Uniform Transient Occupancy Tax Audits of Elsie's Conn Valley Inn, Forest Manor Bed & Breakfast and Meadowlark Country House

RECOMMENDATION

Auditor-Controller requests the Board accept, and instruct the Clerk of the Board to file, the following Audit Reports:

1. Uniform Transient Occupancy Tax Audit of Elsie's Conn Valley Inn for the Period of January 1, 2004 to March 31, 2005;
2. Uniform Transient Occupancy Tax Audit of Forest Manor Bed & Breakfast for the Period of October 1, 2004 to September 30, 2005; and
3. Uniform Transient Occupancy Tax Audit of Meadowlark Country House for the Period of January 1, 2004 to March 31, 2005.

EXECUTIVE SUMMARY

The Internal Audit Section of the Napa County Auditor-Controller's Office has audited the financial statements of the following. Acceptance of said audit reports is requested.

1. Uniform Transient Occupancy Tax Audit of Elsie's Conn Valley Inn for the Period of January 1, 2004 to March 31, 2005;
2. Uniform Transient Occupancy Tax Audit of Forest Manor Bed & Breakfast for the Period of October 1, 2004 to September 30, 2005; and
3. Uniform Transient Occupancy Tax Audit of Meadowlark Country House for the Period of January 1, 2004 to March 31, 2005.

FISCAL IMPACT

Is there a Fiscal Impact? No

ENVIRONMENTAL IMPACT

The proposed action is not a project as defined by 14 California Code of Regulations 15378 (State CEQA Guidelines) and therefore CEQA is not applicable.

BACKGROUND AND DISCUSSION**Transient Occupancy Tax Audits**

Staff conducted the following audits in accordance with auditing standards generally accepted in the United States of America and as stipulated in the engagement letter with the respective agencies:

1. Uniform Transient Occupancy Tax Audit of Elsie's Conn Valley Inn for the Period of January 1, 2004 to March 31, 2005;
2. Uniform Transient Occupancy Tax Audit of Forest Manor Bed & Breakfast for the Period of October 1, 2004 to September 30, 2005; and
3. Uniform Transient Occupancy Tax Audit of Meadowlark Country House for the Period of January 1, 2004 to March 31, 2005.

Results of the Audits: An audit report may contain findings in any of the following three categories:

1. Material Noncompliance
2. Material Internal Control Weakness (Reportable Conditions)
3. Immaterial Internal Control Weakness

The findings noted during the respective audits have been summarized below:

Uniform Transient Occupancy Tax Audit of Elsie's Conn Valley Inn**Category 1: Material Noncompliance****Pre-Numbered Cash Receipts**

Pre-numbered cash receipts are not issued by the B & B. The B & B records reservations and stays on a reservation folio. The reservation folio is not a receipt. It is not issued to the guest and is not a pre-numbered form. Section 3.32.110 of the ordinance states that pre-numbered payment receipts and a cash receipts ledger are both necessary to provide sufficient records to determine the tax to collect and pay.

Record Retention

The operator does not retain credit card receipts. Such receipts could have been used to substantiate revenues and to calculate the tax to pay. Section 3.32.110 of the Uniform Transient Occupancy Tax Ordinance requires the operator to maintain records that are sufficient to calculate the tax to pay and to retain those records for three years for inspection by the Tax Administrator or the County Auditor-Controller.

Category 3: Immaterial Internal Control Weakness

Certificate Not Visible

A certificate of authority to collect transient occupancy tax is posted at the B & B inside a cupboard. Section 3.32.050 of the ordinance requires the B & B operator to obtain a new certificate each year and to post it in a conspicuous place on the premises at all times. The B & B operator has presently suspended their operation as a B & B.

Exemption Not Documented

The operator reported exempt revenues of \$425 in their return for the quarter ending March 31, 2005. The exemption was claimed because the stay was in excess of 30 days. The Transient Occupancy Tax applies only to transients, defined by Section 3.32.020 as someone staying for less than 30 days. The amount reported was the only revenue for the quarter as the normal B & B service was temporarily suspended and the guest was accepted as a "roommate". However, in order to establish that the tax does not apply, the operator must retain records of such a stay including a reservation and receipts, or a separate written agreement. The cash receipts summary did not cover this latest quarter and there was no guest reservation folio completed in relation to the stay. In the absence of documentation of the length of stay, the deduction is not allowable and the amount of \$425 is taxable and subject to interest and penalties.

Tax Inclusive Records

The reservation folios show room rents either tax-inclusive, or separate from the tax. Two of the eight (8) reservations tested did not show the tax separately. The cash receipts ledger is prepared tax inclusive, and a net figure is derived from the total. The tax collected becomes the difference between the gross and net figures. Section 3.32.110 of the ordinance requires the operator to maintain records that show room rent and tax separately.

Bed & Breakfast Use Permit Issues

Although not included in the scope of the audit of Transient Occupancy Tax, we noted that the B & B may be operating in violation of the bed & breakfast use permit. The operator is offering three (3) rooms for rent, whereas the use permit is for 2 rooms. This potential use violation has been referred to the County of Napa, Building Inspection Division.

Uniform Transient Occupancy Tax Audit of Forest Manor Bed & Breakfast

Category 1: Material Noncompliance

Tax Not Collected on the Food Component of the Room Rate

The operators charge a room rate that includes breakfast and do not regularly advertise or make available a lower price for occupancy only. In these circumstances, the full room rate charged to the guest, including the breakfast component, is taxable in accordance with the definition of "rent" provided in Section 3.32.020. The B & B allocates \$50.00 of the room rate for full price bed and breakfast clients, and \$25 for discounted rooms, to the cost of providing breakfast. They deduct these costs from room rates before calculating the Transient Occupancy Tax payable by guests. As a result, the B & B has not collected the full amount of Transient Occupancy Tax imposed by the code. Subject to Section 3.32.090 of the Code, where the operator fails to collect the correct amount of tax, the County's Treasurer-Tax Collector may assess the tax, penalties and interest provided for in the Code against the operator. We have scheduled the following taxable charges (for breakfasts) where no tax was imposed:

	Quarter Ending 12/31/04	Quarter Ending 3/31/05	Quarter Ending 6/30/05	Quarter Ending 9/30/05
Full Price	\$ 1,900	\$ -	\$ 2,700	\$ 2,750
Discounted	<u>5,500</u>	<u>3,100</u>	<u>2,950</u>	<u>4,075</u>
Quarter Total	\$ 7,400	\$ 3,100	\$ 5,650	\$ 6,825

We have assessed the applicable tax, penalties and interest payable on these amounts on page 3 of our report dated November 22, 2005 and calculated a total of \$3,506.56 due to the County.

Pre-Numbered Cash Receipts Not Issued to Customers

The B & B lets rooms to Bed and Breakfast guests and also to clients referred by a separate medical business, Pacifica Pain Management Services Inc (Pacifica), that is owned by the B & B Operator. Pacifica pays the B & B for the accommodation and food expenses incurred by the Pacifica referred clients. Payment is made to the B & B after Pacifica receives payment from their clients' insurers. The B & B does not issue receipts to Pacifica to evidence the respective amounts received. The operator issues credit card receipts to (non-Pacifica) Bed and Breakfast guests. However, these receipts are not numbered sequentially and do not separate room rent from tax.

Payment When Due

Transient occupancy tax is due upon the transient's ceasing to occupy their room (Section 3.32.030). Thus tax owed by Pacifica Pain Management to the B & B on behalf of their clients becomes payable to the B & B when the guest's stay is concluded. At present Pacifica pays the B & B when they in turn collect from their clients' insurer. This arrangement does not comply with the Code and may result in underpayment of tax to the County for any respective quarter.

Uniform Transient Occupancy Tax Audit of Meadowlark Country House

Category 1: Material Noncompliance

Pre-Numbered Cash Receipts

Pre-numbered cash receipts are not issued by the B & B. The B & B records occupancy charges in a cash receipts journal. The journal shows room rent and tax separately for each customer, for each night of accommodation. Section 3.32.110 of the ordinance states that pre-numbered payment receipts which show the room rate separate from the amount of the tax paid as well as a cash receipts ledger are necessary to determine the tax to collect and pay. Such records should be available at all reasonable times, for inspection by the Tax Administrator or the County Auditor-Controller.

Category 3: Immaterial Internal Control Weakness

Transient Occupancy Tax Applied to Non-Occupancy Items

The operator has made limited sales of wine and massage to guests. The sales were additional to the room rent. The operator collected transient occupancy tax in respect of those sales, and paid that tax to the County. Section 3.32.020 defines taxable room rent to include amounts paid for food and drink or other amenities or services when those supplies or services are included in a package deal and are paid for, whether consumed or not. We understand that a Bed and Breakfast permit to sell alcohol allows sales of wine, only when offered as part of a package deal. We have not determined what permit, if any, the operator holds to sell wine.

Transient Occupancy Tax Not Collected on Gift Certificates

The operator advised that Gift Certificates are available for purchase by customers. However, none were purchased during the period under audit. The procedure followed by the operator in issuing, recording and

honoring gift certificates does not include collecting and paying transient occupancy tax for the room rent gifted.

Separate Bank Account

The operator did not maintain a separate bank account for the B & B during the period under audit and up to March 31 2005. A separate bank account for the B & B would provide enhanced accounting control for the room rent and transient occupancy tax.

Incomplete Recording

In the absence of duplicate customer payment receipts, we traced a sample of visitor book entries to the cash receipts journal to gauge completeness of recording. We noted that two (2) different visitors signed the visitor book on December 19, 2004, but did not appear as guests in the cash receipts journal. It is uncertain why these visitors did not pay room rent.

SUPPORTING DOCUMENTS

None

CEO Recommendation: Approve

Reviewed By: Maiko Klieman